



European Corporate Governance 2021 – Beyond traditional corporate governance

EY

Building a better
working world

Beyond traditional corporate governance: What's the role of the board in fostering sustainability and innovation?



The European Corporate Governance Conference 2021 explored how boards can support the process of long-term value creation.

- ▶ Boards should make time to reflect on their company's long-term value creation and its role in the global value chain.
- ▶ Audit committees can assure the reliability of the information used to inform decision-making, making links between financial and sustainability risks.
- ▶ Sustainable corporate governance will help to drive better risk management, greater innovation and higher levels of transparency.

Summary

The European Corporate Governance Conference 2021 explored how sustainable corporate governance can help to foster sustainability and long-term value creation. Key topics included the roles of the audit committee and internal audit, sustainability reporting, remuneration policies, supply chain due diligence, competitiveness, innovation and the European Commission's sustainable corporate governance proposal.

Co-organizers



Partners



Think Ahead

EuropeanIssuers



What is the role of corporate governance in ensuring that companies do not just green their activities, but invent new strategic models? And how can sustainable corporate governance help to foster the long-term existence of companies?

These two questions lay at the heart of the European Corporate Governance Conference 2021, an accompanying event to the Slovenian Presidency of the Council of the EU. The conference was organized by EY CBS BV, ecoDa and the Slovenian Directors' Association, in collaboration with ACCA, BusinessEurope and EuropeanIssuers. Over 600 people, from around 50 countries, registered for the event.

Pivotal moment in history

We have reached a pivotal moment in human history. The world today is wrestling with huge – in some cases, existential – challenges including the COVID-19 pandemic and climate change. The scale of these global challenges is so great that they can only be addressed by governments, institutions, businesses and individuals working together.

While helping to address these global challenges, the EU has an opportunity to push the reset button on its own economy and work toward a greener, more sustainable and more competitive future that delivers long-term value for all its citizens. Yet these objectives will only be achieved with the support of sustainable businesses that have sustainable corporate governance.

Sustainable corporate governance helps to drive greater innovation and better risk management within businesses. It also encourages higher levels of transparency that foster constructive relationships between companies and their stakeholders.

Under its sustainable corporate governance initiative, the European Commission is due to publish proposals for [improving the EU regulatory framework on company law and corporate governance](#), to enable companies to focus on long-term sustainable value creation going forward. Among the important issues being considered as part of these proposals is whether directors' duties of care should be clarified so that they are required to act in the best interests of the company by pursuing long-term value creation and managing sustainability risks.



Challenges to sustainable value creation

While there is a general consensus around the need for companies to pursue sustainable value creation, in practice companies face a number of challenges with this approach. The conference considered these challenges, as well as possible solutions to overcome them:

1 Identification of genuinely sustainable companies

It is in companies' own interests to claim to have sustainable credentials – since these will boost their standing with their stakeholders and help them to attract finance. Unfortunately, this has led to the problem of “greenwashing” – where companies convey false impressions to the public about their business strategies.

Corporate sustainability reporting is vital for showcasing genuinely sustainable companies and differentiating them from their less sustainable peers. Yet reporting is not as effective as it could be at helping stakeholders to make that differentiation due to the many different reporting initiatives and standards currently in existence. The EU is looking to develop its own corporate sustainability reporting standards as part of its proposed Corporate Sustainability Reporting

Directive (CSRD) initiative. Nevertheless, to ensure real comparability and reliability, the ultimate goal should be a globally recognized framework of sustainability standards or, at the very least, the existence of different frameworks and standards that are globally consistent.

It is also important to ensure that sustainability reporting frameworks apply to private companies, as well as listed companies, and to SMEs as well as large corporations. If private companies do not have to comply with the same sustainability reporting requirements as their listed rivals, there is a risk that any unsustainable practices could go undetected. Furthermore, SMEs are integrated into the supply chains of big companies and collectively they are critical to the global transition to a low-carbon future. For those reasons, and to avoid being at a competitive disadvantage compared with larger rivals, they should be required to provide sustainability data.

In future, robust and reliable sustainability reporting – based on strong risk management and effective internal controls – will be key to ensuring that a company builds trust with the finance community. This trust will be crucial for enabling that company to attract sufficient financing to invest in innovation and make the transition to a more sustainable economy.



2 Alignment of long-term value creation with executive remuneration plans

Short-termism remains inherently embedded in the global capital markets, putting pressure on companies and their executives to focus on short-term goals. It is the role of the board to counteract this pressure - and ensure that neither companies, nor their executives, prioritize short-termism at the expense of long-term valuation creation.

