FULL PICTURE SERIES

Policy Workshops from the ECGI Network

2020 WORKSHOP REPORT

DIRECTORS' DUTIES AND SUSTAINABLE CORPORATE GOVERNANCE

NOVEMBER 11-13, 2020

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11 November 2020

Presentation of the Report

Professor Luca Enriques (University of Oxford and ECGI) introduced the programme for the first policy workshop in the ECGI Full Picture Series, outlining the relevance of the EY Report to law-making in the EU and beyond, and the contribution of ECGI research members through written submissions directly to the consultation and through their participation in this workshop.

In the absence of representatives from EY or the EU Commission, who declined participation in the workshop, **Professor Marco Becht** (Solvay Brussels School and ECGI) introduced the report. He pointed to the original starting point, the adoption of Sustainable Development Goals (September 2015) and the Paris Agreement on climate change (April 2016), which prompted discussion on how finance could contribute to these goals. As a partial response, at the end of 2016 the European Commission set up a High-Level Expert Group on Sustainable Finance that published its final report in January 2018. In rapid succession, in March 2018 the EC published a ten-point Action Plan on financing sustainable growth. Action 10 was entitled "fostering sustainable corporate governance and attenuating short-termism in capital markets".

In February 2019 the European Commission required advice on "undue short-term pressure from the financial sector on corporations" from the European Supervisory Authorities, that delivered three separate reports in December of the same year. At the same time a study on "companies' interests, boards' duties and sustainability strategies" was commissioned from EY. The EY Report was published in July 2020, followed by a public consultation period that ended on 8 October. It was against the background of this consultation and the written responses ECGI research members had submitted that the workshop was held.

As requested by the European Commission, the core problem being addressed in the EY Report was that EU companies tend to prioritise the short-term interests of their shareholders over the long-term interests of the company, and fail to fully consider sustainability risks and impacts. The report identifies the drivers, specifying the factors and showing the structure of the options (to legislate or not to legislate) for each driver. The full picture provides seven drivers, twelve issues and thirty-six policy options, as well as an assessment of the potential impact for each of them.

This broad programme has led many to wonder if the right problem was identified at the outset, and if so, whether the proposed policy options are addressing it correctly.

After all, the report, as Professor Enriques underlined, serves as support for what may possibly become one of the most ambitious corporate law reform agendas ever advanced anywhere, as these changes will be (and already are) both fundamental and far-reaching.

> ONE OF THE MOST AMBITIOUS CORPORATE LAW REFORM AGENDAS EVER ADVANCED ANYWHERE
>
> PROFESSOR LUCA ENRIQUES

What Do Financial Economists Know About Short Termism?

The Keynote Briefing was delivered by **Professor Zacharias Sautner** (Frankfurt School of Finance and Management and ECGI) providing a balanced review of the literature panorama, focusing on causation, and looking at empirical evidence published in peer-reviewed journals, in order to deliberate fairly on the policy proposals.

Professor Sautner identified some of the key elements in the concept of short-termism, that is, actions which focus on short-term gains at the expense of long-term value. He provided an illustrative example of the driving forces, consisting of the CEO at the centre, making decisions that may affect the short-term or long-term stock price, while responding to incentives and investor engagement in several forms. The CEO also reacts to analysts (earnings per share targets) and to financial reporting requirements (quarterly earnings targets), all of which influence the delivery of short and long-termist approaches or decisions. He structured his discussion around three empirical dimensions: executive compensation, financial reporting and ownership.

Firstly, in terms of executive compensation, he surveyed evidence documenting that CEOs with more short-term incentives spend less on long-term investments.

Secondly, he reported that several studies showed an association between increased reporting frequency and less investment. Professor Sautner also summarised research documenting that quarterly earnings forecasts/earnings per share targets by analysts induced short-termist behaviours; scholars have found that: (i) 80% of top executives were willing to decrease discretionary spending on R&D or advertising (thus, potentially destroying long-term value) to meet an earnings target; (ii) the probability of share repurchases was higher for those firms that would have just missed the earnings per share forecast without the repurchase.

