Corporate governance as the enabler of sustainable growth

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[Logos of Romania2019.eu and another logo]
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Katie Kummer
EY Global Deputy Vice Chair, Public Policy

Foreword
Building and maintaining trust and confidence between stakeholders and businesses is of the utmost importance.

Corporate governance is the central framework in which companies build trust with their stakeholders, the government, and the wider community. It is more than just the principles that safeguard a company’s interests, but a way to create long-term value. Corporate governance in itself is not a direct value driver or an outcome, but can facilitate or hinder the creation or protection of value.

Forward-looking organizations are able to focus on growth and value creation through the development of strong corporate governance practices. Basic compliance principles are no longer enough to close the growing trust gap. Rebuilding this trust comes in a variety of ways. It begins by going beyond the balance sheet, reporting intangible value and investing in human capital. Sustainable corporate governance focuses on tackling environmental issues in supply chains, diversity in the workforce, as well as, improving the local and global community however possible.

As we are in a time of disruption and new megatrends that shape and change industries, we must constantly seek dynamic, real-time, and transparent practices. Businesses must tell the whole story, including financial and non-financial values, detailing the organization’s plans, objectives and the purposes behind them.

We need to move beyond just sustainable business performance: we need to achieve inclusive growth. If we want to catalyze change, we need to be measuring the factors that reflect the creation of value – not just what regulators want to see. Investors and shareholders need comparable verified outcome metrics to evaluate which companies are positioned well for real long-term success.

Besides the recent initiatives taken by regulatory bodies, asset managers and asset owners are becoming increasingly interested in receiving long-term performance information. This vital information will enable them to make sustainable and long-term investment decisions.

The idea that a company should not just create profits, but also create value that benefits stakeholders across society, is guided by the premise that we all have an important role to play in building a more prosperous society in the long-term.

EY is working with the Coalition for Inclusive Capitalism to identify new metrics to measure and articulate long-term value to investors and other stakeholders. This new tool for businesses and investors will better reflect the full value that companies create and how they impact the world around them. The report, published last November, sets out specific recommendations to companies, asset managers and asset owners to make our vision a reality.

First of all, companies need to create value in key areas of interest for investors and other relevant stakeholders along the investment chain. More disclosure is not necessarily the answer. We need better reporting that brings out more relevant and comparable information on the things that really matter in the long-term. This will provide insights into a company’s long-term plans with consistent reporting metrics and supporting narrative.

Asset managers and asset owners should be encouraged to engage strategically with companies. They can play a role in testing metrics in different categories of value, such as intangibles, and long-term financial performance.

This project is not a conclusion to our questions. But the proposed metrics, founded on the experience and research of 31 companies, and endorsed by global business leaders, will help catalyze wider change.

At EY, we believe a better working world is one where everyone can contribute to and share in the benefits of sustainable economic growth. To achieve this, it is imperative that business and government work together. While policies change, investors understand the need to take a long-term view.

A better working Europe is one that will be built together, harnessing the best of the public and private sectors to realize a world of inclusive growth.
George Ciamba
Minister Delegate for European Affairs, Romania

Opening remarks
Corporate governance remains one of the pivotal elements of sustainable business, enabling companies to build a foundation of trust with the management, the investment communities, the regulatory agencies as well as the public. The quality of governance, both corporate and public, has a direct effect on the national economic performance and ultimately, impacts the global financial stability.

The global economic landscape is transforming at a faster pace than ever. Entrepreneurs and innovators around the world are the driving force behind this expansion. One of the main challenges that the European Union faces today is to achieve smart, sustainable and inclusive growth. For this reason, there is a need for a more ethical approach that focuses not only on profit, but on the overall long-term value of our organizations. Sustainable growth can increase market share and have a positive impact on shareholder value, creating the premises for a win-win outcome. However, it needs to be a joint effort by governments and companies aimed at creating long-term value.

The impact of the digital revolution at both European and global level has led to an integrated global economy where markets are in constant search for investment opportunities around the world. The business environment needs reliable corporate governance arrangements that may strengthen the confidence in a country’s cooperation in stock markets and ensure efficient economic decision-making. At the same time, the next EU budget should have a clear reference to a digital Europe and more fundamental research that could have a great benefit for Europe catching up on the transatlantic competition.

In recent years, the EU initiatives aimed at finalizing the Banking Union and advancing the Capital Market Union played a double role. We must upgrade the regulatory frameworks and consolidate economic resilience, on the one hand, and we must create the premises for a more business-friendly growth oriented economic environment, on the other.