It can be challenging to create executive remuneration plans that are tied to long-term environmental, social and governance (ESG) objectives since some targets are hard to measure and others may become less relevant as the remuneration plan unfolds. Also, it can be hard to identify realistic timelines in which targets should be met. To address these challenges, boards can seek the support of specialist remuneration consultants.

3 Supply chain due diligence

The European Union's sustainable corporate governance initiative aims to help companies better manage sustainability-related matters, both in their own operations and in their supply chains. Its upcoming proposals will therefore encompass mandatory human rights and environmental supply chain due diligence. At present, companies face significant challenges when performing due diligence on their supply chains.

One challenge is the sheer size of supply chains - some companies have millions of first- and second-tier suppliers. Another is that companies may have suppliers that are larger than they are, or suppliers that are controlled by poorly governed states. In these instances, suppliers may refuse to respond to requests for information.

Given the complexity involved, a good approach might be for companies to prioritize due diligence on their riskiest suppliers, as well as on very specific and very clearly defined human rights and local environmental risks. Furthermore, there should be a level playing field, with both EU companies and non-EU companies that operate in the EU expected to comply with the same due diligence obligations.

4 Regulatory environment

While Europe has some bright stars in its start-up scene, the world's largest technology companies all come from either the US or China. Hence these countries appear to have regulatory environments and financing structures that support small businesses to rapidly become very large businesses. In the US, for example, there has been a surge in popularity of SPACs (non-operating, publicly-listed companies set up with the specific purpose of acquiring a private company and taking it public without going through the traditional initial offering process). Europe, in contrast,



does not currently deploy a similar mechanism for channeling large sums of money to fast-growing businesses.

Additionally, there are differences in corporate governance approaches between Europe and the US. Europe is ahead of the US in terms of diversity quotas, for example. In Silicon Valley, on the other hand, there is a strong trend for founders and venture capitalists to retain control over companies through the use of dual-class shares. This is a controversial practice since it creates shareholders with superior voting rights to other shareholders. Nevertheless, there is an argument that when a founder retains control, a company is more likely to maintain its entrepreneurial spirit and adherence to its initial purpose or vision.

An effective regulatory environment is crucial for ensuring that sustainability is a driver of innovation and competitiveness. While robust sustainability frameworks are needed to underpin good practices that drive long-term value creation, too much red tape can be a burden on businesses, especially on startups. It is important that the EU does not over-regulate ESG to the extent that European companies become less competitive than their peers in the US and China.

5 Board structures

Boards have many pressures on their time and must balance a number of competing priorities. As a result,

they can struggle to find sufficient time to reflect on their company's long-term value creation, its opportunities for innovation and its role in the global value chain. By making greater use of committees, they can, however, dedicate more time to these areas. Few boards currently have dedicated sustainability committees. Boards can instead draw on the capabilities of their audit committees to provide effective oversight of sustainability-related matters. Audit committees can help to facilitate sustainable corporate governance by making links between financial and sustainability risks and assuring the reliability of the information that is used to inform decision-making.

To provide effective oversight, audit committees need to ask direct, targeted questions of management, monitor emerging risks, ensure that ESG expertise is considered in decision-making processes, understand the evolving rules and expectations in relation to sustainability reporting, and establish effective internal controls in line with these rules and expectations. Audit committees must ensure that the right processes and procedures are in place to support the organization's activities. This requires them to work closely with the internal audit function, which plays an important role in helping to identify ESG risks and auditing the processes involved with ESG reporting.

Europe currently has two types of board systems - one-



tier boards and two-tier boards. A question that the EU institutions - as well as national governments - might want to consider is which kind of system enables boards to more effectively reflect on their company's sustainability strategy? They might also want to see whether the governance models of private equity firms offer some learnings for the boards of public companies. Directors of private equity firms tend to be both "hands-on" and very well informed, for example. They often have daily conversations with management and rarely rely solely on the information presented at board meetings. They also tend to consider a time horizon that extends well beyond quarterly or semi-annual earnings reports.

Shift toward sustainable corporate governance

Today, a major shift is underway within corporate governance. Organizations are increasingly moving away from the principle of shareholder primacy toward the principle of stakeholder capitalism. Unlike shareholder primacy - which advocates that companies should prioritize the interests of shareholders - stakeholder capitalism recognizes that the interests of shareholders are best served when organizations consider the long-term interests of all of their stakeholders.

Sustainable corporate governance underpins this shift away from shareholder primacy toward stakeholder capitalism. It ensures that a company keeps a long-term perspective, and is able to balance short-term priorities with long-term investments.

