POSITION PAPER

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BUSINESSEUROPE main messages on Sustainable Corporate Governance

Introduction

The business community fully supports the global sustainability agenda and companies are committed to integrating sustainability in the core of their business strategies and models, in a way which fits their specific situation and the needs of their stakeholders. We are also in favour of actions to drive investment into sustainable activities and to support companies in the transition towards more sustainability. The development of appropriate, proportionate and workable tools, taking account of the needs of the real economy, can facilitate this.

As the leading advocate for growth and competitiveness at European level, BUSINESSEUROPE is ready to discuss on how corporate governance can serve as a lever to integrate sustainability into the core of companies' business and strategies.

The messages below are based on a more detailed BUSINESSEUROPE position as a reply to the recent Commission public consultation on sustainable corporate governance.

Main messages

- The **EU corporate governance framework has proven throughout the last two decades that it is still able to adapt to the new challenges** thanks to a framework of well-balanced, targeted rules (some very recent such as Shareholders Rights Directive II and Non-Financial Reporting Directive), complemented by corporate governance codes (frequently updated) and company practices. These remain fit for purpose.
- BUSINESSEUROPE **shares the objectives** of the sustainable corporate governance agenda, for example in terms of sustainable transitions and more resilient value chains but has **strong concerns on the way** the Commission intends to meet them.
- **Corporate governance and due diligence need to be distinguished in the future initiative.** Although these areas are interrelated to some extent, it is not appropriate that they are treated in the same way as seems to be the case so far. There is an attempt to artificially extrapolate the issues and problems from one area to another, disregarding the essence of each of them. This will only lead to inadequate solutions.
- The Commission Roadmap and the public consultation point to **a radical rather than an evolutionary approach** (as it was the case so far) to European corporate governance. Call for action is mainly based on a widely criticised Commission study, which is based on false assumptions and a flawed

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methodology leading to a negative and **misleading (short-termism) picture of European companies that is not supported by facts**[1].

- The affirmation that European companies produce high levels of pay-outs at the expense of low investment intensity is not a realistic depiction of how companies function[2]. Pay-outs are a crucial part of one of the cornerstones of economic policy in most EU countries, namely the mechanism requiring capital to be allocated from companies without profitable investment alternatives to companies with profitable projects, thereby supporting an efficient capital allocation in society. The **levels of R&D of smaller companies across the EU, the expenditure in R&D rate has actually increased** over the time period considered in the Commission study.

- **European companies do take account of the long-term and diverse stakeholders' interests alongside the financial interests of their shareholders**, as well as stakeholders concerns, for example through reporting, committees or regular meetings. This is not only because this is an expectation placed on them, but because they see value in it for the performance of the

[1] Response from Professors Bassen, Lopatta and Ringe, University of Hamburg: "*First, and unfortunately, the Initiative is based on a study by consultancy firm EY that **does not take the basic academic norms of empirical research into account**. It randomly collects empirical findings without filtering by qualitative criteria*."
Response from ECLE (European Company Law Experts): it "*proceeds by **unsupported assertions** – managers and investors are short-termist and corporate law is responsible for it – rather than rigorous demonstration.*"
Center for Corporate Governance, CBS: "*Our main research areas are stewardship (responsible, long-term ownership), board work, and compliance. We find that the EY Study has **serious and systematic flaws in all three areas**.*"
Response from Professor Edmans, London Business School: "*I personally benefit from evidence claiming that the current system is short-termist and needs to be radically reformed. However, **I believe even more strongly in the importance of following the most rigorous evidence, regardless of what it finds**.*"
Response from 21 Nordic law professors: *"the [..] Study is so biased in its approach and so **openly and excessively political in furthering a specific regulatory outcome**, that we find ourselves compelled to address these shortcomings".*
Also **John G. Ruggie**, one of the leading international voices on Business and Human rights has criticised the Commission study and approach by affirming that "*company directors are not the main drivers of short-termism*": https://media.business-humanrights.org/media/documents/EU_mHRDD_paper_John_Ruggie.pdf

[2] The Stockholm School of Economics, has recently published a study (Corporate Governance and Short-Termism: An in-depth Analysis of Swedish data (hhs.se)) that contradicts the Commission Study. Data for 786 companies listed at Nasdaq Stockholm 2000-2019 were analyzed demonstrating that:

- 44 % of the companies did not pay out a dividend.
- the payout ratio of the companies depends on their life cycle.
- the companies with the highest dividend payout are also the companies with the highest profitability while at the same time performing well in terms of sustainability reporting and sustainability ratings.

company as well as for their 'license to operate'. This is often action through company CSR and sustainability commitments.

- Companies need to preserve their **flexibility to determine not only the relevance of specific stakeholder groups to their activity and how they interact with them, but also to assess whether different interests are material** to the company over the short, medium and long-term. This should be done on a case-by-case basis. It is impossible to identify stakeholders as an *ex ante* category, because they represent different and potentially contradictory interests. This also makes the task of defining and assessing the different stakeholder interests/needs a complicated process for companies.
- **Stakeholders** cannot be given, as such, rights to challenge **boards decisions** because they do not have the legitimacy or representativeness to do so.
- **Directors only owe fiduciary duties to the company itself and not to third parties. Directors' duties cannot be transformed into a checklist**. On the contrary, they need the flexibility to identify which stakeholder interests should be considered in accordance with the activity, structure, nature and size of the company.
- An unbalanced legislative intervention would be disproportionate and counterproductive as it would:
  - have a negative impact on several **fundamental principles of our market economy model** such as the freedom of enterprise and property (ownership) rights
  - **disrupt a long-standing and fine-tuned balance** in national corporate governance systems.
  - **lead to deadlocks in the decision-making processes** of companies leading to less risk-taking and less entrepreneurial behaviour.

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