Thirdly, with respect to ownership effects, he referred to evidence that: (I) public firms invested less on average than private firms; (ii) short-term investors were associated with less long-term investments, more frauds, more empire building, and worse M&A decisions; (iii) the presence of activist investors caused higher stock prices, more investment/higher productivity and higher long-term firm values.

Therefore, he concluded that, although short-termism surely deserves a nuanced perspective, the system is not entirely broken and the symptoms should not be confused with the disease, but rather address the right concerns with adequate reforms.

> SHORT-TERMISM IS A FIRST-ORDER ISSUE, BUT ONLY IN CERTAIN PARTS OF THE SYSTEM.
>
> PROFESSOR ZACHARIAS SAUTNER

Part 1: Responses to the European Commission's Consultation by ECGI research members

The first session of the Responses to the EU Commission's Consultation began with the presentation by **Professor Wolf-Georg Ringe** (University of Hamburg, University of Oxford and ECGI), who preliminarily pointed out that this consultation is certainly heading in the right direction, that of correlating sustainability factors with the decisions of the board, while keeping in mind the need for appropriate CSR performance. At the same time, several shortcomings emerged from the report, namely in relation to the mistaken assumption of an equivalence between the concept of shareholder value creation and short-termism. On the same token, the report ignored the phenomenon of market pressure from sustainability-oriented investors, which are increasingly pushing for those goals (further encouraged by the Covid crisis). He, therefore, suggested that the EU Commission should, instead, facilitate investor engagement and foster market standardisation, as well as make use of dynamic regulatory tools.

As to the legal aspects of the consultation, Professor Ringe stressed the importance of considering the context of any legal intervention, as well as the nature of the action and EU political challenges. His intervention highlighted the sharp difference (rectius, political disagreement) in terms of directors' duties and corporate purpose in the EU, where previous attempts to harmonise EU rules or set common standards failed. However, he wondered whether these differences truly matter, as there was virtually no case law on directors' duties in Germany nor in any of the other countries where the business judgment rule is applied as far as shareholder/stakeholder interests are concerned.

He concluded that the proposed legislative changes will have a merely symbolic value from an EU perspective, and a more promising move would be to support investor demands for sustainability (thus, to employ a facilitative regulation in this regard), or to re-think board composition (i.e., attributing formal duties to any director that might be responsible for sustainability on the board).

Professor John C. Coffee, Jr. (Columbia Law School and ECGI) commented that the EY Report on Sustainable Corporate Governance for the European Commission describes a legitimate problem (one even more pronounced in the U.S.), but its proposed remedies are only tenuously and tangentially related to that problem. Bluntly, EY misses the forest for the trees. The real problem lies less with directors and more with shareholders -- or, more accurately, the professional institutional intermediaries who represent the ultimate beneficial owners of the corporation. Today these intermediaries occupy a range of positions on a continuum running from, on one pole, the activist hedge funds who tend to hold positions in companies for a one to two year period to, at the other pole, the "permanent shareholders" (typically diversified and even indexed asset managers, for whom BlackRock is the iconic example). A key point is to recognise that the former (the activists) tend to be the natural champions of shareholder primacy and generally hostile to sustainability, while the "permanent shareholders" tend to take the reverse positions (except when both sides occasionally agree and partner).

The EY Report chiefly focuses on the upward trend in shareholder payout as a percentage of revenues and the downward trend in capital investment ("CapEx") and R&D as a percentage of revenues. Aggravating this problem is the fact that the number of companies with a payout to revenues ratio greater than 75% has also soared. An initial cause is the popularity of stock buybacks. Behind this initial cause lies pressure from activist shareholders and the tax advantages to many shareholders of buybacks over dividends.

Professor Coffee proceeded to survey four of the solutions proposed in the EY Report and offer some alternative options for addressing the problem. His full statement can be read at:

https://ecgi.global/news/european-commission-considers-%E2%80%9Cshort-termism%E2%80%9D-and-%E2%80%9Cwhat-do-you-mean-%E2%80%9D

Oren Sussman (Oxford Said Business School and ECGI) noted that under the heading of "short-termism" the report bundles up many other market failures, primarily environmental ones. This is conceptually confusing but, more seriously, hinders the application of policies more suitable and more effective to resolve these other problems. Most notably, the EU already operates the world's most active carbon-trading system. It is probably the case that the current implicit tax that the system imposes on carbon emission is not high enough to resolve the climate crisis; if so, a more active policy is required. A corporate-governance reform is no substitute to such policy, nor is it likely to be effective.