Additionally, sustainable corporate governance is crucial to providing proper accountability around companies' strategies for long-term value creation, the goals they set themselves and how they measure their progress against these goals. For this reason, sustainable corporate governance will not only support the EU's transition toward a sustainable economy, it will also improve the long-term financial performance, competitiveness, productivity and resilience of EU companies overall.

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

© 2021 EYGM Limited.

All Rights Reserved.

EYG no. 010721-21Gbl

ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, legal or other professional advice. Please refer to your advisors for specific advice.

ey.com

Conference agenda

14.00: Welcome

Irena Prijović, Executive Director, Slovenian Directors' Association (SDA)

14.05: Opening speech

Julie Teigland, EY EMEIA Area Managing Partner and EY Global Leader - Women. Fast forward

Virtual European Corporate
Governance Conference 2021

Julie Teigland

EY EMEIA Area Managing Partner and
EY Global Leader – Women. Fast forward

Beyond Traditional Corporate Governance
Sustainability and Innovation

14:00-17:00 CET, 09 November 2021



Join the conversation #ECGC2021



14.15: Keynote speech

Salla Saastamoinen, Acting Director-General, DG JUST, European Commission

Virtual European Corporate
Governance Conference 2021

Salla Saastamoinen

Acting Director-General, Directorate-General for Justice
and Consumers (DG JUST), European Commission

Beyond Traditional Corporate Governance
Sustainability and Innovation

14:00-17:00 CET, 09 November 2021



Join the conversation #ECGC2021



14.30: Fireside chat between Dr. Roger Barker, Director of Policy and Corporate Governance at the Institute of Directors (IoD) and Göran Espelund, Board Member, Lannebo Fonder AB, moderated by Andrew Hobbs, EY EMEA Public Policy Leader

Virtual European Corporate Governance Conference 2021

09 November 2021



Dr. Roger Barker
Director of Policy and
Corporate Governance, Institute
of Directors



Andrew Hobbs
EMEIA Public Policy
Leader, EY



Göran Espelund
Board Member
Lannebo Fonder AB

Join the conversation #ECGC2021

15.00: Panel 1 - Corporate Governance as a tool to embed SUSTAINABILITY

Panelists:

- Elisabeth Gambert, CSR and International Affairs Director, AFEP
- Leena Linnainmaa, Secretary General, Directors' Institute Finland
- John Bendermacher, Chief Audit Executive, Euroclear
- Susanna Arus, EU Public Affairs and Communications Manager at Frank Bold
- Rachael Johnson, Head of Risk Management and Corporate Governance, ACCA

Moderator: Heidi Hautala, Member of the European Parliament

Virtual European Corporate Governance Conference 2021

14:00-17:00 CET, 09 November 2021



Corporate governance as a tool to embed sustainability

Moderator



Heidi Hautala
Member of the
European Parliament



Leena Linnainmaa
Secretary General,
Directors' Institute
Finland



John Bendermacher
Chief Audit Executive,
ECIIA



Susanna Arus
EU Public Affairs
and Communications
Manager at Frank Bold



Rachael Johnson
Head of Risk
Management and
Corporate Governance,
ACCA



Elisabeth Gambert
CSR & International
Affairs Director, AFEP

Join the conversation #ECGC2021

16.00: Panel 2 - Corporate Governance as a tool to foster Competition and Innovation

Panelists:

- **Anne-Hélène Monsellato**, Independent Director
- **Christoph Van der Elst**, Professor of Business Law and Economics at Tilburg and Gent University
- **Evan Epstein**, Executive Director & Adjunct Professor at UC Hastings College of the Law
- **Philippe Lambrecht**, Chair of Business Europe Legal Committee

Moderator: Andrew Hobbs, EY EMEA Public Policy Leader

Virtual European Corporate Governance Conference 2021

14:00-17:00 CET, 09 November 2021



Corporate governance as a tool to foster competition and innovation

Moderator



Andrew Hobbs
EMEIA Public Policy
Leader, EY



Philippe Lambrecht
Chair of BusinessEurope
Legal Affairs Committee



Christoph Van der Elst
Professor of Business Law
and Economics at Tilburg
and Gent University



Anne-Hélène Monsellato
Independent Director



Evan Epstein
Executive Director & Adjunct
Professor at UC Hastings
College of the Law



Join the conversation #ECGC2021

17.00: Wrap-up

Gorazd Podbevšek, Chairman, Slovenian Directors' Association (SDA), and **Andrew Hobbs**, EY EMEA Public Policy Leader