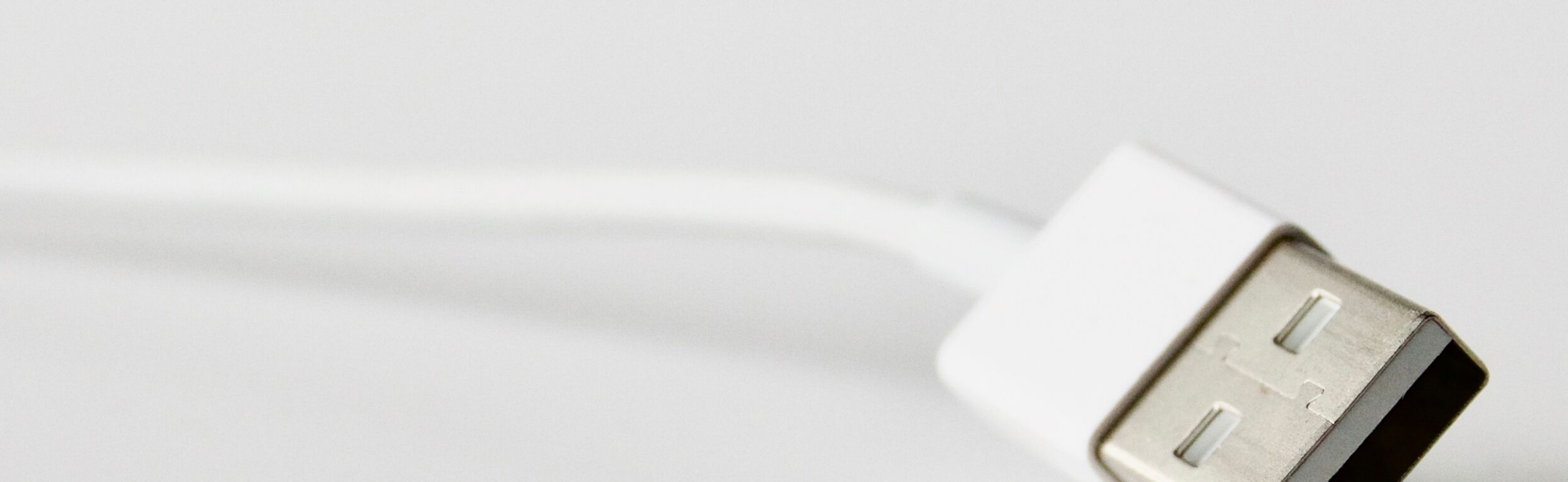
ecgrf

european corporate governance research foundation

The European Corporate Governance Research Foundation



Supporting Global Research on Corporate Governance and Stewardship

www.ecgrf.org

July 2019

ABOUT ECGRF

Background

established 2013

The importance and relevance of Corporate Governance have become self-evident in current times and no longer require explanation or demonstration. Corporate governance practice does however need to be underpinned by thorough and credible scientific research if governments, companies or other institutions that are accountable to stakeholders are to avoid their decisions and actions being taken on the basis of insufficient reflection or bias.

Since 2002, the European Corporate Governance Institute (ECGI), an international not-for-profit association, has become recognised worldwide as the prime promoter and disseminator of independent academic research of quality on corporate governance. Through the initiative of ECGI directors and members, the European Corporate Governance Research Foundation (ECGRF) was created. The principal aim of this Foundation, which was formally established in October 2013, is to provide funding for ECGI to embark on a more ambitious and far-reaching programme of research activities with all the necessary resources and support that this requires.

In this way, ECGRF was established to support the continuing flow of academic research on corporate governance and stewardship for the public good. The integrity of that research is enshrined in its statutes. Yet, with so much happening in today's business and political environment, it can be challenging at times to stand out as a worthy cause with global impact. The Foundation's Trustees, which currently include representatives from Investor AB, BP plc, and BlackRock, are particularly aware of the impact of evidence-based research and value it highly.