Now, coming to the end of the legislative mandate of the European Parliament, the EU legislators have agreed on several proposals pivotal to the economic growth of the EU, including key measures aimed at reducing risks and creating a more robust and more resilient EU banking sector and an action plan to tackle non-performing loans. Other proposals such as growth markets for SMEs, cross-border distribution of funds, and covered bonds will contribute to more efficient financing on investment projects by unlocking additional sources of funding.

After years of tough negotiations on the revision of the European system of Financial Supervision, the newly approved text will strengthen the regulatory architecture of the financial system. It will enable European macro prudential supervisory authorities to better manage shocks and to contribute to efforts to combat money laundering and terrorist financing.

The overall effect is that of a more stable and more resilient market economy equipped with tools to better manage fluctuation and risk across the board and, at the same time, holding companies more accountable. Finally, the EU action plan for sustainable finance put forward new rules on integrating environmental, social and governance factors in investment decision-making process to reflect the latest evolution in corporate governance.

The future of Europe cannot be built without a sustainable economic foundation. Financing growth and development are the driving forces of a Union that empowers and protects. A Union that can stand its ground globally and plays a leadership role in the world.
Prof. Mervyn E. King
Chairman Emeritus of the International Integrated Reporting Council (IIRC) in the United Kingdom and the King Committee on Governance in South Africa
Until the end of the 20th century, corporate leaders looked at value through the financial lens. This shareholder-centric governance model mainly focused on increasing shareholder's wealth instead of the long-term health of the company. However, this system collapsed in 2008.

Time has come to challenge the premise of maximizing shareholder value at any cost and implementing regulations focused only on shareholders. Society is questioning the outcomes, impacts and effects that a product or service has on the three critical dimensions for sustainable development: the economy, the society and the environment. The due diligence of the supply chain, the respect of human rights and of the environment, and the perception of stakeholders and citizens through social media have put intangible assets under scrutiny. We cannot carry on business as usual; we’ve got to carry on business as usual.

Does your company make its money in a sustainable manner? Value is no longer looked at through financial lens. It is looked at through value creation lens that result in corporate social investment. Today, intangible assets represent 86% while other assets are only at 14%. The intangible assets suddenly have a greater percentage part of the market capitalization of iconic companies.

Since the 1930s, financial reporting has been the rule. However, in order to have a “Healthy Company”, we need the collective mind of the board and the management to ensure the long-term health of the company, including the long-term interest of all its stakeholders. And this means inclusive capitalism.

One of the first steps to address these challenges was the launch of the Principles of Responsible Investment in 2006. Investors started thinking differently on how to make capital available and, as a result, the due diligence of a company in the world’s capital markets changed completely. From then on, it was not only about financial due diligence, but, holistically, questions were asked about how the company produces value and creates positive impact. If companies do not implement such an approach, their actions and investments are not representative of the priorities of the 21st century.

In 2008, the Global Reporting Initiative agreed that financial reporting is critical but it’s no longer enough. As we are in a resource-constrained world, it is a crucial element for companies to be sustainable and to build their business model and strategy around sustainability issues. This is no longer a silo of Corporate Social Responsibility, but it should be embedded into the overall long-term strategy of the company.

Reporting became outcomes-based with integrated reporting. Governance covers not only how you direct, how you steer the company, but also how you manage it. The oversight of the board on management and its decisions is key. Boards need to be fully informed about stakeholder relationships, sources of value creation and, overall, how the company makes its money. The agenda items need to change at board meetings in order to focus on the pressing subjects that impact the long-term value of the company.

The criteria for success during the 20th century was to increase share price and profit, no matter the cost to society and the environment. In the value creation model, the outputs stop inside the company, yet the product or service goes out into society to create positive outcomes and to ameliorate the negatives. What are common sense principles of corporate governance in this changed world? It’s easy if you remember the following acronym: ICRAFT (Integrity, Competence, Responsibility, Accountability, Fairness and Transparency).

Companies applying these principles will be practicing good governance that creates an ethical culture and effective leadership, value in a sustainable manner, adequate effective controls and informed oversight, and, most importantly, trust and confidence of community and legitimacy of operations.

The vision must be to have a company-centric governance model which moves away from yesterday’s primacy of the shareholder. It needs to be implemented mindfully to achieve the right outcomes within its business model.

The only thing worse than being blind is having sight and no vision.

Hellen Keller
Corporate governance as a means to achieving long-term value and sustainable growth

The first panel discussed the tools currently available for organizations to implement long-term value strategies and the mindset that needs to evolve in order to reach sustainable growth.

