

Lost in detail: setting priorities for corporations in challenging times

Daniela Weber-Rey looks at different approaches being pursued in Europe to restore trust in business



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The financial markets crisis: improve business, confine risk

Ten years ago we experienced a severe shock. The financial markets crisis jumbled the banking sector upside down, the subsequent crises turned around sovereign debt, and the Eurozone came under challenge – the consequences will impact an entire generation and may well have contributed to the nationalist movements in a number of countries. In any event, these crises have led to a deep loss of trust in the banking sector and in business more generally. All political and public authorities, think-tanks, institutions of all type and academia in many fields have spent time thinking about ways to improve our business environment, to confine risks, and to create more responsibility amongst the leaders and senior management in the financial sector and beyond.

Corporate governance: regulation and controls

The starting point was the view that there may have been many causes for the financial markets crisis, but that it would not have developed in such a rampant manner if the corporate governance of finan-

cial institutions globally had been better. Corporate governance deals with relationships (amongst the corporate bodies of a company) and structures (setting objectives and monitoring the company's performance). We have been working all over the Western world – in particular in Europe – to improve and strengthen corporate governance rules for 10 years now. We have built controls over controls over controls. Clearly there is now regulatory fatigue. It is questionable whether all these efforts to achieve more quality in company decision-making, accountability and controls have really improved our corporate governance. Have we overdone it, created too much complexity, lost the compass for clear principles on the way? Have we really been able to reduce risk for the companies, the financial sector or our economies as a whole? We have definitely reduced the systemic risk in the financial sector by demanding more capital, better liquidity, less leverage (i.e. use of debt), better risk control and compliance management. But we do not seem to have created a better sense of responsibility. We haven't found a way to hold senior executives to account. We have improved our corporate governance frameworks, but we

haven't got to the core of it, as we haven't been able to restore the trust of our people in business and finance.

Sustainability: long-term profitability and reporting

In the area of corporate social responsibility (CSR) a different effort has been made to create sustainable business models throughout Europe. An EU Directive of 2014,¹ which the 28 EU Member States transposed into their own national legislation by December 2016, provides for much more transparency on four core issues through obligatory reporting by certain large (mainly listed) companies and financial institutions: environmental, social and employee matters, respect for human rights, and anti-corruption and bribery matters.

These are valuable efforts and we shall see what impact they will have. The CSR-reporting will help contain risk and prepare for challenges, and it may contribute to companies better recognising their moral responsibility. But reporting obligations on such CSR aspects have been established irrespective of the business model of a company. They come *post facto*. It does not force the governing bodies of a company to look at their objectives in order to avoid – from the outset, and intrinsically – any particular activity or approach in how it does business, how it deals with its employees, its customers and others, and how it makes the business model in itself sustainable. The concern is that this reporting on CSR aspects will remain a tick-box effort, not really enough to shake up companies and force them to take a new look at the way they do business.

About culture, integrity, values and purpose to (re)build trust

The search is therefore still on for another approach that does not create ever more rules, recommendations and complexity in corporate governance, and that goes beyond mere transparency. It is clear that the regulatory efforts of recent years have not been sufficient to build trust – to change corporate culture effectively such that trust can be rebuilt in society at large. The heavy regulation with an uncertain outcome has led many countries to take a step back and to look at different issues. Particularly in the regulatory environment of the financial sector there has

been a lot of reference to culture – cultural change as the way to improve governance, culture as a topic to be taken actively care of by management and boards, culture as an indicator of understanding corporate behaviour.

The UK Institute of Business Ethics, just as one example, published in March 2018 an entire Board Briefing on the topic 'Culture Indicators – understanding corporate behaviour' (author Peter Montagnon), which clearly shows that we are not there yet, that means to improve culture (and to supervise improvement) are still in the making, far from reality in many cases. Its Executive Summary also states clearly:

The starting point is that there can be no effective oversight of corporate culture unless boards have first set and promulgated a statement of values and purpose against which expected behaviour can be defined and measured.

UK: building trust with society as a whole

When the new UK Corporate Governance Code was introduced in July 2018 by the Financial Reporting Council (FRC), its Chairman Sir Win Bischoff said:

... the new Code considers economic and social issues ... and with its overarching theme of trust, is paramount in promoting transparency and integrity in business for society as a whole.

Or according to the aforementioned Board Briefing of the Institute of Business Ethics:

Values also matter because they shape the relationships between the company and society as a whole, from which it derives its licence to operate. [Chapter 2]

Even though the 2004 OECD (first issue of the) 'Principles of Corporate Governance' already referred to business ethics and societal interests, for many years the call seems to have been for clear-cut rules of a more technical nature. Now, however, a fuller picture is sought. The business community, academia and regulators alike are looking beyond the detailed rules and seeking to define the companies' licence to operate as granted by authorities and society. As the Introduction to the new UK Corporate Governance Code words it:

Companies do not exist in isolation. Successful and sustainable businesses underpin our economy and society by providing employment and creating prosperity.