In recent years, the ECGI has increased the number of Research Members (now 277) contributing from around the globe and has broadened the scope of research to become fully engaged on new topics such as stewardship and ESG, as well as offering a fresh take on old topics. The range of activities which includes conferences, roundtables, papers, communications and support for research projects, has also been greatly increased. However, providing free public access to reliable information does not happen without effort. This effort is a culmination of financial support and great work of all of the ECGI and ECGRF representatives.

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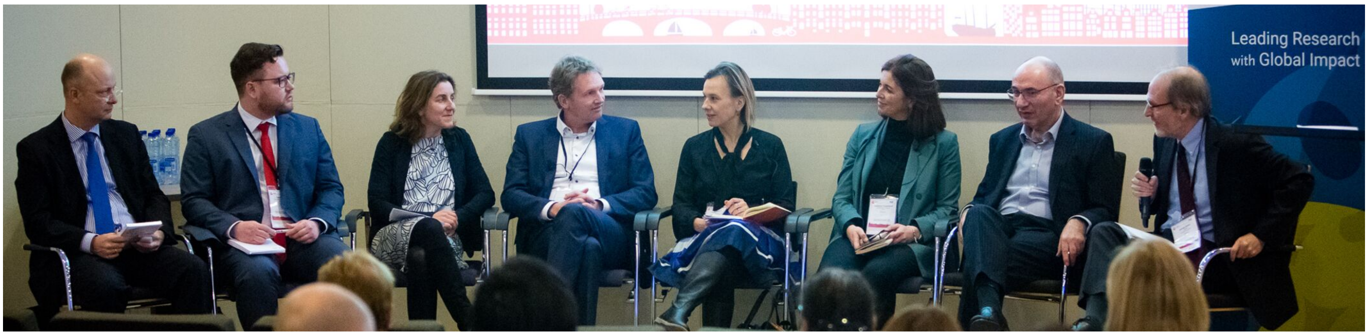
Patronage

The European Corporate Governance Research Foundation (ECGRF) is actively considering partners to join the cause for improving corporate governance and stewardship practices around the world. The Trustees of the Foundation are committed to building a solid financial framework to support the activities and accessibility of high quality research that is produced globally under the auspices of the European Corporate Governance Institute (ECGI).

The commitment requires a philanthropic (charitable) donation of EUR 50,000 annually for five consecutive years (total EUR 250,000). It is possible to activate a break option after the second year which would result in a reduced commitment of three years of consecutive annual contributions (total EUR 150,000).



The European Corporate Governance Institute (ECGI) and The European Corporate Governance Research Foundation (ECGRF)

With a network of 277 international researchers that have been appointed based of the quality of their work, ECGI distributes incisive knowledge on a vast range of topics relating to corporate governance and stewardship. It is a unique network in that it has a **multi-disciplinary nature** (law, finance, economics and management) with a **multi-region focus**. Many of the topics covered within the scope of research are touched on later in this document. ECGI's network extends beyond this core group of researchers, with over 640 members worldwide, each with a specific interest in the topics studied. This places ECGI as the leading academic source of research with a long-standing reputation for quality and integrity. The Trustees of ECGRF are also members of ECGI. The majority are Research Members, representing the interests of the ECGI Research Members who are the guardians of its academic integrity, while the balance comprises independent Practitioner Members and Patron Members of ECGI. This relationship between the two organisations strengthens and supports the activities of ECGI, while ensuring that academic independence is not compromised. Patrons of the Foundation can therefore expect to become de facto Patron Members of ECGI and thereby engage in all of the opportunities afforded to members, while remaining adequately removed to ensure that all reputations are maintained.

Why Corporate Governance and Stewardship?