Maija Laurila
Head of Company Law Unit, DG JUST, European Commission

Today’s challenges are partially driven by and have major impacts on businesses. Business, investors, employees and other stakeholders are increasingly aware that fairness and sustainability are economically imperative in the long-run.

When companies focus too much on creating value within short-term timeframes, they forgo investment in productive assets, research and development, new technologies and in their workforce. However, these investments are key for the long-term performance of companies as well as preparedness for responding to sustainability challenges. Companies should not only be doing what is right for their short-term, shareholders’ value, but should also be doing what is right for the society at large. Furthermore, short-termism amplifies social and societal problems including human rights abuses, growing inequalities and the environmental crisis.

Over the last years, the Commission has taken key actions across its policies to foster more responsible and sustainable business. The Reflection Paper “Towards a sustainable Europe by 2030” published by the European Commission on January 2019 underlines that businesses have a vital role to play in sustainability transition. For instance, in 2017, 78% of the world’s top companies included CSR in their annual reporting.

Sustainability will remain on the agenda of the new Commission and should become even more important in the future. The challenges are unprecedented and there is urgency to act. We need to do that together.
You cannot challenge management if you are part of management. Transparency helps to restore trust.

Guylaine Saucier

Bogdan Ion
Country Managing Partner, EY Romania & Moldova/Chief Operating Officer EY Central, Eastern and Southeastern Europe & Central Asia

The key questions that should be addressed in today’s debate are the role of corporate reporting in measuring the drivers for value protection and which are the most fundamental steps that businesses can take to build more sustainable practices. After all, the financial services sector needs to be ready to take action under a different perspective of corporate reporting.

Moderator

Mathilde Mesnard
Deputy Director for Financial and Enterprise Affairs, OECD

Megatrends such as globalization and digitalization are shifting the boundaries of the firm and pushing leaders to revise their governance models. In the current crisis of trust, it is urgent to adopt a more sustainable, proactive (i.e., beyond compliance) corporate governance model. With increased investor emphasis on firms’ commitment to governance issues, this approach is necessary for companies to create long-term value, to become more resilient, and, in the end, to strengthen their social license to operate. Consumers, employees, investors and stakeholders in general are expecting companies to conduct their business, responsibly, sustainably, and with integrity. They are sending clear messages asking for a shift from a governance model focused on shareholders to one that integrates the broader value-creation ecosystem, including stakeholders, reflecting and deepening the purpose of the firm.

Panel

Which aspects need to change in corporate governance?

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- Increased presence of independent directors on the Board: 4.1
- Separation of Chairman and CEO positions: 4.2
- Greater transparency on CG structures: 4
- Similar structures for large private companies and PIEs: 3
We need to be much more ambitious in the definition of directors’ duties. Directors must be fully compliant and have done due diligence on responsible business conduct throughout their entire global supply chain.

Mathilde Mesnard
Sergiu Oprescu  
President Alpha Bank Romania, President Romanian Banking Association

Corporate governance should not be the finish line. The goal should be to have a change in the culture in order to be conducive of sustainability within the company. Companies need to make sure that they are not only creating financial value, but also social and natural capital value. Accordingly, it is very important to implement proper corporate governance and to have the right people that will define sustainability within the board and to challenge the status quo. It is a must to have an increased presence of independent directors on the board through specialized committees. Yet, there is still a long road ahead of us.

Jan-Menko Grummer  
Member of Embankment Project for Inclusive Capitalism (EPIC)

Effective, efficient and transparent corporate governance structures are the basis for sustainable business and for long-term decisions in the company. Corporate governance is not a value driver by itself, but it can facilitate or can hinder value protection or value creation. Long-term value means considering sustainability and inclusiveness in business and investing decisions. The Embankment Project for Inclusive Capitalism report (November 2018) identifies the value drivers important for sustainable and inclusive growth and proposes potential metrics to assess them. The fact that non-financial reporting is not standardized makes it difficult to benchmark companies and make investment decisions.

Paola Schwizer  
Affiliate Professor of Banking and Insurance, SDA Bocconi School of Management

Sustainability must be addressed as an integrated part of the business model, and not as an externality. Stakeholders are not satisfied with the current quality of sustainability reporting. If companies want a longer payback, they must rethink their business model, invest in R&D and more efficient internal production processes, intensively collaborate with stakeholders, and educate suppliers and customers on the use of natural resources. Inefficient companies will fail and fall out of the market.

Boards should not only get insights on future scenarios but take the lead and be informed from external experts, in order to be able to steer and provide strategic oversight. Boards must have the right mix in terms of skills, gender, nationality and experience.
Key challenges for non-listed companies

The second panel addressed the challenges for different types of corporate structures, such as small and medium companies, startups, family owned companies and state owned companies, to adopt the main principles of good corporate governance.

