CORPORATE GOVERNANCE FOR A CHANGING WORLD

Draft report of a global roundtable series

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About Frank Bold: Frank Bold is a purpose-driven law firm established in 1995 with four offices in the Czech Republic as well as offices in Krakow, Poland and Brussels, Belgium. The firm seeks to use the power of business and non-profit approaches to solve social and environmental problems. Frank Bold provides legal expertise in corporate accountability to the European institutions as well as to NGOs in many countries.

About the Purpose of the Corporation Project: Frank Bold has launched the Purpose of the Corporation Project, an apolitical, collaborative initiative exploring the relationship between a mainstream model of corporate governance focused narrowly on shareholder primacy and short-termism, and seeking to foster the development of a more balanced approach to corporate governance regulation and business management. The Project uniquely positions itself at the juncture of academia, business and policy to promote a dialogue between all groups. This dialogue, on the forefront of understanding and meeting the evolving challenges of corporate governance, is intended to advance thinking, practice, and policy in these areas.

After the Global Financial Crisis, the contemporary model of corporate governance became increasingly criticized for forcing companies to focus on short-term profit maximisation for shareholders only at the expense of long-term strategizing, innovation and sustainability. Continued reliance on this model limits the scope and impact of efforts by policy-makers to mitigate these effects. A consensus has begun to emerge that companies should focus on creating long-term sustainable value but we lack agreement on how to achieve this outcome. In order to produce more clarity on appropriate structures and practice for publicly listed companies, the Purpose of the Corporation Project was designed to first identify the outcomes that corporate governance should deliver and envision a desired future.

The stock exchange and notably the publicly traded company originated in the 17th century as concepts that would serve the public good (see Johnson, 2010). The financial crisis has shown to what extent the originally public purpose of these concepts has been lost. This presents an opportunity to discuss the idea of public company and to find ways to align stakeholders in this debate towards a beneficial and forward oriented model.

Authors:

The report has been written by Dr. Jeroen Veldman from Cass Business School, and Filip Gregor and Paige Morrow, both from Frank Bold. Significant contributions were made by Prof. Andrew Johnston from the University of Sheffield and Prof. Hugh Willmott and Prof. André Spicer from Cass Business School.

The following scholars also contributed reflections: Charlotte Villiers, University of Bristol; Prof. David Collison, University of Dundee; Prof. Blanche Segrestin, Mines ParisTech; Prof. Andrew Keay, University of Leeds; Dr. Thomas Dallery, Université du Littoral Côte d'Opale; Dr. Tristan Auvray, Université Paris XIII; Dr. Jay Cullen, University of Sheffield; Dr. Andreas Ruehmkorf, University of Sheffield; Dr. Genevieve LeBaron, University of Sheffield.

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INTRODUCTION

Perhaps the most important question for the economy is thinking through how companies should be managed and for what ends (Wolf 2014). It is therefore imperative that firms - particularly the world's largest public companies - be governed responsibly.

With this context in mind, the Purpose of the Corporation Project launched a global roundtable series on corporate governance at Cass Business School in London in September 2014, with subsequent discussions held in New York, Zurich, Brussels and in France, Germany and the Netherlands (locations to be confirmed).

The objective of the roundtable series is to identify the desired outcomes of corporate governance through a unique discussion that is global in scope but tailored to the particular characteristics of each region. Given the difficulty of identifying what is truly good governance, the roundtables bring together thought leaders in business management, investment, regulatory, academic and civil society communities (the "roundtable participants") to identify the key desired outcomes of corporate governance towards which we should be moving.

This draft report is divided into two parts:

> I - A summary of the major points of discussion from the London roundtable without attribution to allow and promote the open exchange of ideas and expertise.
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> II - Subsequent to the London roundtable, several senior academics provided their reflections on the conclusions of the roundtable to place the discussion within the broader regulatory and business context; sketch out potential paths towards policy and practice reform; and identify weaknesses of both current and alternative approaches. These reflections follow the roundtable summary.

Both parts will evolve over the course of the series of roundtables and culminate in a final publication which will be presented at a launch event in Brussels.

The conclusions reached in this report reflect the research and opinions of the authors, which may not reflect the views of all participants. The authors welcome corrections, comments and suggestions for improvement.

SUMMARY OF CASS ROUNDTABLE DISCUSSION

PURPOSE OF THE CORPORATION

It was proposed as a starting assumption that the question of how to define the purpose of the corporation is paramount in company law. Connected to this was the debate around whose interest the corporation should serve. The roundtable participants universally agreed that the popular perception amongst business leaders since the 1970s has been that the purpose of the corporation is to maximise shareholder value. Yet the discussants were of the common understanding that such a narrow interpretation of corporate purpose is not embedded in company law. It is rather a result of market forces and a flawed structure of incentives – both on the demand and supply sides of equity markets, i.e., both within companies and in asset management markets. Rejecting the maximisation of shareholder value as the principal purpose of the corporation, participants discussed what purpose should be identified or restored to guide corporate decision-making and to rekindle social trust in business. One participant stated that businesses should be considered 'servants' of society. *"Very few would state that the primary purpose of an organisation is to make money; return is a side effect"*, observed another participant.