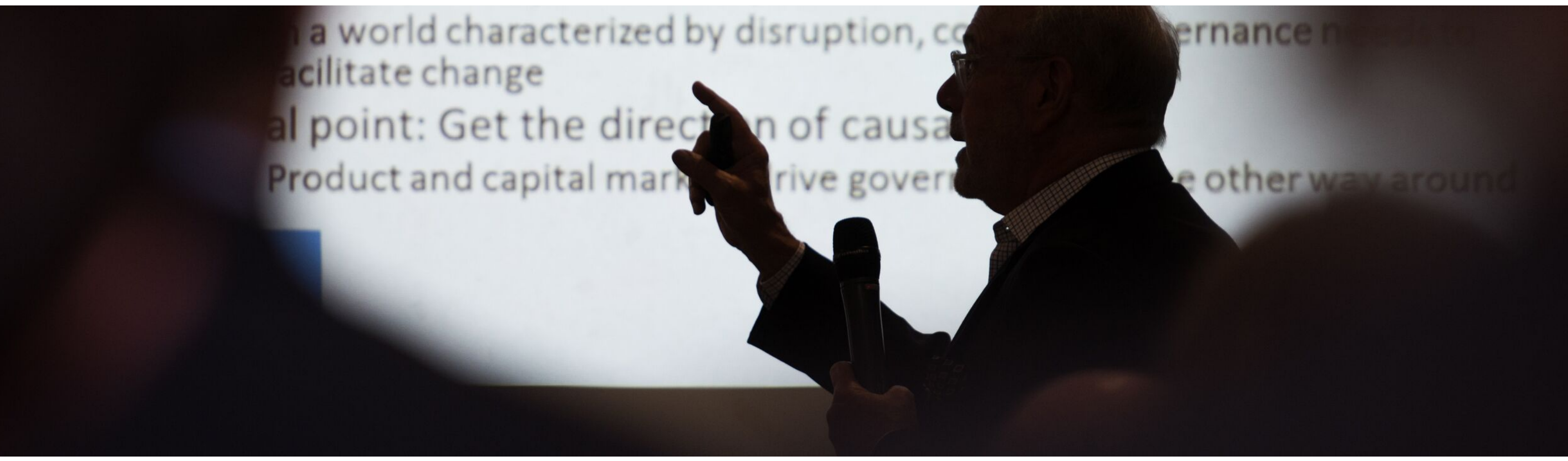
Corporate governance lies at the heart of our market-based economic systems, and is increasingly important in a more integrated global economy. It is the interface between capital markets and companies, between employees and executives, between society, governments, and the corporate sector. In other words, it sits at the centre of the success and failure of our economic systems. As such it warrants knowledge, research by academics, practitioners and policymakers, and all those who can afford to take a step back and think about new corporate governance trends and challenges by taking the long view. That is precisely what ECGI seeks to provide and what ECGRF seeks to stimulate. ECGI draws on the finest minds in academia, the business community and government from all over the world to tackle some of the most important issues that confront business and governments today. It uses the power of research to highlight new challenges and guide policy to benefit all. Corporate governance refers to the way in which private and public companies, new ventures and financial institutions are governed to foster, inter alia the interests of their owners, and society at large.

Current Patrons

BlackRock

bp

investor



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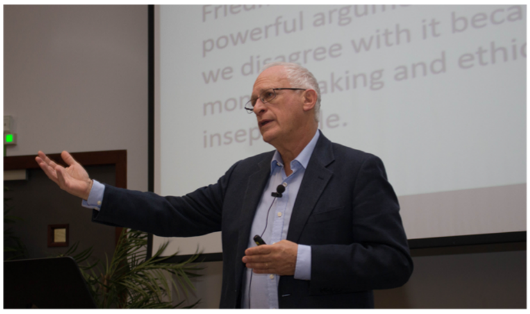
About the European Corporate Governance Institute (ECGI)

ECGI developed around a comparative multi-country project that was to study the ownership and control of listed companies in Europe. Following this, the researchers, on behalf of the European Association of Securities Dealers (EASD) developed a pan-European corporate governance code that could be adopted by companies from any jurisdiction. Their work also informed the OECD's first corporate governance principles and provided the groundwork for a comparison of corporate governance codes project for the European Commission. Another notable research project was ECGI's contribution to the European Commission commissioned study on one-share-one-vote. The study had four well defined parts: An institutional investor survey, some data collection, a legal survey and a survey of the academic literature. The academic surveys contributed significantly to the European Commission's decision to refrain from regulatory intervention in the control of listed companies in Europe. The arguments and evidence presented were fully accepted.

