



Universität Hamburg
DER FORSCHUNG | DER LEHRE | DER BILDUNG

FAKULTÄT
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PROF W. GEORG RINGE

CORPORATE GOVERNANCE & SUSTAINABILITY

ECGI ONLINE POLICY WORKSHOP

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Sustainable Corporate Governance Initiative
of the Directorate-General for Justice and Consumers

Feedback Statement from

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Economics

Law

Politics

Economic context



Right direction

- integration of sustainability factors in decision-making correlates positively with financial performance (Friede, Busch & Bassen 2015; Grewal, Hauptmann & Serafeim 2020; Orlitzky, Schmidt & Rynes 2003; Revelli & Viviani 2015)
- integration of sustainability at the board level is a prerequisite for better CSR performance (Barko, Cremer and Renneboog 2018)

Economic context



Conceptual misunderstandings

- assumption that shareholder value (SHV) creation is a short-term phenomenon
- Short-term investors can have a positive effect on firm valuation (Doering et al 2020) when the threat of exit is high -> disciplines management to increase the value of the company
 - however, may also reduce R&D expenditure (Aghion, van Reenen and Zingales 2013) -> negative long-term effect
 - long-term investors can increase investment in innovation through their monitoring (Kim, Park and Song 2019)
- short-term investors: additional important CG mechanism, in combination with LT investors and their incentive to engage
- Short-term \neq shareholder value; long-term \neq stakeholderism

Gaps



Serious omission: market pressure

- need to take positive **investor demand** into account: grow trend of ESG engagement from asset managers and asset owners
 - rather than short-termist pressure (Fried & Wang 2020)
- engagement activities usually address the board directly or indirectly (via AGM or proxy voting) – proxy for improving sustainability at the board level
- evidence of a positive effect of board member engagement on CSR performance
 - Barko, Cremer and Renneboog (2018) show that companies improve their ESG rating during the engagement process
 - Flammer (2015) and Hoepner et al (2020) document the success of engagement activities
- Market demand: ideal channel for furthering the broader objectives of the Initiative



Legal Design Challenges

- context of legal measures crucial
 - Directors' duties vague
 - low levels of litigation and enforcement in Europe (Armour, Black, Cheffins and Nolan 2009): absence of class actions & prohibition on contingency fees
- Nature of action unclear: legislation versus guidance
 - global investors promote sustainability goals
 - stewardship best practices worldwide (Ringe 2020)
 - central banks steering towards green finance strategy (ECB 2020)
 - Facilitative rather than restrictive law needed: market standardization; facilitate greater investor engagement; innovative and dynamic tools of regulation
- Political difficulties in Europe

Political disagreement

Directors duties / Corporate Purpose

- No common standard
- Previous attempts at harmonisation failed



(1) 'Stakeholder approach'

- Germany: 'The Management Board is responsible for managing the company in the interest of the enterprise, thus taking into account the interests of the shareholders, its employees and other stakeholders, with the objective of sustainable creation of value.' (GCCG 4.1.1)



Political disagreement

(2) 'Shareholder approach'

- Sweden: 'The interest of companies is to generate profit for distribution to its shareholder(s)'. (Companies Act, Ch 3 sec. 3)
- US – but serious discussion right now



STATEMENT ON THE PURPOSE OF A CORPORATION

Americans deserve an economy that allows each person to succeed through hard work and creativity and to lead a life of meaning and dignity. We believe the free market system is the best means of generating good jobs, a strong and sustainable economy, innovation, a healthy environment and economic opportunity for all.

Businesses play a vital role in the economy by creating jobs, fostering innovation and providing essential goods and services. Businesses make and sell consumer products; manufacture equipment and vehicles; support the national defense; grow and produce food; provide healthcare; generate and deliver energy; and offer financial, communications and other services that underpin economic growth.

WHILE EACH OF OUR INDIVIDUAL COMPANIES SERVES ITS OWN CORPORATE PURPOSE, WE SHARE A FUNDAMENTAL COMMITMENT TO ALL OF OUR STAKEHOLDERS. WE COMMIT TO:

DELIVERING VALUE TO OUR CUSTOMERS. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations.

INVESTING IN OUR EMPLOYEES. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.

DEALING FAIRLY AND ETHICALLY WITH OUR SUPPLIERS. We are dedicated to serving as good partners to the other companies, large and small, that help us meet our missions.

SUPPORTING THE COMMUNITIES IN WHICH WE WORK. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.

GENERATING LONG-TERM VALUE FOR SHAREHOLDERS, WHO PROVIDE THE CAPITAL THAT ALLOWS COMPANIES TO INVEST, GROW AND INNOVATE. We are committed to transparency and effective engagement with shareholders.

EACH OF OUR STAKEHOLDERS IS ESSENTIAL. WE COMMIT TO DELIVER VALUE TO ALL OF THEM, FOR THE FUTURE SUCCESS OF OUR COMPANIES, OUR COMMUNITIES AND OUR COUNTRY.