Several individuals proposed that great businesses exist to provide goods, services and employment (an example cited was David Packard, who adopted this approach at Hewlett-Packard). Moreover, some participants suggested that business should be considered a part of society and as a result the needs of many different stakeholders (e.g. employees, customers, future shareholders, future generations etc.) need to be taken into account. In order to strike a balance between the different stakeholders involved in a company, it seemed clear that business must return a profit to be sustained, but that a balance must be found between making a return and a company's broader responsibilities.

Such an approach aligns a company's purpose with sustainable profits, the creation of good jobs and minimizing the impact on the environment. The outcomes are positive stakeholder relations and societal approval, as well as long-term business success and the creation of an enduring institution that creates wealth for its shareholders on an ongoing basis (a similar point is made by Mayer, 2013). One participant analogised that companies must choose between the 'high and low road' models to generate profits; the high road is more socially desirable and will have positive outcomes beyond simple, immediate financial returns. The participant asked us to consider why the UK (and indeed all countries) have so many 'low road' companies and whether this was partially due to the incentives and regulations currently in place.

SHORT-TERMISM

Since the 2008 financial crisis, a growing number of voices have urged Western economies to move toward a true long-term sustainable growth agenda. There was agreement in the room that short-termism in corporate governance and financial markets is related to a limited conception of the nature and purpose of the corporation. The most serious problem identified by the participants was the excessive orientation on short-term financial returns in corporate governance. The group highlighted several interlinked causes of short-termism, including (a lack of clarity about) corporate purpose, continued reliance on the model of shareholder primacy, the threat of shareholder litigation or hostile takeover, patterns of executive remuneration, and a lack of worker (or other stakeholder) voice.

There were a number of important observations made in general terms about the effects of short-termism. It was noted that the consequences of a short-term orientation can be seen in low levels of investment and innovation, static or declining productivity, the ever expanding amount of share buybacks, as well as various forms of financial engineering that seek to bolster a company's current share price. Since both the causes and the consequences of this short-term orientation are multi-dimensional, there is a need for reforms that involve many stakeholders. As one participant remarked, "*everyone is in favour of the long-term, except in the short-term*". It was suggested there is a need for responsible investors – and society more broadly – to convey their expectation that companies will look beyond short-term returns.

The UK and other economies have many companies focused narrowly on short-term returns. Identifying the factors in the regulatory structure that contribute to this phenomenon will resolve many of the issues around corporate responsibility, some said. There needs to be a greater focus on how profit is being generated, as well as the uses which are made of that profit, which, beyond returning cash to shareholders, might include higher wages for employees, investments in firm-specific human capital as well as investments in the business itself. These changes are both macro-economically and socially desirable: in other words, it is in the interest of companies to ensure that there is demand for the goods and services they produce.

Several roundtable participants saw the declining number of public companies, particularly in the UK and US, as an indication that corporate governance needs to be overhauled. Yet, as roundtable participants also noted, this has not happened. The focus on quarterly returns persists and is possibly worsening. Business leaders may want to do the right thing but they are trapped in a cycle that prevents them from looking after the long-term health of their organizations and the societies in which they operate. Pension fund trustees need to plan for the future but also to produce returns to meet their current liabilities, which in a zero interest rate environment pushes them towards riskier investments and a more short-term perspective. Analysts rely on – and are rewarded for – short-term trading and are therefore resistant to changes designed to promote long-termism.

Companies also find themselves under pressure from an increasing number of overseas investors, as the majority of shares of UK listed companies are now held by shareholders outside of the UK. Those investors may consider themselves to have less responsibility for the impacts of corporations on the societies in which they are embedded.

There was debate about the effectiveness of several **measures** that could be used to foster longer time horizons:

Need for remuneration policies that reward long-termism

It was stated that the ‘sell’ side of the stock market has a hold on corporate governance. Business leaders respond to the demands of sellers rather than buyers, as sellers drive the direction of the share price. There seemed to be consensus that the current model of remuneration fosters short-termism as executives’ decisions require immediate market validation in order to trigger rewards under their employment contracts. There was recurrent discussion on the need to develop new metrics to reward executives for long-term resource allocation and growth in order for there to be any meaningful shift in business practice. One participant suggested that stock options should vest in the very long-term, such as upon retirement.

Balancing diverging stakeholder voices

It was suggested that the main question is how companies should balance the legitimate need of investors to obtain returns with the company’s own interests and the broader interests of society. This provoked the reflection that greater clarity on this issue might make it easier to adjust the existing framework of regulations and incentives affecting corporate governance.

The role of stewardship

A number of discussants suggested that investors in general are disinterested in corporate governance and contribute to short-term market orientation. The UK Stewardship Code is trying to address the situation, although questions remained regarding its effectiveness, given its limited scope and the changing nature and structure of institutional investment. It would be desirable to understand the interests of investors and of ultimate beneficiaries; the extent to which they may correlate with the interests of the company and society; and their ability to engage positively in corporate governance. It seemed clear to participants that the end beneficiaries of institutional investors (such as pensioners) would generally prefer for their money to be managed responsibly and in accordance with basic ethical principles.

However, it was unclear to some participants whether greater transparency would allow end beneficiaries to express their preferences in a way that would positively impact on the investment decisions of asset managers. Trustees must invest for the long-term but are punished for short-term volatility in their portfolios, and we do not yet have enough information about how to foster truly long-term management. It was suggested there may be an opportunity to ‘nudge’ market actors in the right direction through the strategic use of incentives, in addition to the use of soft and hard law.