As ECGI evolved and the network expanded, a more formal constituted structure was put in place. Since then, Research Members worldwide were appointed to the Institute and have independently engaged in countless projects with policymakers, practitioners and others. ECGI makes it possible to identify the leading scholars on corporate governance globally.

ECGI has published over 1,000 Working Papers on vital, current topics. By 2018, it had acquired over 640 members from more than 57 different countries, had hosted over 30 international conferences, numerous workshops, and provided training for 18 doctoral students. It continues to maintain a directory of international Corporate Governance Codes from over 100 jurisdictions and three of its 277 Research Members, Jean Tirole, Oliver Hart and Bengt Holmström, have won Nobel Prizes.

Consistent with the ECGI tagline "Leading Research with Global Impact", the present development plan, which is available on request, proposes that ECGI continues to capture the research output of its global network of Research Members, to make its existing engagement with practitioners and policymakers more effective, and to disseminate the results of these activities worldwide to achieve global impact. The plan also foresees that ECGI will support research projects undertaken by its Research Members and stimulate the development of new projects in the Institute's name.



Topics

Selection of Topics covered by ECGI Research Members

Common Ownership

Common Ownership centres on the implications of growing horizontal ownership concentration in industries by large investment managers, especially those offering index tracking funds. The debate addresses the competition analysis of any company that may want to engage in a horizontal merger (or any merger at all). And because it directly affects the actions of large asset managers as shareholders, it is also bears directly on the debate over large asset managers' stewardship role.

Corporate Culture

Often considered vague and elusive, "Corporate culture" is becoming an increasingly important theme in contemporary corporate governance. Recent attention given to culture arguably reflects a growing awareness that corporate governance is "a complex system, whose structure and functioning depend on more than law and economics" (Licht, 2014). Although the concept of organisational culture is relatively new to corporate governance, its roots go back many decades to literature in the fields of sociology, anthropology and psychology (Hsieh et al, 2018). Numerous rationales have been offered to support the need for a good corporate culture – namely, that it is a vital component of effective risk management; that it contributes to compliance; that it supports professionalism, integrity and accountability; and that good corporate cultures promotes long-term financial and business success.

Diversity

Diversity on company boards has become an important corporate governance issue in recent years. Many justifications have been given for the need for greater gender diversity on boards, including, controversially, that it enhances board decision-making and improves corporate performance. Other justifications are that gender diversity broadens the pool of qualified directors, and that it is also an important reflection of the values of justice and equality in society. In recent years, jurisdictions around the world have adopted a variety of regulatory techniques to improve the gender balance on boards. As the ECGI Working Papers demonstrate, issues relating to diversity, including gender diversity, can arise in a wide range of different contexts – for example, the structure of boards (Adams, 2017; Adams and Kirchmaier, 2016); whether gender diversity affects firm value (Eckbo et al, 2016); reporting practices concerning diversity (Ahern and Clarke, 2013); the impact of gender diversity on governance and corporate decisions making (Evgeniou and Vermaelen, 2017; Chen et al, 2016; Adams and Ferreira, 2004); the impact of more women in senior management positions (Adams and Funk, 2010); and gender issues relating to executive pay (Kulich et al, 2010).

Environmental, Social and Governance (ESG)

Institutional investors increasingly take environmental, social and governance (ESG) issues into account when making investments in portfolio firms. This can be in the form of direct shareholder engagement or through screening, whereby firms with certain ESG characteristics end up on positive or negative (exclusion) investment lists. ESG investment can also imply the divestment of portfolio firms. While many institutional investors started to incorporate G topics, such as board structure or executive compensation, several decades ago, the integration of E&S issues into the investment process is a more recent phenomenon. E topics include climate change, waste, pollution and water rights, while S issues may be related to human rights issues, weapons, tobacco, and labour standards. ESG investing is set to have a major impact on many portfolio firms. By 2018, more than 2,000 signatories representing over US$80 trillion of assets had signed the UN Principles for Responsible Investment (PRI), a document that commits its signers to consider ESG factors when making investment decisions. An important driver behind the increasing importance of ESG investment is academic research indicating that incorporating ESG factors into the investment process can lead to higher investment returns and lower risks.