Mark Davis
Regional Director for Romania and Bulgaria, EBRD

Policy-makers have the responsibility to establish a flexible and proportionate regulatory framework that meets the needs of corporates under a variety of different circumstances. If the regulatory framework is not fit for purpose, entrepreneurs are likely to disregard it. In opposition to the old concept of corporate profitability, companies are expected to adopt a social responsibility corporate governance model.

Shareholders understand that companies need the right systems, including through corporate governance, to enhance their capital structure, their perception in the market and their stability and profitability. Accordingly, the value creation of a company depends on a robust capital structure. Yet, SMEs and entrepreneurs face several challenges in terms of the succession and ownership.

As regards state owned companies (SOEs), the state needs to be clear about expectations regarding responsible behavior towards all stakeholders. It’s not just the company, it’s not just the workers but it’s also about citizens and consumers in a society.

Leena Linnainmaa
Deputy Chief Executive, Finland Chamber of Commerce & Chair ECGCN

Companies face many challenges nowadays, for example, with regards to the increase in digitalization. Is your company composed of competent talent who can tackle the future challenges of digitalization? How can we address succession within companies?
Luc Vansteenkiste
Chairman, European Issuers

Corporate governance is a gradual and continuous process of improvement of behavior and mindset. Only when listed companies are unwilling to adopt a code on a voluntary basis, requirements, such as remuneration transparency, should be mandated. As regards non-listed companies, a code should only apply for educational non-binding purposes. The number of independent directors of non-quoted companies is increasing, and it has advantages to the long-term value of the companies. We should, as a priority, change mindset and behaviors, look for solutions, find the answers and not to impose by law.

Radu Craciun
CEO, BCR Pensions

Boards’ quality and performance is of growing importance considering the current challenges of digitalization and the new dimensions of globalization. Ironically, the more globalized the world, the easier it will be to tap into the pool of local skills, raising their relevance. The freedom and speed at which data travels around the globe creates interconnections between experts, helps them share and improve their skills and, finally, turns into a virtual hub of expertise with a significant competitive edge. Shareholders are facing now the challenges of selecting, across the globe, the best talent for the boards and to use them in a proper way.

Joelle Simon
Deputy Director General Legal, Ethics & Corporate Governance, MEDEF

In 1995, MEDEF and AFEP jointly established the corporate governance code for listed companies. 20 years later, corporate governance is no longer an option. The objective is now to convince more and more private companies in France, whatever the size, to adopt the essential principles of good corporate governance, not as a burden but as a way to boost their growth and promote long-term value creation. The only way is to have very flexible rules, which are more attractive for investors and help access financial markets. This is a question of education and of changing the behavior of companies, for example, by promoting diversity on boards in terms of gender, generation, qualifications, country of origin.

Do we need a CG code for medium-sized and large unlisted companies?

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Gender quotas for boards were the only way to speed up the movement because in our organizations there is still a culture of doubt regarding women in leadership.

Joelle Simon

“Gender quotas for boards were the only way to speed up the movement because in our organizations there is still a culture of doubt regarding women in leadership.

Joelle Simon

Lucian Claudiu Anghel
Chairman of the Board of Governors, Bucharest Stock Exchange and President of the Executive Committee, BCR Banca pentru Locuinte

The Bucharest Stock Exchange adopted its code of corporate governance in 2015 with the support of EBRD. Together with relevant local companies we established a platform, ARIR, for the development of Investor Relations professionals that contributes to the implementation of best practices in investor communication.

The code sets an example of principles which are useful also for SMEs and start-ups to rethink their entire organization and to improve their workflow. Now it’s the moment to establish an independent institute to monitor how the code is being implemented. Two powerful measures to improve the investor relations activities would be for CEOs to have shares of his listed company and to ensure that at least one of CEO's KPI is directly linked to the share prices evolution, as well as implementation of the stock option plans for employees.

Johan Meyer
CEO Franklin Templeton and Portfolio Manager, Fondul Proprietatea

In Romania, current legislation defines the principles for selection of board members and executive managers by companies, and transparency requirements. However, these rules are still seen as an obstacle. In fact, there has been way too many examples of corporate governance failures which led to the financial failures of important SOEs. This situation hinders the development of the company’s long-term sustainability strategy. Ultimately, the objective of Romania is to upgrade the local market, but without significant listings it won’t be possible. Investors need to have the confidence that they are investing in a clear and transparent framework that enables them to truthfully collaborate with the board and the executives.