12 November 2020

Part 2: Responses to the European Commission's Consultation by ECGI research members

Opening the second day of the conference, Professor Becht repeated that the broader EU Commission programme aims at making the EU market economy work for people, not only addressing short-termism, but also inequality and, more generally, stakeholder capitalism, enlightened shareholder value, responsible investment, responsible banking and corporate purpose.

Professor Paul Davies (University of Oxford and ECGI) continued the round of presentations in response to the EU Commission's consultation presenting his remarks also in his capacity of member of the European Company Law Experts Group. However, instead of delving into that document, he rather focused on the Consultation paper (issued on July 26, 2020), which immediately followed the publication of the EY Report, building on its data, without mentioning the initial adverse reactions to that document.

In other words, the Consultation document ended up being highly controverted both in terms of relevance and interpretation, and (even as to its structure) unlikely to fit the purpose for which it was originally aimed. For example, Question 8 of the Consultation – concerning whether corporate directors should balance the interests of all stakeholders instead of considering the short-term financial interest of shareholders, and if this should be clarified in legislation as part of the director's duty of care – required a yes/no answer, neither of which would reflect the views of a consultee who thought the appropriate focus was on the long-term interests of the shareholders. Moreover, Question 8 contained two questions that ought to have been kept separate: the appropriate focus and how to give effect to that focus.

Similarly, Question 10 – regarding the possibility to integrate sustainability risks, impacts and opportunities into the company's strategy, decisions and oversight – cannot be answered by those who disagree with its factual predicate.

The consultation document basically included three shortcomings or, at least, weaknesses.

Firstly, it addressed symptoms, not causes. Since the EY Report accepted that the current formulation of directors' duties in countries' legal systems did not require directors to focus on the short-term interests of shareholders, the explanation of this short-term focus (if it exists) must lie elsewhere. Consequently, it would be really helpful to explore and understand the roots of this alleged erroneous interpretation of the law. Changing the legal duty without addressing the true drivers of behaviour might not produce any change in that behaviour, whilst a change in behaviour brought about by addressing the extra-legal factors might remove the need to amend the legal duty.

Secondly, in so far as the EY Report identifies the drivers of short-termism, it points to the growing pressure from investors for short-term results. However, as recently at 2017 the Commission viewed institutional investors as part of the solution, not part of the problem. Requiring greater alignment between the interests of the ultimate shareholder beneficiaries and the actions of directors was presented in Recital 14 of the 2017 amendments to the Shareholder Rights' Directive II as something which «can help improve the financial and non-financial performance of companies, including as regards ESG» factors. The contradiction between this approach and that of the EY Report and the Consultation Document is startling, especially in the light of the growth of ESG investing since 2017.

Thirdly, the EY Report and the Consultation document did not explore the balance between internal corporate governance and external regulation for dealing with corporate externalities, in particular the impacts of business behaviour on the environment. Professor Davies would prefer those decisions to be taken by elected politicians rather than by the boards of private companies.

In conclusion, both short-termism and the impact of business activities on environment are serious problems, and they deserve a more sophisticated analysis and response than is provided by the EY Report and the Consultation document.

THE EXPLANATION OF THIS SHORT-TERM FOCUS (IF IT EXISTS) MUST LIE ELSEWHERE

PROFESSOR PAUL DAVIES

Professor Mark J. Roe (Harvard Law School and ECGI) introduced the submission, which was written with Professors Holger Spamann, Jesse Fried and Charles Wang (and which was supported by their colleagues J. Mark Ramseyer, Allen Ferrell, Reinier Kraakman, Lucian A. Bebchuk, and Robert Clark). Professor Roe criticised the EY Report on four grounds: (i) it conflated time horizon problems with other problems that would call for differing cures, (ii) it failed to measure the buyback problem correctly, as Jesse Fried would demonstrate, (iii) it misused the prevailing academic literature and (iv) it failed to consider the costs of the potential cures, as Holger Spamann would demonstrate.