BRT.org/OurCommitment Business Roundtable

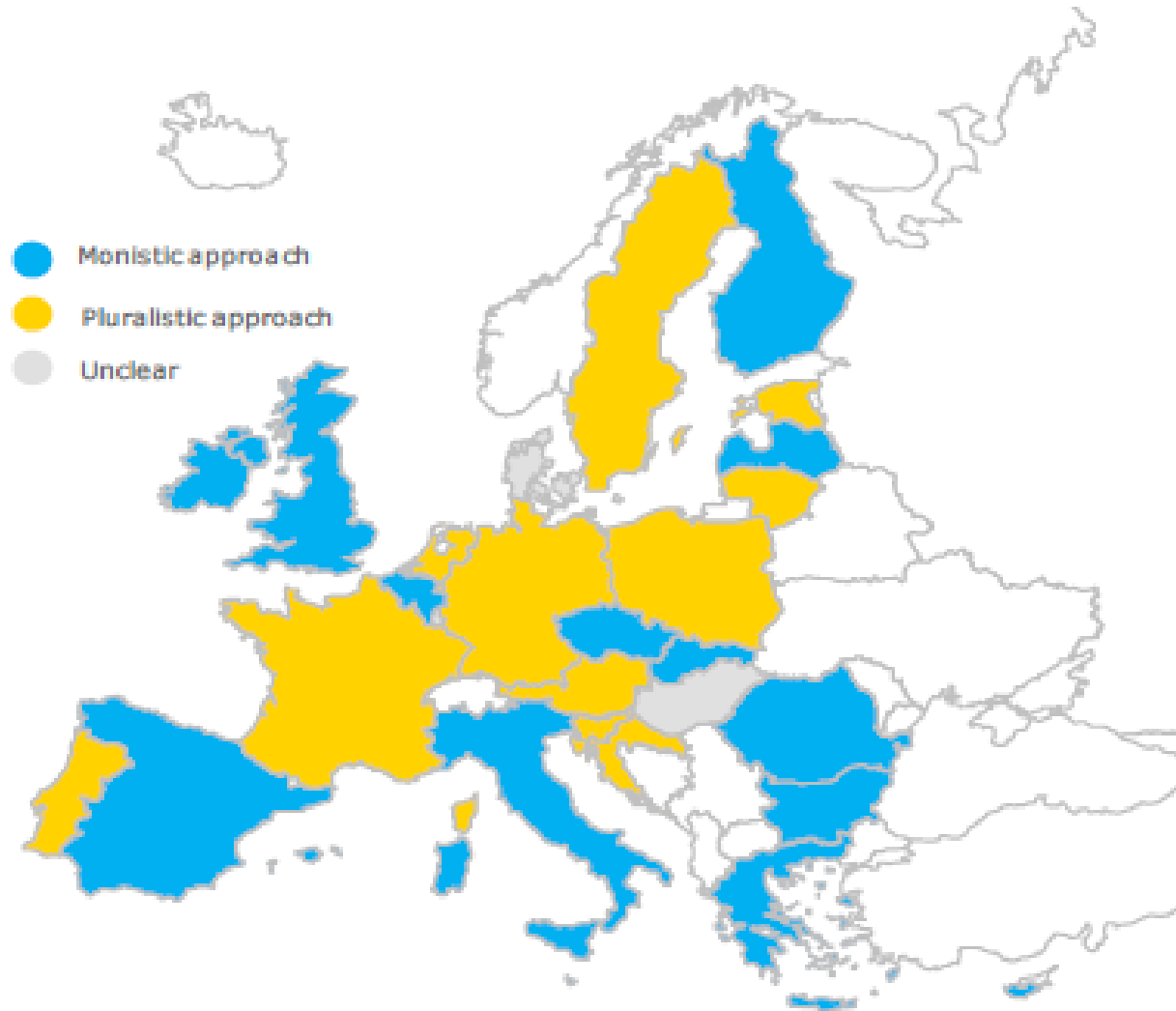
Political disagreement

(3) ‘Somewhere in between’



- UK: A director of a company must [...] promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
 - (a) the likely consequences of any decision in the long term,
 - (b) the interests of the company's employees,
 - (c) the need to foster the company's business relationships with suppliers, customers and others,
 - (d) the impact of the company's operations on the community and the environment,
[...]

(CA 2006, s 172)





Does it matter?

Does it matter?

Virtually no case-law in Germany

- BGH 1989 (*Opel*): ‘Unternehmensinteresse’ involves balancing of different groups’ interests
- BGH 1997 (*Arag/Garmenbeck*): obiter dictum, emphasising directors’ discretion
- OLG Frankfurt 2011: discusses different approaches and deploras lack of clarity; we only know for sure that board may take into account *shareholders’* interests

There is no case where the question really mattered!

NB: Employee representation on the board

Does it matter?

Does it matter in SHV jurisdictions?

- Business Judgment Rule: director not liable if
 - business decision based in good faith
 - and on adequate and appropriate processes and information concerning the matter
- Private enforcement very low in Europe
- Easy to argue that matter indirectly benefits shareholders
- We want directors to take risks!



Implications

Implications?

- Formal directors' duties possibly less important – at most, symbolic value from an EU move
- Investor demand may drive sustainability: facilitative regulation needed
- Important to look at context
 - enforcement, litigation rules, costs, standing
 - Board composition: who sits on the board – maybe case for a CSO?
 - Remuneration, selection, etc



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