EXECUTIVE PAY AND PROFIT DISTRIBUTION

The roundtable’s earlier reflections on the purpose of the corporation flowed to the linked issue of how to distribute corporate surplus. One important point was that our understanding of the objective of business – whether to generate profit or societal benefit or some other outcome – will influence the distribution of profits. A repeated item of discussion was how returns should be split between shareholders, employees, and society.

It seemed clear to the participants that the current model for executive remuneration with its emphasis on stock options has led to increasing pay differentials. This not only impacts on the legitimacy of corporate operations and their social licence to operate; it also skews wealth distribution with adverse effects on the sustainability of demand across the economy as a whole.

The widening gap between management and employee salaries was evident to all participants; the question of what level of inequality is desirable was a point of debate. One participant quoted John Mackey, co-founder of the US supermarket chain Whole Foods, who has publicly stated that the maximum salary of top executives should be no more than 19 times the average employee’s pay (Mackey, 2009).

BUSINESS CULTURE AND CREATING ACCOUNTABILITY

Business culture and ethics are critical in aligning corporate behaviour with societal expectations, it was proposed. Participants said there is a need to identify how to enhance accountability and increase transparency of corporate behaviour, while remaining sensitive to issues of commercial confidentiality, in order to (re)introduce ethical responsibility and awareness of the firm’s relationship with stakeholders. It was noted that it is challenging to create consistent culture across a company’s business units, sites and subsidiaries. Multinational companies with subsidiaries across the globe may therefore experience a disconnection between board policy and day-to-day business operations that should be addressed.

The importance of organisations not being afraid to allow internal or external expressions of disagreement or to show weakness came across as a key point of discussion. It was suggested that firms should foster a culture where employees feel comfortable ‘speaking up’ to senior management.

The discussion moved to the role of workers in corporate governance, where there were sharply diverging views. Certain participants said that it is important to listen to the workforce and give a mechanism for collective voice. Some went further to propose that employee participation might be accomplished in part through worker representation on boards, on board committees or in general meetings, although it may include other changes.

One example raised in this context was the employee-owned John Lewis Partnership in the UK, which successfully operates upmarket department stores, supermarkets and some other services. Another participant observed that nonprofit foundations in Northern Europe own controlling interests in a substantial number of industrial companies, including globally competitive firms such as Ikea, Heineken and Carlsberg. On the other side of the Atlantic, technology companies such as Google and Zynga have introduced dual class structures that allow the founders to retain control over long-term business strategy by holding special voting shares – although a roundtable participant noted that these IT firms have been criticized for continuing to concentrate capital amongst a small group of founders and top executives. Others did not support increasing employee voice, and noted that management frequently oppose expanded collective bargaining.

At the board level, many discussants felt that more diversity was needed in terms of gender, race, skills and professions to foster the right kind of thinking. It was observed that directors frequently lack expertise in matters of concern to society such as sustainability. One participant put forward the suggestion that companies could invite stakeholders with backgrounds in human rights, environmental protection, or other areas of concern to provide guidance to the board directly by serving as non-executive directors.

FINANCIAL MARKETS

Several participants noted that shareholders are frequently spoken about as though they are a homogeneous group with closely matched interests, when in fact they are divided into those who own shares and hold them as assets that produce a revenue stream, and those who are traders. It was suggested that there should be renewed focus on the ultimate beneficiaries of investments, such as ordinary citizens through pension funds. The tendency to focus on short-term shareholders comes at the expense of the interests of ultimate beneficiaries. One discussant suggested that intermediaries are interfering with the move to a long-term stewardship approach.

Looking beyond the company itself, a number of participants suggested that additional lessons must be learned from the financial crisis and the spectre of ongoing market volatility. Governance of the financial industry has perhaps not been adequately reformed because policymakers and regulators have failed to address the structural issues that contribute to volatility. For example, corporate valuation methods such as discounted cash flow analysis rely on a discounting factor that overvalues short-term gains and fails to properly account for future growth. On the other side, analysts rely on churn in their clients' portfolios to generate income. This issue cannot be solved by the market alone and must be addressed through regulation.

The failure to create strong regulatory structures for the banking and finance sectors has led to ongoing public distrust and the continued problem of moral hazard. A participant highlighted that banks have been allowed to take on tremendous risk, aware that they will be bailed out if they fail. In future instances of firm collapse, discussants suggested it may be necessary to allow firms to fail to allow for risk within business and innovation.

One specialist on socially responsible investment suggested sustainability and transparency could be increased through the introduction of a benchmark giving investors, civil society, regulators, the media and the public information about the business' performance on a range of relevant issues. The benchmark could show how companies are performing relative to both objective criteria and each other, similar to the Access to Medicine Index (www.accesstomedicineindex.org).

SUSTAINABILITY

One line of questioning was how far we should go to integrate companies' carbon footprints and environmental damage into business models. Negative externalities may be addressed through taxes, regulation, collaborative efforts between business and society, consumer pressure and voluntary action such as corporate social responsibility (CSR) initiatives. Relying on the market to value externalities will be difficult without regulatory intervention to create the necessary structures and incentives.

Many participants noted that certain firms recognize the reputational risk associated with failing to act sustainably and have at times worked together to reduce waste (the example was given of Ray Anderson's Interface, which adopted 'Mission Zero' to reduce waste in the creation of carpet-tile) (The Economist, 2011). However, business efforts and consumer pressure are uneven and often ineffective. Given the market environment in which companies operate, it may be necessary to change the regulatory framework in order to steer all market participants towards greater sustainability and stimulate better sustainability standards in particular industries.