Professor Roe pointed out that many of the issues considered to be short-term problems in the report were not time horizon failures but externalities and that the most pernicious externalities tended to be longer-term and not short-term problems. By conflating time horizon problems with externalities, the report had the potential to confuse the policy-making response and to see even more short-termism than there is (by mistakenly considering most externalities to be time horizon problems).

Focusing on the potential for public firms to have truncated time horizons, he also showed that (i) the report's use of academic evidence was inapt because academic work looking at the time horizon problems inside the large U.S. public corporation is quite mixed while the report considered only evidence for there being a problem, and; (ii) policymakers who seek to move from the academic literature to policy-making face several difficulties: First, findings of short-termism at some firms are not systemic problems, as long as other firms pick up the slack. Second, short-termism, like the pernicious long-termism of some firms overinvesting in a stale business, is often an inevitable cost of having listed, public companies.

If we wanted listed companies because of their capital-raising capacity and potential to act at large scale, there will inevitably be costs, and some of those costs are intermittently excessive short-termism and intermittently excessive long-termism. Policymakers need to take care in addressing difficulties not to damage the quite beneficial aspects of the public firm in gathering capital and investing it at scale.

Professor Holger Spamann (Harvard Law School and ECGI) continued by reiterating that: (i) the corporate governance system was imperfect but not broken and thus needed to be tuned with care, and (ii) short-termism per se is not a valid rationale for mandatory EU regulation because unlike externalities, short-termism is primarily a problem for investors. Investors can therefore be expected to address short-termism themselves, if it is real; regulators might help by enlarging, not restricting, the set of available arrangements, i.e., with opt-in rules (under the principle of subsidiarity, however, this should be for national regulators to decide).

More specifically, Professor Spamann delved into Option C of the report (mandatory elements), which is the option favoured by the report itself (with the exception of incentivising long-term holdings and prohibiting earnings guidance and quarterly reporting, which the report itself deemed disproportionate). He noted that three of the six remaining proposals were likely to do neither much good nor harm: long-term director compensation and sustainability strategies were already widespread, and "considering" sustainability in director nominations was a soft requirement. He was more critical of proposals to tie director remuneration to sustainability metrics and mandate stakeholder involvement, noting the irony that the report itself had been unable to identify the right metrics and the relevant stakeholders.

Professor Spamann explained that enlarging director duties from shareholder primacy to a stakeholder approach was likely to have little effect because shareholder primacy was not practically enforceable anyway, and data show that similar changes in U.S. state legislation had no measurable effect. He sounded a strong warning against granting stakeholders standing to enforce director duties, pointing out that the global standard of corporate governance was not to rely on judicial enforcement of ill-defined duties, including duties that favour shareholders.

Professor Jesse M. Fried (Harvard Law School and ECGI) concluded the critique from the Harvard submission, providing results of an empirical paper co-authored with Charles Wang. The paper points out severe flaws in the evidence of short-termism presented by the EY Report. First, the EY Report claims that shareholder payouts are high and increasing, but fails to account for equity issuances that move capital in the opposite direction. These issuances exceed repurchases, and net shareholder payouts are in fact quite moderate. In fact, smaller faster-growing EU public firms are actually net equity absorbers during the period analysed by EY. Second, the EY Report uses a biased and incomplete sample of EU public firms in measuring investment, concluding from this improper sample that investment intensity has been declining. But across all EU public firms, investment intensity has been increasing. And cash balances among EU firms have actually been rising, suggesting that investment levels are not higher because of a lack of capital, but because of a lack of opportunities. In light of all of these flaws, EU policymakers should not rely on the EY study but rather run from it. A full critique is accessible at:

https://ecgi.global/news/european-commission%E2%80%99s-sustainable-corporate-governance-report-critique.

Professor Marc Goergen (IE Business School and ECGI) focused on the objective in the report of achieving greater sustainability through improved board gender balance, which is supported by his research. He illustrated the findings from his US study which indicates that board gender balance fosters sustainability with parallels in the Europe. He suggested that it would be easier to pursue the proposed policy goals with modified board composition rather than changing directors' duties. Professor Goergen studied increases in renewable energy consumption, distinguishing firms with male and female directors from the Bloomberg data on the consumption of renewable energy by S&P 1500 firms. He noted that the overall growth for such firms was more pronounced when more female directors were observed, and the percentage of renewable energy consumption was higher for this group.