What are the largest CG problems for SOEs?

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<tr>
<td><strong>Restrictions on directors’ remuneration</strong></td>
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<td><strong>Director appointments</strong></td>
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<td><strong>Non-compliance of CG codes</strong></td>
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<td><strong>Changing politics and unpredictability</strong></td>
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Corporate governance as a tool to improve business ethics

The third panel discussed how the concept of business ethics is evolving to meet technological, social and environmental challenges, and help companies move towards a new culture of non-financial reporting and transparency.

Olivier Boutellis-Taft
Accountancy Europe, CEO

We live in an age of massive disruption both on the geopolitical stage and technological front. Over the years, businesses have had to comply with more and more rules which have not produced better social and economic outcomes. Today, we live in an age of massive disruption both on the geopolitical stage and technological front – but more fundamentally the main disruption we face is a vital environmental crisis.

If we truly want to change the status quo, everybody must play their own role to make that happen. Clearly, we need to find a way of doing business differently which means first changing our way of thinking and acting. Thus, it is imperative that we move from maximizing sales to sustainable prosperity as a way to ensure the profitability and continuity of companies. It is crucial that we understand the importance of shifting to a circular, sustainable economy as we are using our planet’s resources faster than it can regenerate – and we can no longer let that happen.

The United Nations 17 Sustainable Development Goals (SDGs) provide a good benchmark to help us understand what trends will impact business and what a responsible company is expected to do. However, as scientists from the Stockholm Resilience Centre have demonstrated achieving the SDGs while staying within the planetary boundaries will be extremely challenging.

We need a new boardroom culture – people who think differently and have the courage to challenge the status quo. Policymakers also have a role to play. When drafting legislation, they need to think how it can influence behavior and making sure it is well enforced. Regulation that is not enforced does not serve any purpose. If we want to encourage firms that promote sustainable practices, we really need to make sure they operate on a level playing field.

“The financial services industry is like an irrigation system in the farm, if we compare it to the economy as a whole — without a proper irrigation system, farmland will not survive.”

Jo Iwasaki
The notion of business ethics is constantly changing to meet economic, social and environmental challenges. The following questions are for businesses to consider:

- How does information contribute to the good ethical citizenship profile of legal persons such as companies?
- How do we extend and redefine directors' duties in the context of sustainability?

The business model and practices promoted by Helsinki Capital Partners (HCP), a small certified benefit corporation in Finland, provide best practices on how asset managers can positively contribute to the debate on sustainability and ethics in the financial services industry. The role of investors in corporate ethics and ESG disclosure is very much focused on investor stewardship. If we truly want the financial services industry to be more transparent and more accessible, change needs to come from within the industry itself. What HCP does can be replicated by other players in the industry – it just needs a bit of courage and strong collective action.

Today, we need to adopt a new approach to ethics in order to better cope with environmental, social and governance issues we are witnessing around the world nowadays. We have to understand that ethics goes well beyond merely complying with legal requirements. Linking ethics to the disclosure of non-financial information provides a great opportunity to improve the reputation of corporates and board members. We also have to provide our people with the right skills to understand how to apply ethical principles, which can, in turn, help us solve the challenges we face today. It has been proved that companies that are leaders in non-financial disclosure are also champions of ethical behavior, demonstrating a strong correlation between the two.
Adrian Codiaslu  
President, CFA Romania

An integral part of the CFA Institute’s mission is to promote the highest standards of ethics, market integrity and professional excellence, which collectively contribute to the ultimate benefit of society through the sustainable value generated by efficient financial markets. CFA Institute develops codes of ethics, guidelines and standards of professional conduct that guide the investment industry while encouraging sound ethical behavior and practices. The code of conduct developed by CFA puts the client’s interests and needs first. The CFA code of ethics requires financial analysts to act with integrity, demonstrate competence and professionalism, uphold their duties to clients, disclose any potential conflicts of interests, and distinguish between fact and opinion in the presentation of investment analysis and recommendations.

Béatrice Richez-Baum  
Director General, ecoDa

Companies can no longer consider themselves solely as pure economic agents. They now have to build relationships with stakeholders, respect the environment and develop a new social order. To a certain extent, nowadays, companies have to overcome the failings of other institutions. States cease to hold the monopoly of the general interest. The good news is that ethics pays off. The best companies see ethics less as a constraint, but more as a tool to innovate. We should see ethics as a process rather than a product. That is why boards should refuse an ideological “one-size-fits-all” approach. Also, codes and guidelines should remain principle-based if we want to promote true ethical discussions at the board level.

Do you think that business ethics and culture are important for sustainable growth?