Various comments pointed to the fact that companies are responsive to changes in regulatory conditions. Although Google has openly acknowledged that it structures its dealings to reduce its tax footprint, Chair Eric Schmidt has acknowledged that Google would pay greater taxes if so required (Stephens, 2013). Greater involvement of stakeholders (through information and consultation) would also facilitate the identification of externalities and allow the identification of mutually acceptable solutions to those social costs.

ACCOUNTING MODELS

There was some agreement that current accounting models fail to account for positive social benefits that accrue to society as a whole, or on the other hand for risk or harms that are 'socialised' or 'externalised' outside the firm, such as the increased cost of provided public healthcare caused by tobacco companies. Whereas most business models are built so that shareholders benefit from the risk when it fails to materialise, other stakeholders are impacted when risk taking causes damage, and there are no penalties for this type of risk taking. Conversely, companies that carefully manage risk often incur additional costs; the example was given of a company that built a factory in Burma and spent an additional 10% on the cost of construction to prevent fatalities.

It was suggested that taxation models should be designed to eliminate externalities and create a level playing field for all companies. This brought out the fundamental tension between market-based solutions and government regulation. Certain participants felt that market-driven solutions to externalities would be difficult to implement and that regional or global regulation was needed, although this would be challenging because most regulation is done at the national level.

II ACADEMIC POINTERS

ACADEMIC POINTERS

Several senior academics in attendance listened to the conversations and solicited reflections on the main conclusions of the roundtable from a broad network of academics. These reflections, which are summarized below, address challenges, potential paths forward to policy reform and changes of business practice, and pitfalls. The analysis is intended to engender reflection and provide the basis for further discussion. The academic responses have been coordinated by Dr. Jeroen Veldman from Cass Business School, with significant contributions from Prof. Andrew Johnston from the University of Sheffield and Prof. Hugh Willmott and Prof. André Spicer from Cass Business School. The following scholars kindly offered their reflections:

Charlotte Villiers, University of Bristol; Prof. David Collison, University of Dundee; Prof. Blanche Segrestin, Mines ParisTech; Prof. Andrew Keay, University of Leeds; Dr. Thomas Dallery, Université du Littoral Côte d'Opale; Dr. Tristan Auvray, Université Paris XIII; Dr. Jay Cullen, University of Sheffield; Dr. Andreas Ruehmkorf, University of Sheffield; Dr. Genevieve LeBaron, University of Sheffield.

The views summarized below reflect scholarly reflections by these authors on main themes concerning the academic debate on corporate governance and are not necessarily endorsed by participants at the roundtable.

This section first looks at **principles governing the purpose of the corporation** in company law and their influence on how directors balance diverse interests.

The analysis then proceeds to reflect on the **opportunities for shareholder and stakeholder engagement in corporate governance** for the benefit of company and society at large.

Finally, the section concludes by examining some of the **ways in which capital and product markets influence companies and their behavior**, and then canvassing some ways in which this influence can be guided and steered towards the public good.

1. WHAT IS A COMPANY AND WHAT PURPOSE IS IT MEANT TO SERVE?

Since the 1970s, it has become commonplace to think that corporations are legally obliged to maximize shareholder value. However, Company Law across all jurisdictions (The Modern Corporation Project, 2014b) has historically allowed for a much broader perspective on the purpose of a corporation (Berle, 1954; Biondi et al., 2007).

In the UK context, article 3(1)(c) of the EU Takeover Directive (2004/25/EC) stipulates a duty for directors to act in the interests of “the company as a whole” while section 172 of the UK Company Act 2006 (c 46) obliges the directors to act in good faith so as to ‘promote the success of the company for the benefit of its members as a whole’. Although there has been broad discussion about the interpretation of this phrase there is a consensus among company lawyers that even although ‘members’ are equated with shareholders and the ‘interests of the company’ are equated with the collective interest of the shareholders, present and future, directors are still entitled to take account of any stakeholder interest which they consider will further the interests of the company and/or promote the success of the company for the benefit of its members (The Modern Corporation Project, 2014b). As a result, directors can take into account a wider range of interests, including likely long-term consequences, the interests of the employees, impact on the environment etc.

In combination with the courts’ long-standing tradition of refusing to review management decisions taken in good faith (an implicit business judgement rule) it is virtually impossible for an individual shareholder in the UK context to challenge management decisions before the courts; the directors themselves set the time frames within which their decisions should pay off, and so are permitted but not obliged to adopt a very long term perspective; and the directors have a very broad discretion in law to take account of stakeholder interests (Sjåfjell et al., 2015). The duty of directors "to promote the success of the company for the benefit of its members as a whole" thus permits directors both theoretically and practically to go beyond narrow shareholder wealth maximization as measured by the current share price and instead to adopt a long-term approach to wealth creation that allows to create value for shareholders, workers, customers, environment and society at large. In practice, however, directors rarely exercise this broad discretion, perhaps due to pressure either internally or from shareholders, perhaps because the law is not communicated clearly.