Executive Compensation and Say on Pay

Executive compensation has been a major corporate governance topic since the 1990s. Previously viewed as a fiduciary duty problem, it was reinterpreted as an issue of misalignment of managerial and shareholder interests. Under this paradigm, pay for performance became a self-executing governance technique to align the interests of management and shareholders, providing incentives for superior corporate performance. Since the 1990s, there has been much debate about whether executive compensation is determined efficiently by disinterested directors (the optimal contracting model) or whether there are systemic problems in executive pay due to the ability of corporate managers to exert control over the pay-setting environment and process (the managerial power model). The primary focus under optimal contracting model was on the design and structure of optimal compensation contracts. The managerial power model, however, suggested the need for stronger regulatory techniques to reduce management's inherent power advantage and flaws in compensation arrangements.

Many regarded executive compensation to be a contributing factor in past crises, amid growing concern about wealth concentration and income inequality. This led to the introduction around the world of new regulatory techniques to control executive compensation such as "say on pay", which accords shareholders stronger participatory rights in relation to executive compensation. Many jurisdictions have now adopted say on pay. Although the trend might, at first sight, suggest regulatory convergence, there are, in fact, a range of different forms of say on pay, with varying levels of stringency and shareholder power. Say on pay is itself highly controversial. It inevitably shifts more power to institutional investors, and arguably gives them a quasi-regulatory role with respect to executive pay. Some commentators view this as a valuable check and balance on managerial power in a dispersed ownership context, and as consistent with institutional investors' evolving stewardship role. Others, however, regard shareholders as at least partly responsible for perverse incentives in executive pay. According to these commentators, say on pay represents a dangerous regulatory development, which has the potential to harm other stakeholder groups.

Hedge Fund Activism

Hedge funds are engaging in a form of shareholder activism and monitoring that differs fundamentally from previous activist efforts by other institutional investors. Unlike mutual funds and pension funds, hedge funds may be able to influence corporate boards and managements due to key differences arising from their different organizational form and the incentives that they face. Hedge funds employ highly incentivized managers who manage large unregulated pools of capital. Because they are not subject to regulation that governs mutual funds and pension funds, hedge funds can hold highly concentrated positions in small numbers of companies, and use leverage and derivatives to extend their reach. Hedge fund managers also suffer few conflicts of interest because they are not beholden to the management of the firms whose shares they hold. After the financial crisis, hedge funds have been subject to some new regulation, including limited disclosures to regulators, but those have not fundamentally altered their business. In sum, hedge funds are better positioned to act as informed monitors than other institutional investors. The long-term effects of hedge fund activism are hotly debated. DeHann, Larcker and McClure (2018) find pre- to post activism returns are insignificantly different from zero and further find no evidence of abnormal post-activism performance improvements. Bebchuk, Brav and Jiang (2015) argue that policy makers should not accept claims that hedge fund activism is costly to firms and their shareholders in the long term.

Stewardship

Stewardship is an important concept in corporate governance, which can apply to a range of corporate participants, including the state, directors and shareholders. In recent times, however, the focus in this area has been on shareholder stewardship, specifically on the rise of Shareholder Stewardship Codes. Shareholder Stewardship Codes reflect the growing influence of institutional investors. The codes, which first appeared in the aftermath of the 2007-2009 global financial crisis, represented a response to concern that institutional investors had been too passive in providing oversight during the crisis. These codes encouraged shareholders to exercise their legal rights and increase their level of engagement in corporate governance as a constraint on managerial power and excessive risk-taking. Although the Stewardship Code phenomenon might at first sight suggest corporate governance convergence, there are many differences in Stewardship Codes around the world, which can influence their effectiveness. A common theme in contemporary international Stewardship Codes, regardless of their issuing body, is the need for long-term, sustainable investment horizons. Also, Stewardship Codes increasingly promote ESG issues. In the relatively short time they have been on the corporate governance radar, Stewardship Codes have provoked a considerable amount of controversy. Some commentators have suggested that shareholder stewardship is unlikely to be effective, because investors often lack appropriate incentives to become engaged in corporation governance and traditional free-riding issues will continue to apply in this context.