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<td>1</td>
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<tr>
<td>No, they are not so important</td>
<td>1.1</td>
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<tr>
<td>Yes, partially</td>
<td>1.7</td>
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<tr>
<td>Yes, there is a strong correlation</td>
<td>4.6</td>
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<td>Strongly agree</td>
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“The good news is that ethics pays off. The best companies see ethics less as a constraint, but more as a tool to innovate.

Béatrice Richez-Baum

Pedro Oliveira
Director for Legal Affairs, BusinessEurope

Businesses need to understand that the world is not the same as it used to be. Today, we are seeing all values and conventions being challenged from a social, political and economic point of view. According to the latest Edelman Trust Barometer, the majority of people trust businesses more than governments and media, because people believe that companies can drive change and provide solutions to today’s challenges, cybersecurity or climate protection being some of them.

Implementing a good corporate culture can help to leverage that trust from people and promote positive change. We should also not forget that it is not the law that creates a company’s culture: rather, it needs to come from within the company itself.

Business ethics is important for sustainability reporting because ... (select the statement you agree with the most)

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<tr>
<td><strong>Strongly disagree</strong></td>
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<tr>
<td>Business ethics enhances corporate reputation</td>
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<tr>
<td>Sustainability reporting includes qualitative and forward-looking information</td>
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<tr>
<td>Sustainability reporting is not always subject to independent assurance</td>
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Director independence and board effectiveness

The final panel looked at how true independence of directors is key to building an efficient and high-performing boards, which is at the heart of sound corporate governance.

The audit world is becoming more and more complex, with new dynamics and emerging trends shaping the financial markets and the financial reporting environment as we know it today. Audit quality is at the heart of the entire financial reporting process, providing the basis for the trust of investors, and other stakeholders, including the wider society, and safeguarding the public interest. Audit contributes, to a very large extent, to fostering a more transparent, sustainable and inclusive financial ecosystem. In this environment, audit committees, the internal audit function and the auditor constitute a solid triumvirate that is committed to building and maintaining that trust in the financial markets.

Setting the right tone at the top and having a strong corporate culture is key for audit quality. The leadership needs to ensure that audit is not just a business, but rather a public duty. As such, it is crucial that audit firms compete on quality rather than price. But today, the audit world is changing very fast.

Technology is not only transforming the methodology, character and process of an audit itself but also as an impact on the audit firm’s business model and governance. Audit firms are increasingly adopting modern tools to get additional or alternative audit evidence or to identify risks or to detect fraud. Digitization is revolutionizing how audits are conducted, and how the audit business, audit quality and auditor’s independence is prioritized within the service portfolio, given the steady double digit growth of the audit firms’ advisory arms.

In addition, people’s strategies will have to be reconsidered completely as career, compensation and skillset models will change substantially.

Although these developments have the potential to improve audit quality significantly, the road is long and paved with some uncertainties and possible inefficiencies.

The audit industry is also being shaken up by regulatory developments as we live in a globalized and interconnected world, the developments concerning the audit market in the UK are likely to have an impact also on global networks, the financial reporting and corporate governance systems, the role of audit committees and the behavior of investors and all other stakeholders in the UK, Europe and beyond. Audit regulators are taking a gradual step-by-step approach by looking more at audit firms’ quality control systems than at individual audits, increasingly holding audit firms to account, and intensifying dialogue with many stakeholders, including audit committees, global organizations and relevant authorities.
Setting the right tone at the top and having a strong corporate culture is key for audit quality. Audit is not just a business but rather a public duty.

Ralf Bose

Sorana Baciu
President, Independent Directors Association, Romania

The role of a board is becoming increasingly important and it is even more important how it is structured, how it is remunerated and how it performs. The audit committee is at the heart of board performance and independence is the key to having a high-performing audit committee. These questions are for boards to consider:

- Whose interests are independent directors supposed to serve? And in light of the implementation of the EU Shareholders Directive, what interests are directors defending?
- How can independent directors be sure they have the right level of information to make the right decisions?
- How do we ensure the right diversity in the boardroom?

Carmine Di Noia
Commissioner, CONSOB & Deputy Chair of the Corporate Governance Committee, OECD

Today, we continue to see strong demand from various stakeholders, shareholders, investors to build an effective board of directors. In order to encourage board participation and attendance, it is crucial that companies share their figures and experiences to better understand how boards can improve their overall performance. Knowing the educational background of board members also helps to better evaluate their activities. True independence comes from competence: if you are competent, you are more independent because you understand the overall context better. Also, timely availability of pre-meeting information is key to having an efficient and high-performing board of directors. Unless we leave time for boards to do business, we may end up transforming them into a mere compliance exercise.