2. IMPROVING MANAGEMENT

The discussion between the experts on the panel recognized that UK Company law allows boards to take account of a range of issues and interests broader than shareholder value alone; that this broader responsibility was necessary to sustain a long-term perspective on companies and the broader economy; and that the issues of purpose and accountability are central to the establishment of a broader responsibility. However, it also became clear that better guidance could be provided to help directors to strike the right balance between the interests of different stakeholders (see also Tsagas, 2013: 38-40).

2.1 PURPOSE AND ACCOUNTABILITY IN COMPANY LAW AND CORPORATE GOVERNANCE

Although there is no legal requirement for the maximization of shareholder value in EU and UK law, the phrasing to ‘have regard to’ in section 172 of the UK Company Law Act is ambiguous and leaves legal uncertainty (Tsagas, 2014) about how this phrase should be interpreted in relation to various market participants and constituencies, about how underlying interests can be identified, and about how these interests relate to the duties of directors, shareholders, institutional investors, fund managers, and regulators. We will discuss these issues below.

The practical issues are further compounded by the development of restricted notions of corporate purpose in dominant versions of corporate governance theory (Aglietta and Rebérioux, 2005) and by codifications of corporate governance that focus on shareholders as the primary providers of monitoring and oversight (Veldman and Willmott, 2015). To facilitate a broader uptake of corporate purpose by corporate boards, a broad clarification and revision of these principles and codifications is necessary (Aglietta and Rebérioux, 2005).

2.2 INTEGRATING ESG INTO GOVERNANCE AND REPORTING

A second way to improve management practice is through the integration of broader principles for evaluating business practice into governance and reporting frameworks. The new European non-financial reporting directive (Directive 2014/95/EU) and the International <IR> Framework are creating a conceptual framework for this strategy, although they do not yet provide clear metrics (see e.g. Adams, 2015). With regard to sustainability, the Sustainable Companies Project[1] has proposed a realignment of directors duties with the objective of embedding long-term plans for a company's business within planetary boundaries. The basis for the integration of human rights into business management, in particular in the context of complex value chains, is provided by the concept of human rights due diligence endorsed by the UN.[2] These principles are not yet sufficiently precise for practical use but they provide a basis for the development of clear objectives and metrics and, ultimately, of a governance framework.

2.3 DEVELOPING NEW BUSINESS MODELS

A third way to improve management practice is through the use of business models that explicitly facilitate the uptake of a broad purpose by boards. Inspiration can come from a variety of corporate forms and options beyond the traditional listed company form. Cooperatives, social enterprises, and charities have long existed and have been joined in the last decade by new forms of 'profit-with-purpose' companies with flexible purposes purpose-oriented boards (Segrestin et al., 2015). Combining conventional for-profit legal forms with a deliberate social or environmental mission (Clark and Babson, 2012). These new company forms offer a mixture that allows to balance protection of shareholder interests with safeguards for company's innovative, social or environmental purpose (Mayer, 2013). Some large multinational companies, such as Carl Zeiss, John Lewis, Equal Exchange and NovoNordisk, have also formalized their mission and the related governance principles, leading not only to a formalization of an extended purpose, but also to transparency and accountability with regard to corporate purpose (See Segrestin and Hatchuel, 2012) The Benefit corporation community is attempting to institutionalise and foster this development (Liao, 2015: 303).

2.4 IMPROVING EXECUTIVE INCENTIVE STRUCTURES

A fourth way to improve management relates to the role of executive remuneration as an incentive structure for the creation of value. Academic research suggests that the widespread use of stock options in executive pay schemes and other forms of variable compensation allows senior executives to procure huge compensation awards (Lazonick, 2013) and that the effect has been to incentivise executives to maximise the current share price (Bebchuk and Fried, 2006). Research also suggests that these practices have led to the increased use of takeovers, share buybacks and other financial techniques in corporate strategy, based on increasingly truncated time horizons. Inside the firm, this focus has led to the depletion of companies' resources at the expense of investments in human capital and innovation (The Modern Corporation Project, 2014b). Outside the firm, this type of remuneration has produced negative social results. With income and wealth inequality rising across developed jurisdictions (High Pay Centre 2014; Piketty 2014), and with the increases in top executive and director pay outstripping all comparable measures of economic return (BIS, 2011) the practices of executive pay are contributing to a sense of injustice amongst the general workforce, exacerbated because recent years have witnessed reduced social mobility and fewer opportunities for lower-paid workers. Seminal management theorist Drucker thought top executives should not earn more than 20 times the average salary in the company.[3] Contemporary academics argue that some pragmatic steps can be taken to refocus on long-term sustainable value creation: share buy-backs could be strictly regulated in order to prevent manipulation of stock price for the short term and artificial increases in pay, stock options could be discouraged, and minimum time horizons could be set for their award (see Mayer, 2013).

3. CORPORATE GOVERNANCE ACTORS

Developing the basis for the adoption of a broader corporate purpose cannot stop with boards. The Roundtable also discussed the role of shareholders, institutional shareholders, and fund managers as important actors influencing the strategy of companies.

3.1 SHAREHOLDERS

Shareholders hold a special position in corporate governance and in company law. Company law identifies shareholders as the 'members' of a corporation; shares give shareholders limited economic rights, in particular the right to receive dividends provided a distribution of corporate profits is legally permissible; and a dividend is actually declared by the board of directors.

Shareholders also have a right to attend and vote at general meetings, and usually have exclusive collective rights to elect the members of the corporation's board of directors. Finally, in listed companies at least, shareholders can vote with their feet, that is, they can sell their shares. As a result of this special position, shareholders are often seen as the primary constituency for accountability and for monitoring the corporation's performance (Sjåfjell et al., 2015).