As a consequence, Principle 1 B states:

The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture.

Integrity, values and culture are presented as underpinning how a company will serve society as a whole.

We have improved our corporate governance frameworks, but we haven't been able to restore the trust of our people in business and finance.

¹ EU Directive on the disclosure of non-financial and diversity information, 2014/95/EU.

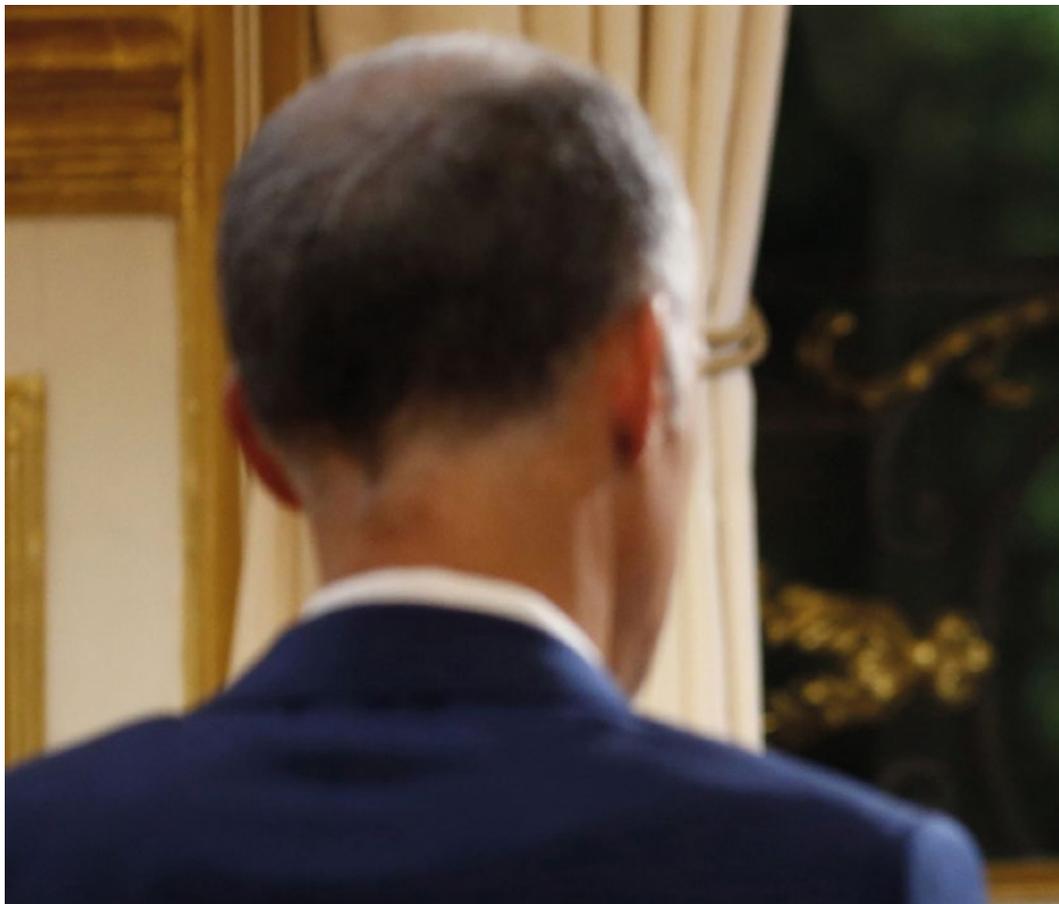
France: purpose and 'la raison d'être'

While the debate about a company's purpose and its role in society was going on in the UK, Emmanuel Macron, the French President, launched a similar public debate. Business associations provided considerable push-back when ideas were first aired about requesting companies to define in the articles their '*raison d'être*', their right to exist. This approach goes well beyond the purpose of a company. It immediately links purpose with societal aspects and the so-called licence to operate. Whereas the purpose is something aimed for, a goal, the '*raison d'être*' is more far-reaching and suggests that a company would be deprived of its right to exist if not complied with.