He considered the gender socialisation theory and ethical theories to point out why women are more inclined towards the usage of renewable energy before concluding that the presence of women enhances renewable energy consumption and increases firm value. Thus, pushing board gender diversity on the agenda, especially in some EU Member States and assuring the presence of the critical mass of two to three female directors on the board may be beneficial towards the objectives.

Professor Jennifer Hill (Monash University and ECGI) addressed a number of drivers and issues in the EY study, from a comparative law perspective. Her presentation focused on a number of specific issues in the EY study – namely Issues 1.1 (the formulation of directors' duties), 2.1 (shareholder activism) and 7.1 and 7.2 (low levels of enforcement of directors' duties).

Professor Hill noted that the EY Report seems to assume that corporate law is either "shareholder-centered" or "stakeholder-centered", and that there is a Manichean, and irreconcilable, divide between these two approaches. In her view, however, a better way to approach the matter may be to accept there are two fundamental problems in corporate law: (i) agency problems between shareholders and managers, and (ii) corporate conduct that results in negative externalities and harm to society. This second problem focuses on how corporations make profits.

She stated that both these problems need to be addressed, but that fiduciary duties do not necessarily need to do all the "heavy lifting" in this regard. Other corporate governance mechanisms such as corporate governance codes and institutional investor activism are also important. Indeed, the increasing attention to ESG issues by institutional investors demonstrate that these investors are extremely interested in how profits are made.

In terms of the issue of low levels of enforcement of directors' duties (particularly the duty of care) Professor Hill noted that not all jurisdictions are the same. For example, some jurisdictions, such as Australia, have relatively high levels of enforcement for the duty of care, due to its distinctive public enforcement model.

Professor Theo Vermaelen (INSEAD and ECGI) focused his remarks on: (i) "the buyback derangement syndrome" that was believed to be confined to the U.S. but is now seemingly spreading to Europe (ii) why the so-called evidence that buybacks are value destroying ignores long term evidence.

He noted that the report ignores that investors who receive money when a company repurchases shares either spend the money or reinvest it with companies who need funds. It also assumes that firms have no access to external finance so that pay-outs are missed opportunities for better investments. While some buybacks could be bad the same thing can be said by investments in real assets. The report disregards the extensive literature on share buybacks, except politically motivated anti-share buyback papers such as Lazonick's paper in the HBR. It ignores the extensive evidence that buybacks on average are good for long-term shareholder value, they are not a short-term stock price or manipulation scheme. Professor Vermaelen further offered that unless sustainability goals and long-term shareholder value remain consistent, there will inevitably be a trade-off. Without such consistency boards, which are appointed by shareholders (not society) should not pursue sustainability goals.

> THE GLOBAL STANDARD OF CORPORATE GOVERNANCE IS NOT TO RELY ON JUDICIAL ENFORCEMENT OF ILL-DEFINED DUTIES
>
> PROFESSOR HOLGER SPAMANN

13 November 2020

Part 3: Responses to the European Commission's Consultation by ECGI research members

After a brief introduction by **Professor Lucrezia Reichlin** (Professor of Economics at the London Business School and ECGI), **Professor Alex Edmans** (London Business School and ECGI) discussed the importance of using only the highest-quality, peer-reviewed academic evidence when forming policy. He stressed the criticality of learning from the evidence to arrive at conclusions, rather than starting with a viewpoint and then searching for evidence to support it. He argued that this unbiased approach seems to have been forsaken in the case of the EY Report. He pointed out that "short-term shareholder value", a term frequently used in the EY Report, does not make sense as shareholder value is a long-term concept – it is the present value of all future dividends. He then separated the problems into two issues, that of horizon (long-term v. short-term) and that of objective (shareholder value v. stakeholder value), and argued that the EY Report conflated the two.

Starting with the former, many of the problems highlighted by the EY Report result from an excessive focus on short-term profit, not long-term shareholder value. Since shareholder value is a long-term concept, the solution may require more shareholder capitalism, not less. He pointed to the extensive literature which confirms; (i) CEO equity incentives lead to long-term shareholder returns; (ii) long-term CEO pay improves profitability, innovation and stakeholder value; (iii) short-term incentives lead to investment cuts.