However, research suggests that increased "shareholder empowerment delivers management a simple and emphatic marching order: manage to maximize the market price of the stock" (Bratton and Wachter, 2010: 653). If the interest of investors is in the first place to receive a return on their investment, this often creates a conflict of interest between them and a company if management pursues a strategy with a different time horizon and/or which is incorrectly valuated by the capital market. Where shareholders take the lower cost route of selling in preference to engagement, this puts downwards pressure on the share price, leading executives to engage in financial engineering and buy-backs in order to drive the share price back up. Academic studies confirm that these activities, which are driven by capital market pressures, impact negatively on productive investment (Hecht, 2014; Lazonick, 2013; Orhangazi, 2008; Stockhammer, 2004).

Fueled by a growing position for institutional investors, ambiguous formulations in company law, and theories of corporate governance dominated by the shareholder value perspective, the past three decades have seen an explicit assumption on the part of investors that companies in general, and boards in particular, exist to serve their interests primarily. With a growing practical engagement of investors with board strategy (Pye, 2001; 2002), there is a danger that company directors equate such shareholder and capital market pressures with a norm requiring them to maximize returns to shareholders in the short term.[4]

3.2 STEWARDSHIP

In an attempt to solve the governance gap produced by relying on shareholders as the primary recipients of monitoring and accountability (Mayer, 2013) despite their seeming inability to move away from short-term value maximization, the Financial Reporting Council (FRC) has focused on institutional investors to exercise a 'stewardship' role. The Code aims to enhance the quality of engagement between asset managers and companies to help improve long-term risk-adjusted returns to shareholders (FRC, 2014). The objective of the Stewardship Code is to encourage shareholder engagement in corporate governance, increase monitoring of the board and address the problem of short-termism. The basis of an underlying idea of stewardship is to promote the long term success of companies "in such a way that the ultimate providers of capital also prosper." The uptake of such 'enlightened shareholdership' will benefit "companies, investors and the economy as a whole." (FRC, 2014: 1).

The academics argue that there are multiple reasons to doubt whether stewardship is a viable concept, and whether it can be realistically expected that investors will implement these recommendations and act as quasi-owners (see e.g. Chiu, 2012; Johnston and Morrow, 2015).

1 There is an ongoing debate if stewardship can be prescribed. Studies on the effectiveness of "say on pay" requirements in the UK and the US suggest that few shareholders are able or willing to engage in such a way (BIS, 2012).

2 There is no penalty prescribed for failure to comply or provide a satisfactory explanation (FRC, 2014: 3). The Code "strongly encourages" all institutional investors to disclose their own level of compliance with the Code's principles, but operates on a comply or explain basis, and the FRC merely retains on its website a list of asset owners, asset managers and service providers that have published a statement on their compliance or otherwise with the Code (FRC, 2014: 3). In other settings, such as the UK Code of Corporate Governance, adoption of the comply or explain principle has inspired patchy compliance at best (Keay, 2013; Veldman and Willmott, 2015). At the moment, the only clear incentive for asset managers working for institutional investors is financial. Pension funds, for instance, hold 'substantial current obligations'. Therefore, there can be no guarantee that these institutional investors will have the long-term perspective expected of them (Millon, 2013: 930). Melis (2014) has argued that, overall, institutional investors identify their primary interest as their relative financial performance and the Kay Review (2012 at 5.18) noted that asset managers typically have a "short performance horizon".

3 The concept of stewardship assumes that the interests of various types of beneficiaries can be clearly identified. However, a misalignment between asset managers' incentives and end beneficiaries' interests was identified officially in the UK as long ago as 2001 in the Myners Report. Generally, an unequivocal identification of the interests of recognized end beneficiaries seems a problematic assumption, as pension holders, for instance, provide a very mixed picture in terms of their interests, and these interests can shift over time (Mayer, 2013). Moreover, institutional investors are increasingly investing in alternative investment funds which select investments and engage in activism according to their own priorities. To argue that these 'subsidiary' investors would still act exclusively on the basis of the interests of the end beneficiaries of an institutional investor like a pension fund seems an even more problematic assumption.

4 The concept of stewardship seems to adopt an overly romantic and static idea of shareholders, their interests and their willingness and capacity to organize for the defense of long-term interests of other constituencies involved in corporate governance. Implicitly, the search is for "real investors" who do "not care to pump up stock prices in the short term if that endangers the firm's solvency and long-term growth prospects" (Tsagas, 2014: 32) and thereby "want what we as a society want and we as end-user, individual investors want; which is for corporations to create sustainable wealth." (Strine, 2010: 26). However, as the Kraft takeover of Cadbury showed, despite the strategic presence of institutional shareholders with a long-term perspective, a takeover situation can rapidly lead to a shift in shareholding positions, and thereby to a shift in the way company directors assess their fiduciary duties to the remaining shareholders (Mayer, 2013; Tsagas, 2014).

5 The Stewardship Code only relates to home institutional investors (who hold 41% of shares), while it does not apply to foreign investors (who also hold 41% of shares) (UK Office for National Statistics, 2012: 3). With stewardship per se a problematic concept, other suggestions have been made to promote a focus on the long term.