Technology and Corporate Governance

Digital technologies and digital transformation are shifting the way our economy is functioning, our social relationships are structured and decision taking processes are shaped. Technological developments are also envisaging corporate organizations, currently highly centralized entities with formal and informal procedures and processes, often slowing decision taking processes and creating information asymmetries. Technology can drive change of corporations. First, distributed ledger technology (DLT) and blockchains can ensure that the data is stored in a verifiable and immutable way, and there is no longer any need for an intermediary to establish trust between the company and shareholders. A permissioned distributed ledger can also constitute a set of rules for shareholder voting, including majority requirements and access rights, so that shareholders can exercise their rights in accordance with the applicable corporate law framework and the company's articles of association. Blockchain technology can harmonize shareholder engagement opportunities by offering a common discussion platform for shareholders and board members. Decentralization can also affect the work of the corporate board. Ultimately a decentralized autonomous organization (DAO) is a governance system that work with smart contracts and could have the ability to take over (part of) the work of the centrally designated board. Next, artificial intelligence (AI) is more and more used in different ways including artificial neural networks, fuzzy systems, evolutionary computing, intelligent agents and probabilistic reasoning models. These tools are helpful for the analysis of data trends, the provision of forecasts, the anticipation of users' data needs, and so on. AI helps to make and shape the decision-taking process and has the ability to support and even replace of human decision-making, particularly under conditions of uncertainty. It already resulted in the use of a robo-director Vital with a board observer status. All these developments clearly pose new questions, such as: Does blockchain have promise as a tool for registering ownership claims and the exercise of voting rights in listed corporations? What is the impact of AI and big data analysis on firms' management and governance? Will smart contracts affect the boundaries between firms and markets in a number of industries? Could robo-directors be elected to the board?

Other research topics include:

Bankruptcy
Boards
Company Law
Competition
Contracts
Capital
Ethics, Trust and Governance
Foreign Investment
Labour and Finance
Listings
M&A
Management
Ownership
Private Equity
Related Party Transactions and Tunneling
Regulation
Responsibility, ESG, Sustainable Finance
Reporting
Risk
Shares and voting
Shareholder Rights
Shareholder Value
Short-termism
Stakeholders
Tax
Takeovers

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Governance

The ECGRF has been established under Belgian Law as an international not-for-profit Foundation. This legal vehicle is governed by its Articles of the Foundation (Deed of 11 October 2013). It was approved by Belgian Royal Decree on 26 November 2013. Future amendments to these articles must be approved by three-quarters of the Board of Trustees and two-thirds of the ECGI Board. Patrons of the Foundation are legal entities and/or individuals who have committed to funding the ECGRF. Patrons are designated to the Patron's Council by the Board of Trustees with the concurring assent of the ECGI. Patrons automatically then become Patron Members of the ECGI. Patrons elect a chairman among their number and meet in Council upon a call from their chair or their deputy. At a joint meeting held at least once a year between the Council, the Board of Trustees of the Foundation and the Board of Directors of the ECGI, the Council of Patrons may express its views and advice on the orientation of the activities of the Foundation and the ECGI. The Council of Patrons has the right to nominate up to one-third of the Board of Trustees of the Foundation.

Trustees

Professor Ernst-Ludwig von Thadden (Chair)
University of Mannheim
ECGI Fellow

Ms. Amra Balic
BlackRock

Professor Erik Berglöf
London School of Economics and Political Science (LSE)
ECGI Fellow

Professor Patrick Bolton
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Professor Paola Sapienza
Kellogg School of Business
ECGI Fellow

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