Regarding shareholders v. stakeholders, and referencing his book on the subject, Professor Edmans observed that the report assumes what he terms a "fixed-pie mentality" where anything acquired that goes to shareholders is at the expense of stakeholders. Under this fallacy, increasing the slice that goes to society requires reducing the slice that goes to shareholders, by weakening their rights. However, rigorous evidence shows that shareholder activism grows the pie, creating value for both stakeholders and shareholders. Reducing shareholder rights, he cautioned, would not lead to stakeholder capitalism but "managerial capitalism", where managers pursue their own interests, or coast, shrinking the pie for both shareholders and stakeholders.

Professor Edmans noted that the report ignored the high-quality evidence on buybacks, which finds that: (i) share buybacks increase the stock price not only in the short-term, but even more in the long-term; (ii) CEOs do not use share buybacks to meet short-term earnings targets, and (iii) the money paid out via share buybacks gets invested elsewhere in the economy.

Finally, Professor Edmans argued that the EY Report was wrong to criticise investors' short holding periods. He highlighted that an investor's holding period is critically different from its horizon. Even if an investor sells in the short-term, this could be based on their assessment of a company's long-term value – even if the company's profits are high, the investor might sell because it recognises that it has not invested sufficiently for the future.

Thus, the loyalty incentives proposed by the report may backfire, as they encourage investors to stick with a company even if it is mortgaging its future.

Professor Steen Thomsen (Copenhagen Business School and ECGI) presented his response to the consultation, stating that corporate governance is concerned with decisions under uncertainty and asymmetric information whereas issues with a well-defined solutions (such as climate action) are best served by rules (legislation) such as a carbon tax. He asked whether that sustainable governance could be a second-best instrument less likely to provoke a public backlash? However, he argued that improving sustainability through corporate governance is much less efficient than by legislation and can lead to undesirable side-effects and higher costs (jobs and lower competitiveness) with limited effect on the sustainability.

He proposed some less radical reforms such as (i) clarifying that directors can prioritise corporate purpose and stakeholder interests in takeover situations; (ii) strengthening long-term ownership through tax incentives or dual-class shares; (iii) introducing sustainability committees on company boards; (iv) promoting long-term board compensation with restricted stock for an extended period; (v) recommending advisory stakeholder councils prioritising outsiders; (vi) reinforcing corporate purpose through board representation by long-term shareholders.

In conclusion, Professor Thomsen cautioned against the unlimited and widespread directors' liability amendments which could damage European business while increasing risk aversion and reducing entrepreneurship, growth and competitiveness, leading potentially to a second wave of "Eurosclerosis".

Professor Mariassunta Giannetti (Stockholm School of Economics and ECGI) noted that models of corporate governance provide nuanced implications on the desirability of different governance arrangements to maximise shareholder value. Short-term ownership is a case in point. She argued that the threat of exit of short-term investors, which due to the structure of their liabilities have strong incentives to sell when uncertainty increases, may be beneficial under some circumstances. In particular, it is desirable if quick reactions are value-increasing.

In a paper forthcoming in Management Science, Professor Giannetti has shown that following an increase in competitive pressure, firms have stronger incentives to restructure and adapt to the new environment to avoid short-term investors' selloffs. Firms with ex-ante relatively more short-term investors invest, innovate and turnover their executives more. As a consequence of their fast reactions, these firms maintain market share and have better short-term and long-term performance than their peers. Professor Giannetti concluded that the presence of short-term owners may be desirable to interrupt inefficient long-term projects. This is particularly relevant in situations characterised by low-interest rates, in which low profitability firms, the so-called zombies, are able to survive hampering the process of creative destruction.