It is not surprising that a somewhat softer approach was ultimately chosen in France. First, the French Corporate Governance Code produced and revised by the employers' associations AFEP and MEDEF was changed to incorporate a reference to social and environmental aspects in its June 2018 version, which has now been published. There has long been a general emphasis in a number of recommendations on acting always in the corporate (best) interest. The corporate interest is well defined in French law. The Code now covers more so-called social and environmental aspects, responsibilities and risk controls, to promote long-term value creation by the company. It should be mentioned that an earlier draft of the new Code version (26 February 2018) covered in Recommendation 1.4 not only social and environmental but also societal dimensions which were to be considered for value-creation and corporate purpose. But this aspect was dropped after the consultation phase – French business was not quite ready to take this extra step.

However, for some years there has existed a helpful recommendation in the French Code which brings the French 'corporate purpose' ('*objet social*') very close to the understanding of purpose as described above. Recommendation 5.2, para 2 reads:

The Board of Directors must respect the specific competence of the shareholders' meeting if the transaction that it is proposing is such as to modify, in fact or in law, the corporate purpose, which is the very basis of the contract founding the



French President Emmanuel Macron, interviewed at the Élysée Palace on 15 October 2017
Photo: by Philippe Wojazer / AFP / Getty Images

corporation.

And yet, the French president and government clearly took the view that more needed to be done, that a higher purpose needed to be determined to re-establish trust in business.

Therefore, the French Minister of Economy and Finance, Bruno le Maire, presented the draft law – 'PACTE' –, which was adopted by the National Assembly on 9 October 2018, for sign-off by the Senate in 2019. PACTE, the 'Action Plan for Business Growth and Transformation',² has a clear aim, which is to create 'liberated companies that are better funded, more innovative and fairer'. Under the heading 'Fairer Companies', the French Government states:

Companies do more than simply seek to make a profit. The PACTE will modify the Civil Code in order to assert their social and environmental role and provide them with a true *raison d'être*. [Government homepage]

The challenge of 'rethinking the role companies play in society' was amongst the core topics at the start of the debate in France. Placing companies back in the centre of society by way of 'far-reaching reform of the philosophy behind business practices' (President Macron on 15 October 2017) is indeed reaching high. On 11 December 2017 Nicolas Hulot, the (former) French Minister of Ecological and Inclusive Transition, affirmed that he wanted

to evolve corporate purpose, which can no longer be simply profit-centered, ... [but] will ensure that the principles and values of this social and solidarity economy, this pioneering economy, the one that lends a hand, the one that shares, the one that prefers cooperation to competition, now becomes the norm and no longer the exception.

Redefining the corporation and its ultimate purpose is considered by many in France to be the most ambitious and

2 In French: 'Plan d'Action pour la Croissance et la Transformation des Entreprises'.



innovative approach to governance for decades. The notion of the social interest of a corporation, protecting the primary interest of the corporation and society as a whole, leads to many tensions with employers' associations and company representatives. The concern was, in a nutshell, that this approach would create a competitive disadvantage for French companies, make them dependent on environmental activists, lead to multiple disputes, and so on. But a number of CEOs of CAC40 companies (the large listed companies in France) and financial institutions agreed with the approach and called for a change of mindset in pursuit of the general interest (e.g. Antoine Frérot, Veolia; Emmanuel Faber, Danone; Pascal Demurger, MAIF). One of the leading French newspapers, *Le Monde*, headlined 'Better consideration for the general interest could be a major competitive advantage'.

After intense debate, the draft presented and voted on in a first procedural step still has the ambition to anchor the social interest of a corporation in the French Civil and the Commercial Code, and to

incite companies to reflect on their '*raison d'être*'. While the 'social interest' is to be hard law, a softer solution is suggested for the '*raison d'être*'. The intention is to change the Civil Code such that companies have the possibility – not the obligation – to incorporate their *raison d'être* into their statute. The expectation is that such an option will entice companies to be more oriented to the long term. Under the heading 'Raison d'être' in the 962-page document detailing the proposals of the PACTE and covering the impact study, a full page (p. 547/8) deals with the '*raison d'être*', as opposed to the '*objet social*' (corporate purpose) on the one hand and the '*intérêt social*' (corporate interest) on the other hand. The consequences of non-adherence to the '*raison d'être*' (right to exist) are meant to touch in particular on the relationship between the executives and shareholders. The shareholders should be able to hold management to account and ultimately revoke their appointment. The aim is to raise the visibility of the foundational basis of certain aspects of the company's activities. A violation should corre-

spond to a breach of the statute, which is supposed to give judges the possibility to consider the violation of the *raison d'être* as an element of causality in any claim for damages. This seems to widen considerably the discretion of judges to hold executives to account.

It will be very interesting to see whether this novel attempt to incorporate the idea of a higher purpose, a '*raison d'être*', into French law will succeed – far-reaching even in its boiled-down version. It is an approach that is without detailed regulation, is more inward-looking, and is in the hands of the company and its shareholders (and the judges), thereby possibly reaching deeper to the core of how to rebuild trust.