Do you think that AI will take over the decision-making process in the board?

Audience poll

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<th>Strongly disagree</th>
<th>Of course!</th>
<th>Not so sure...</th>
<th>It is never going to happen!</th>
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| 1.9               | 2.4        | 2.7           | 5

Strongly agree
Corporate governance is not a science, but rather, an art, a living argument which is based on discussions, our own perceptions and intelligence. For that to happen, it is essential to have a board which is well integrated with the life and strategy of the company. Qualified independent directors play a key role in achieving good governance, therefore it is not right to evaluate their performance based solely on a set of negative criteria. Independence necessarily needs objectivity of mind and character. We should encourage independent directors to express their own views, challenge others’ opinions and ask more and better questions about the company’s financials and sustainable goals. When independent directors only sit on the audit committee but not on the board of directors, they often have a limited vision of what the strategic risks of the company are, and are not well positioned to direct the internal control framework to address those risks. One question that boards should consider is: how can we ensure a good flow of communication between the audit committee and the board of directors if independent directors sitting on the audit committee are not part of the board?

Overconfidence and groupthink remain today the biggest obstacles to having a strong and effective board. In order to build a strong and successful board that contributes to the company’s growth, it is crucial to bring together independent directors with those who are not independent. We need to combine short-sightedness and knowledge of seasoned members with naïveté and inexperience of newcomers. We also need to ensure a good balance of men and women. Having this balance at the board table helps to improve the quality of thinking and raise the level of discussions. We need to move to a more societal advisory board that represents all stakeholders in society and fosters greater and deeper links with the outside world. The added value of independent directors lies in their ability to think long-term, ask naïve questions, and work through trial and error, instead of theorizing.
Corporate governance is not a science, but rather, an art, a living argument which is based on discussions, our own perceptions and intelligence.

Gian Piero Cigna

Merima Zupcevic Buzadzic
Corporate Governance Lead for the Europe and Central Asia, IFC

We have entered an era where disruptive technologies have become more than a buzzword— they are transforming and reshaping entire industries as we speak. Today, boards are the driving force behind the company, and as such, they need to keep abreast of the latest technological developments and understand the implications these may have on their companies. There is no future without embracing the full potential of disruptive technologies. It has been proven that companies with lighter assets have a higher market capitalization on the basis of what they can offer for the future. We should not worry too much about AI taking over the decision-making process in the board, but we should instead change the profile and upgrade the skills of board members. Having a diversity of opinions and a variety of different skills in the board is what truly matters: the wider you throw the net, the better the chances are of not falling into the trap of groupthink, as you involve more people who will bring different opinions and perspectives to the table.

What do you think is the “right” share of independent directors in the boards?

Audience poll

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>0–15%</th>
<th>25–30%</th>
<th>Over 50%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1.6</td>
<td>2.9</td>
<td>3.6</td>
</tr>
</tbody>
</table>
Boards could usefully apply ICRAFT principles for better governance.

Supported by corporate governance principles, companies should promote a company-centric governance model which moves away from shareholder primacy and focuses instead on creating long-term value and sustainable growth for all stakeholders.

Boards should be required to establish a company’s purpose, values and strategy ensuring that these and its culture are aligned. Boards should articulate how the culture supports the successful delivery of the strategy and business model.

Boards should be required to assess and monitor culture.

In supporting the EU’s sustainable finance agenda, the corporate reporting model needs to change so that it is simpler, more accessible and decision-oriented. It should be addressed to all stakeholders, not just investors, using commonly understood metrics to measure and demonstrate the value a company creates for everyone. See EPIC for more detail (available at EPIC-value.com)

Corporate governance frameworks should always allow for flexibility and proportionality, particularly with respect to companies’ size, location, sector and ownership structure.

Companies need to better understand how investors and others value good governance and transparency as a way of enhancing their capital base and also improving stakeholder perceptions (i.e. building trust).

In order to build trust, customer loyalty and reputational capital, companies need to see ethics as an enabler of innovation and sustainability, or even as a competitive differentiator and not just a compliance exercise.

All market participants need to be constantly alive to how technological disruption can both improve corporate governance and pose risks to it.
Is the debate around shareholder primacy fundamentally a red herring?¹

The notion that shareholders’ interests should trump the interests of all other company stakeholders has been repeatedly challenged since the financial crisis. Those who ask the question are often not saying that the interests of shareholders are unimportant, or that the pursuit of profit is irrelevant. They are saying instead that there are many others besides shareholders who have a legitimate interest in how companies behave and how they repay the privileges society has conferred on them such as limited liability and, in the case of public companies, the opportunity to access capital markets.