Professor Amir Licht (Interdisciplinary Center of Herzliya and ECGI) tackled what the report identifies as "Driver 1" - namely, the idea that directors' duties are interpreted narrowly as limited to shareholders' interest. The report's comparative assessment of three different options for addressing it (a, b, and c) suggests that it is the most effective, efficient, equally coherent and equally proportioned one. Professor Licht noted that the evidence does not back the report's claimed mechanism. He pointed to his joint research with Renée Adams and Lilach Sagiv, which shows that directors do not address shareholder-stakeholder tensions in the way the report presumes. Moreover, directors take a principled, value-based approach to such tension notwithstanding legal injunctions. This suggests that Option C and similar formal legal reforms could be an exercise in futility. Policy makers had better focus on internalising public interest into firm's calculations, e.g., through a Pigouvian tax.

Professor Rolf Skog (University of Gothenburg and ECGI), continued the round of comments, referencing the ECLE submission that Prof. Davies presented and the joint submission with Nordic Company Law and Business professors, with which he was both associated. He added that the Swedish Companies Act requires the bylaws to set its goals (not to be confused with its corporate purpose) but grants full contractual freedom. He noted that this freedom is challenged by the report, arguing in favour of mandating companies to have a different scope, that being an attack on fundamental property rights. He referenced Easterbrook and Fischel; stating that the corporation is a financing device, and there is no such thing as company interest.

In the initiative for a Capital Markets Union, the EU Commission expressed concern for the lack of efficient supply of risk capital. Professor Skog suggested that the proposals in the report will enhance investors' uncertainty, and if approved, EU companies would likely receive less access to risk capital, hampering businesses, and hindering the incentives to undertake forward-looking investments needed to sustain sustainable economic growth, leading the entire European business sector to fall behind the rest of the world.

Professor Per Strömberg (Stockholm School of Economics and ECGI) concluded the panel discussion by emphasising the difference between short-term ownership and short-term behaviour. He claimed that short-termist behaviour is the problem, not short-term ownership, as long as stock prices are sufficiently informative and reflect long-term profits.

Short-termist behaviour is related to the lack of sufficient information of what is really going on in the firm. Owners who want to maintain the ability to constantly trade their shares – such as mutual funds – have to make sure they do not become insiders. Such owners will be forced to rely on public information, such as quarterly financial disclosures, rather than direct dialogue and engagement with the board and management. In contrast, shareholders who are willing to bear the cost to give up some of the liquidity of their shares, will be able to engage with management and fill the role as active owners. The key to good governance is to ensure a proper ownership structure that strikes a balance between active informed "illiquid" owners and arms-length less-informed owners who provide liquidity in the shares and help make prices more informative.

In the light of this argument, addressing short-termism through curbing dividends and pay-outs will be counterproductive: long-term owners need to get liquidity somehow and, in case they do not, they have to sell their own shares. More productive policies could include: (i) improving ESG measurement and disclosure; (ii) allowing (without mandating) managers to look at the best interest of the company as a whole but use a "shield"-approach (allowing managers to consider stakeholder interests) rather than a "sword"-approach; and (iii) facilitating the ability of informed owners to influence firm's decisions e.g. by making it easier for owners with a meaningful stake to get board representation. Beware of the potential negative effects of wealth and inheritance tax on the ability of physical owners to exercise informed governance.

In conclusion, **Professor Marco Becht** (Université libre de Bruxelles and ECGI) highlighted the unanimous verdict regarding the EY Report by presenters and discussants, as well as the clear recommendation to the EU Commission to disregard the study. Professor Becht noted that there was still room for academics to comment, for example, on the reports of the three European Supervisory Authorities and in the ongoing consultation on "sustainable corporate governance". Many ideas and insights had been put forth already during the three half-day workshop and it was hoped that some of these would be taken up in the European Commissions revised 2021 agenda. There was also unanimous agreement that corporate governance is central to sustainability, but that most of the actions proposed in the EY Report are not those that are needed to deliver on the sustainable growth objectives. Worse, if implemented, they could do harm.

> THE KEY TO GOOD GOVERNANCE IS TO ENSURE A PROPER OWNERSHIP STRUCTURE THAT STRIKES A BALANCE BETWEEN ACTIVE INFORMED "ILLIQUID" OWNERS AND ARMS-LENGTH LESS-INFORMED OWNERS WHO PROVIDE LIQUIDITY IN THE SHARES AND HELP MAKE PRICES MORE INFORMATIVE.
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> **PROFESSOR PER STRÖMBERG**

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