Germany: corporate purpose and societal responsibility

German Corporate Law knows three concepts.

The *company objective* details what a company is allowed to be active in, as decided by its shareholders ('*Unternehmensgegenstand*'). In case of changes, a formal change of the statutes is necessary.

The *corporate purpose* ('*Gesellschaftszweck*') – which is often confused with its objective, and is not defined in such a formal manner – may be wider than the objective: the objective may serve as the means to reach the purpose. It is usually to gain profit (and special rules apply if no profit is intended), otherwise all but illegal goals can be pursued, including idealistic goals, with special rules applying to regulated industries (e.g. the financial sector).

And the *company interest* ('*Unternehmensinteresse*') provides the behavioural rules for the legal representatives – management and board – and the basis for their responsibility and liability. Germany follows a stakeholder approach, which means that the company interest needs to take into account not only the interests of the company itself and its shareholders but also the interest of other stakeholders, in particular the employees.

The 'company interest' is not defined in law, but the German Corporate Governance Code makes reference to it. The Code is developed and adapted periodically by a Commission instituted by the Ministry of Justice. It highlights the 'company interest' by including reference to it as a core responsibility for the management in Germany's dual board system, the '*Vorstand*'. Since 2009 the Code also contains a definition of the 'company interest', translating the German term with 'the company's best interests' in its preamble (para 4):

The Code highlights the obligation of the Management and Supervisory Boards to ensure the continued existence of the company and its sustainable value creation in line with the principles of the social market economy (the company's best interests).

This amendment occurred in light of

the clear findings after the Lehman collapse in 2007 and the ensuing financial markets crisis that the obligations of top management and board members needed to be strengthened. The two aspects particularly referred to in relation to a company's continued existence and value creation are sustainability and the principles of the (German) social market economy. Many of the discussions now being held in France and the UK were already part of the common thinking in Germany, in particular stakeholder value, sustainability and social aspects. It should be acknowledged, though, that the corporate interest as understood in France ('*intérêt social*') with the goal of economic viability and sustainability, serving as a measure also e.g. for responsibility and liability of management, is not so dissimilar to the German understanding.

To strengthen further the aspect of ethical behaviour on top of legality, the concept of '*Ehrbare Kaufmann*' (reputable business person) was introduced into the German Code in 2017. This concept is not well known in Europe and refers to ideals of the Hanseatic business world.

The German Code is undergoing in 2018 a complete restructuring and streamlining, while without any intent to change the recommendations massively. The intention is to modernise the structure, make it more business-like and less legalistic. At the same time, the recommendations on 'independence' of (supervisory) board members and remuneration of executives / (management) board members are being completely overhauled in an effort to take account of recent developments³ and the perceived necessity to create more transparency and less possibilities to back out. In the current version of the draft, most likely to be presented for public consultation by the end of 2018, the preamble is to be extended to cover also for the first time social, environmental and societal responsibilities of a company:

The company and its responsible bodies have to take account in their actions of the role of the company in society and to reflect on their societal responsibility. Social and environmental factors influence the

company's business success. In the interest of the company, the '*Vorstand*' and the '*Aufsichtsrat*' (management and supervisory boards) ascertain that the potential consequences of these factors on the company strategy and operational decisions are recognised and addressed.⁴

While this is a different approach compared to the French '*raison d'être*', it wishes to achieve the same goal: to create more responsible companies in which society can again place trust.

A common goal – and further efforts

It is clear that in the UK, France, and Germany, as indeed in all of Europe, there is a general view that more needs to be done to restore trust in business and finance. Each country is attempting its own approach. The route chosen may be different in each case, but it is running in parallel and with the same goal. Whether one or the other approach will be more successful in rebuilding trust in finance and business remains to be seen. Cultural change to rebuild trust is in any event a long road with no immediately visible success.

The British Academy's ambitious programme of research on 'The Future of the Corporation' may well have an impact on the parallel efforts in some of the leading European countries, thereby assisting public policy in Europe to find novel ways forward for the corporation of the 21st century.

3 For example, the revised EU Shareholder Rights' Directive, EU Directive 2017/828 of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement.

4 The German text reads: 'Das Unternehmen und seine Organe haben sich in ihrem Handeln der Rolle des Unternehmens in der Gesellschaft und ihrer gesellschaftlichen Verantwortung bewusst zu sein. Sozial- und Umweltfaktoren beeinflussen den Unternehmenserfolg. Im Interesse des Unternehmens stellen Vorstand und Aufsichtsrat sicher, dass die potentiellen Auswirkungen dieser Faktoren auf die Unternehmensstrategie und operative Entscheidungen erkannt und adressiert werden'.