In relation to asset management, fund managers could receive a clear mandate to pursue other goals than the maximization of share value, given a clear brief on what those specific goals are, empowered by the mandate to engage with company boards about those goals; and remunerated on the basis of those goals. A second option could be to incite (through accounting reforms) or constrain (through the introduction of a ceiling value) institutional investors to delegate their funds to a specific asset management entity who would act as a strategic entity in firms, acting on a similar mandate as a fund manager, but with its own dedicated assets.

To foster the capacity of an institutional investor to behave like a strategic partner in a specific firm, it has been argued that a corporate governance framework may provide incentives to investors on the basis of the composition of their portfolio and their turnover rate. This may be achieved by setting voting rights proportional to the time of presence in a firm's capital. An example could be the French Loi Florange, which sets as a default rule that shareholders who hold shares for two years or more double voting rights (Mayer, 2013: 206). It could also involve a reduction in capital gains tax payable on shares held for a certain period of time. The use of incentives for long-term shareholding was also contemplated at the EU level in the current revision of the Shareholder Rights Directive (Johnston and Morrow, 2015).

This may be also be achieved by increasing voting rights proportional to the acquisition of newly issued shares. It would be possible to argue that only the issuance of new shares takes part in the financing of firms and that the secondary market where one can buy 'old', already issued shares is only there to provide liquidity to speculative shareholders, but does not provide financing to firms. This would allow to push for more newly issued securities in institutional investors' portfolios.

Finally, this may be achieved by identifying strategic investors with a consistent track record of responsible and long-term engagement with corporate strategy and giving these access to representation in the board.

3.3 SHAREHOLDERS, STEWARDSHIP, AND CORPORATE GOVERNANCE

The discussion by the experts and academics demonstrates the difficulty of clearly identifying interests and rights relating to various stakeholders and connecting these to definite positions in the shareholder community. In the absence of a clear identification and protection of the variety of interests that pertain to the company, the odds remain strongly stacked against the wider interests that both the UK Company Law Act and the Stewardship Code seek to protect, in particular under the current takeover regime (Mayer, 2013). This is all the more true in the UK situation, in which protective instruments such as staggered boards, use poison pills, and incorporation in states that offer a broader corporate charter are not available, as they are in the USA (Mayer, 2013).

In this context, a focus on shareholders may easily end up empowering short-term focused speculative investors (Mayer, 2013; Johnston and Morrow, 2015) Therefore, attempts to promote a long-term perspective by focusing exclusively on shareholders in relation to corporate governance and accountability must be carefully scrutinised (see also Veldman and Willmott, 2015).

3.4. EMPLOYEES

In the Roundtable discussion, it was suggested that it should be considered how corporate governance systems may better involve or consider the interests of employees. The model of corporate governance that focuses on short-term value maximization produces its value on the basis of a systematic breach of implicit contracts between companies and employees (See Biondi et al., 2007). This has induced a transfer of risk and responsibility to employees through intensifying deregulation and competition in labour markets, while at the same time company-internal reward systems have put downward pressure on wages and working conditions. Once these types of opportunism become institutionalized, these breaches have effects beyond the individual company as employees across the economy become reluctant to specialise and commit themselves to a particular employer and to acquire firm-specific skills in return for a share in the productivity gains that result.

The result is a low-trust economy with low productivity (for an overview of this argument, see Johnston, 2009). The interests of employees are typically aligned with those of the company as an ongoing enterprise and the creation of economic prosperity in the long-term (see Villiers, 2014 and Talbot, 2014). Therefore, involving employees in corporate governance can be a means to counterbalance pressure from capital markets and from short-term investors and redevelop trust between companies and their employees.

One way of engaging employees in corporate governance is by providing their nominees seats in the board of directors. The well-known German system of co-determination guarantees workers representation in the supervisory board and one seat in the management board. Co-determination leads to a better dialogue and closer alignment of interests between the management and employees (Cremers and Vitols, 2013). Interestingly, in Germany it also correlates with a more active engagement of shareholders in corporate governance. This arrangement is generally regarded as successful in Germany and as one of the reasons why Germany dealt successfully with the impacts of recent financial crisis on its manufacturing sector (Kleinknecht, 2015).

A second method of enabling workers' influence in the board is to develop systems of disclosure and transparency that involve workers' representation (Cremers and Vitols, 2013). Part of this system can be the expansion of the concept of 'say on pay' to workers. This entitles them to express a view via their representatives on pay ratios and the likely effects of the pay policy on the long-term interests of the company (For further examples of employee involvement in corporate governance, see Williamson, 2013; Conchon, 2013). The draft text of the 2014/2015 revision of the Shareholder Rights Directive initially required giving workers a 'say on pay' but this proposal failed to pass a vote in Parliament.

4. CONSUMER/CUSTOMER INFLUENCE

Customers and consumers are not directly represented in corporate governance, but managers and shareholders must consider their interests if they are concerned with the company's long term success. The creation of real value for customers is key for a company's success on the market for goods and services, which in turn is essential for the firm's success on capital markets (Mayer, 2013). Creating wealth for shareholders on an ongoing basis means adopting customer value creation and shareholder wealth creation as joint and mutually reinforcing objectives, although they must be pursued within the confines of a properly defined needs-based customer segment. In doing so, forward thinking leaders are in a position to make a choice to create value for customers in ways that preserve and whenever possible enhance community wellbeing. Paul Polman, CEO of Unilever, articulated this understanding with respect to sustainability, explaining that sustainability is not only compatible with profitability, but also indispensable for a company's success in the long-term (Confino, 2012). This perspective is now embedded in Unilever's purpose[5] and in NovoNordisk's business philosophy (Morsing and Oswald, 2009).

