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ecoDa's Reaction to the Accountancy Europe Report

"10 Ideas to make CG a driver of a sustainable economy"

ecoDa welcomes the report drafted by Accountancy Europe on « 10 ideas to make Corporate Governance a driver of a sustainable economy ». It is an interesting and insightful report, dealing with issues of great relevance for the new European Commission. The challenges for Europe are huge: We are facing low productivity growth and are lagging in adoption of new technologies. At the same time we need to attract talents and want to position ourselves as a front-runner in terms of climate-change related issues. All those issues are extremely interconnected and require highly innovative leadership.

Over the past years, Corporate Governance has gained increased importance for coping with these problems. Our member institutes have played their role in this context by raising awareness of the virtues of good Corporate Governance and by professionalizing the role and the function of the Board. It is obvious nowadays that boards must ensure that companies create value for their shareholders and their relevant stakeholders in a sustainable manner, and that businesses cannot expect to remain competitive in the long run if they destroy the ecosystem in which they operate.

However, the downside of these achievements is an increasing tendency to look upon Corporate Governance as an omnipotent catalyst for solving a variety of social, economic and environmental issues that the political system fails to deal with efficiently. ecoDa is opposed to such a development. Policymakers and regulators should define the rules and boundaries for business activities considered necessary to ensure that they are consistent with long-term societal interests, allowing companies to seek to fulfill their purpose and accomplish their goals as they see fit within this framework, but not try to micro-manage companies into acting in ways more or less alien to their nature as entrepreneurial enterprises.

Based on these overall considerations we have the following main comments on the report.

1. **Keep some leeway for boards to remain innovative leaders**

   When it comes to climate-related issues, the legislator can accelerate change. The legislator may indeed further shrink the limits of the playing field within which companies may freely act to fulfil their purpose. This is certainly a straight-forward and efficient way of making companies comply with societal interests. However, regulators have to understand the limits of this approach. Boards should not be turned into a compliance body that only looks at the mechanical respect of the legislation. Regulation is welcome as long as the level of responsibilities remains manageable and does not turn board members into police officers without a normative frame of reference (as could potentially be the case with an EU legislation on due diligence throughout the supply chain), nor into consultative bodies where various more or less incompatible interests can be pursued, thus decreasing decision-making efficiency (cf. Directors' Duties). Responsible boards must arbitrate between the responsibilities they assume and those they reject but they should not be stuck in an imbroglio of divergent interests.

2. **Consider the management function as having a prime responsibility when it comes to sustainability**

ecoDa is of the opinion that also the management function has a strong responsibility when it comes to sustainability. Corporate governance is not only about the board. It involves management, shareholders, investors, stakeholders, etc. So, the roles and responsibilities of all players should be discussed. The report refers to a "*collective responsibility for governments, businesses and citizen alike*", but it does not target at all the management which is conspicuously absent throughout the text. ecoDa would like to recall that boards supervise the operations from a macro-level position while executives are responsible for carrying out day-to-day operations. As expressed by Lutgart van den Berghe (ecoDa, GUBERNA) at a conference organized by the European Commission on EU Corporate Governance in XXI Century (26 June 2017): "*In contrast to the shareholders, who legally only meet once a year, and the board who periodically gathers to direct and control the firm, the executives are the true leaders of the firm, and this on a daily basis. This contrasts greatly with the limited attention they get in the corporate governance codes and EU directives: such recommendations and directives have largely neglected their pivotal role, unless for regulating the remuneration of executives*". The role of the Board in matters of strategy is often to discuss and approve or disapprove proposals made by management. It is important to reassert a proper balance of powers between boards and management and to set a crisp line between boards' and management's legal and fiduciary duties. In earlier 2000's, more attention was devoted to the separation of powers between the company's governance bodies i.e. the Board, the General Meeting and the Management to ensure efficient checks and balances. Besides the division of duties, limits of powers have to be fixed for each body. In addition, transforming the business models and moving towards a sustainable economy cannot be considered a residual power that may be exercised solely by the board.

Visionary leaders have challenged the *status quo* and built innovative solutions within their extended ecosystem. The Accountancy Europe's report correctly points to the need to make board composition fit for purpose. Here again, ecoDa would like to emphasize in addition the importance of the selection and recruitment of the CEO and senior management. Business failures have shown that the best recipe for disaster is to get CEOs who diverge from the company values and strategy. Boards have to choose CEOs who are aligned with the culture and the purpose of the company and who have a new, innovative mindset. This is certainly an area where boards have to exercise true leadership, not only in selecting CEOs but also when they need to take a firm stand and dismiss a CEO who does not perform well in the boundaries fixed by the board on behalf of the shareholders. Some national institutes of directors (like the Swedish Academy of Board Directors) include in their education programme for board members the specific dimension of CEO's selection.

3. **Request shareholders to disclose the corporate purpose**

The regulator could certainly stress the need for shareholders to be transparent on the corporate purpose they have set for the company. And when doing so, shareholders should be encouraged to consider including also aspects that are not exclusively financial but may nonetheless contribute to the success of the company.

4. **Enhance dialogue between boards and investors when it comes to sustainability**

As correctly pointed out in the Accountancy Europe report, business cannot be conducted in isolation. However, we disagree with the statement that directors need to engage with, and take into account, all conceivable stakeholders of the company, at least on a more or less equal footing. Doing so may risk to weaken the vital role of competitive companies in the modern market economy, both regarding their function as suppliers of goods and services and as instruments for the efficient allocation of capital in the society. It may be worth re-iterating in this context that directors' prime duty is to promote the corporate purpose, as defined by the shareholders, taking other relevant stakeholder interests into account to the extent these are instrumental to the fulfilment of the company's purpose.

What we do agree on is that sustainability cannot be addressed in isolation by the management, the board and the shareholders. It is definitely an issue that requires more dialogue among boards and investors. ecoDa is currently working together with Mazars on a new project to analyse how leading institutional investors interact with the boards of businesses in which they invest on sustainability-related issues. There should be a more thorough discussion between the Board and shareholders/investors about the purpose and long-term objectives of the company to reach common understanding of the expectations. There is certainly a need to develop best practices in that sense.

5. **Value the role of the Corporate Governance Codes**

The Accountancy Europe's report considers that boards need to anticipate regulatory reforms. In general, companies must self-assert an ambition, superior to the norms of law, if they want to be excellent. For us, the CG Codes and the "comply or explain" principle have always served as drivers towards improved corporate governance practices.

6. **Don't reinvent the wheel – no need for a European CG Code**

ecoDa does support the claim made in the Accountancy Europe's report for a European regulatory framework for corporate governance but ecoDa does not see the added value of a European CG Code. The OECD CG principles are broad enough to accommodate the national CG specificities (difficult to imagine that the EU will come with better high principles). It is important to accept that there is not one valid governance model throughout the EU. Europe offers an enormous diversity in governance practices, corporate forms and shareholding structures which call for a tailored approach. In general, every aspect of corporate life cannot be harmonized. If the European Commission wants to establish a common EU CG model, it should be limited it to high-level principles.

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About ecoDa:

The European Confederation of Directors Associations (ecoDa) is a not-for-profit association founded in December 2004 under the laws of Belgium. Through its 22 national institutes of directors (the main national institutes existing in Europe), ecoDa represents approximately 55,000 board directors from across the EU. ecoDa's member organizations represent board directors from the largest public companies to the smallest private firms, both listed and unlisted.

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