At the 23rd European Corporate Governance Conference, held in Bucharest in April, international corporate governance expert Professor Mervyn King talked about the concept of the ‘healthy company’. This is a concept that resonates strongly with me. If companies don’t acknowledge their important role as enablers of sustainable growth over the long-term, they will suffer increasingly fierce criticism from their stakeholders and ultimately compromise their place in the broader social and economic ecosystem. In other words, those privileges I mention above will be taken away.

Mind the expectations gap
Unfortunately, companies that want to respond positively to this challenge are wrestling with an expectations gap. This expectations gap is between the majority of stakeholders, who want companies to be more long-term focused and take better account of their interests, and financial markets, which are still largely focused on short-term results. For the gap to close, we need the financial system be part of the solution, rather than part of the problem. So how can we bring this change about?

The good news is that there is a growing community of investors who are already focused on sustainability issues because they know that they will have a financial impact, either positive or negative, further down the line. Among these investors are Vanguard, which has launched two exchange-traded funds with an environmental, social and governance (ESG) focus; State Street, which offers a number of ESG products; and BlackRock, which even has its own mission statement on sustainability. These investors recognize that a company that pollutes the atmosphere, or is careless with its energy consumption, is creating a liability that will have to be borne by someone, somewhere, at a later point in time. If the company does not end up bearing the cost directly, then society will end up paying the bill. That inequity will catch up with the company eventually in both financial and non-financial ways.

Metrics and money
If investors are to allocate capital towards companies that focus on the long-term interests of their stakeholders, they need to be able to identify these companies and compare them with their peers. Although more and more

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¹ This perspective from Andrew Hobbs are his reflections on the discussions held at the 23rd European Corporate Governance Conference in Bucharest, Romania on 2 April 2019.
Andrew Hobbs
Partner
EY EMEIA Public Policy Leader

Sustainability information has become available to investors in recent years, many are still not confident about using it—often because it comes from different sources and cannot necessarily be tied back to performance over time. EY recognizes this, which is why we co-founded the Embankment Project for Inclusive Capitalism. The project has set out a number of different value drivers that are important for companies looking to achieve sustainable and inclusive growth—value drivers such as talent, innovation, environmental commitments and corporate governance—and the potential metrics that could be used to assess them.

Within the investment community, it is often said that companies get the investors they deserve. So, we will know we have succeeded in providing investors with the metrics that they need to measure long-term value when the money really starts moving—when it is the most sustainable companies that get the most investment or investment at a cheaper rate. When this happens, we will see a real change in attitudes. Unsustainable companies will quickly realize that their more forward-looking peers are overtaking them because they have the backing of investors who prioritize a long-term vision, above short-term results.

Back to the boardroom
Alongside metrics, we also need to embed new ways of thinking into the boardroom. That doesn’t necessarily mean stuffing boards with tech entrepreneurs, but it does mean understanding upcoming generations—how they think and what their values are. There is an opportunity for boards to get support from their own ‘advisory group’—a collective of people from different generations and walks of life who act as a kind of strategic focus group in terms of bringing fresh views and perspectives into the boardroom.

The role of boards is critical in making sure that the long-term viability of a company is not sacrificed at the altar of short-term profit. They can give investors a better picture of their company’s long-term value, which will influence investors’ attitudes and decisions. They can also invest in assurance about a company’s resilience so that stakeholders have a better understanding and more confidence in what the company does to protect jobs and supply chains. Good businesses that thrive in the long-term take risks, but they also mitigate against those risks coming to pass. That’s why, in today’s fast-moving and volatile world, companies must prepare—and prove that they are prepared—to withstand shocks. Or if they are not prepared, they need to be clear to their stakeholders about that reality. Some companies, though, will fail, and we have to accept that.

Ensuring the long-term success of our most significant businesses—and all the jobs and wealth they create—is a collective responsibility. Everyone in the ecosystem has a role to play—boards, management, investors, auditors, customers, employees, suppliers and regulators. Yet, it is down to boards to lead the way and to make sure that they put sustainability front and centre of their agendas, and publicly convey how they are committed to delivering long-term value.

Doing right by the environment, doing right by society, and doing right by employees isn’t just about doing the right thing. Since it should lead ultimately to better financial performance over time, it is also in the best interests of shareholders. In the end then, perhaps the debate around shareholder primacy is actually a red herring. Because focusing on long-term sustainable growth will provide shareholders with the greatest value of all.
About EY

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