To foster the positive influence of consumers and customers at large (see Smith, 2008: 281), a company needs to ensure that information provided to the public can both elevate public concern and motivate other companies to start to change (Vogel, 2007). Focused benchmarks are the most promising tools to make information about companies' behaviour in matters of public concern more accessible and to give such concern power to influence business standards. The Access to Medicine Index is an example of how these criteria could be implemented through an open-source system. The openness and simplicity of these benchmarking tools are key to provide a system that creates a debate both within and outside of the company on how to foster constant improvement.

5. CONCLUSIONS

Colin Mayer (2013), professor of corporate finance at Saïd Business School, Oxford University, has argued that we need to reinvent corporations in order to foster the trust necessary for the public as well as the private sector to thrive.

The participants in the Roundtable at Cass Business School voiced similar opinions. An overall theme that emerged from the discussion between the panel experts was that UK company law recognizes a broader responsibility for company boards than shareholder value alone; that this broader responsibility is necessary to sustain a long-term perspective on companies and the broader economy; and that the issues of purpose and accountability are central to the establishment of a broader responsibility. However, it also became clear that better guidance could be provided to help directors to strike the right balance between the interests of different stakeholders.

This document has provided a number of pointers on how to interpret existing frameworks, how existing models can be upgraded, and where to find further guidance. Overall, we suggest that the most important issue that came forward in the discussion by the experts, both in the Roundtable and the academics was the issue of purpose. Purpose defines what the corporation can do, what goals the corporation sets for itself, and how it prioritizes the means to reach those goals. From the question of purpose the other issues are derived.

As outlined in the summary of the discussion, there was agreement that we need to reform executive pay structures, develop new metrics for value creation, update existing accounting models, explore how sustainability can be integrated into business models, and foster an integral business culture embedding a company's purpose in all its aspects.

> A major question identified in the discussion was how to associate good quality management and sound business decisions with a focus on the long-term and sustainability. The importance of intangible assets, the long-term development of the company, and broader environmental and social issues associated with company's business are not usually recognized in the time horizons reflected by capital markets. This problem is further exacerbated by the incentives for boards and fund managers that are aligned with these horizons.
>
> A second and related question that deserves careful attention is the extent to which corporate governance, premised on accountability to shareholders, can contribute to long-term sustainable value if the desired improvement does not directly result to improved economic performance in the short-term.
>
> In relation to boards, the main challenge is how to reconnect boards to the long-term success of the company. How can we provide a legal and corporate governance framework, as well as an incentive structure, that encourages boards to unequivocally serve the long-term interests of 'the corporation' (and reassures them that this is lawful), and align their fiduciary duties with more than just the maximization of the gains of those shareholders with the shortest time horizon?
>
> In relation to alternative business models, we can ask if it would be possible to incentivize businesses to prioritize a broader concept of purpose, for instance by providing tax relief to such corporations.
>
> In relation to investors, we are led to ask what the 'business case' is for relying on shareholder monitoring. Given the failure of 'enlightened shareholder value' to protect anything but the bottom line over the last decades, and given the practical and conceptual problematics of stewardship, is it wise to rely on increased shareholder involvement in monitoring? Are we not simply giving away monitoring powers to activist short-term shareholders? And what kind of role do investors themselves realistically want and expect to play?
>
> A third question is, who else in the broad domain of corporate governance can be provided with monitoring tasks? And to what extent can we rely on boardroom culture to drive meaningful change?
>
> A fourth question is whether we can expand the issue of monitoring into intangible assets. How can accounting and benchmarking systems and metrics be enhanced to evidence these currently intangible assets?
>
> Finally, we ask, specifically in the UK context in which this event was organized at Cass Business School, whether shareholders' rights shouldn't be differentiated. It may be worthwhile to differentiate between different classes of investors and make voting and returns more conditional – for example, by holding a stock for a minimum period.

The roundtable discussion and the academic reflections will provide a starting point to develop these questions and to bring these issues forward in a global roundtable series. The combined results of the roundtable discussions and research summaries will be published at the conclusion of the series in 2016 and will form the basis for future engagement with policymakers, academics and the business community.

ENDNOTES

1. http://www.jus.uio.no/ifp/english/research/projects/sustainable-companies/
2. In 2011, UN Special Representative Professor John Ruggie published the "Guiding Principles for the implementation of the United Nations 'Protect, Respect and Remedy' Framework" ("Guiding Principles"), which were unanimously adopted by the UN Human Rights Council in June 2011. The Guiding Principles set out the responsibilities of businesses to respect human rights alongside the obligations of states to protect human rights and ensure adequate remedy in the event of a violation.
3. Peter Drucker (1984) wrote: "I have often advised managers that a 20 to 1 salary ratio is the limit beyond which they can not go if they don't want resentment and falling morale to hit their companies."
4. BIS (2010: 3) noted in its evaluation of the Companies Act 2006 : "s172 duty: high awareness but minimal changes in behaviour".
5. Unilever's official purpose is "to make sustainable living commonplace", see http://www.unilever.com/sustainable-living/the-sustainable-living-plan/our-strategy/.

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