



European
Citizens'
Seminars

The citizens' contribution to
European public policy design
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Answers to the European Commission's Consultation on "EU Corporate Governance framework"

Dear Sirs,

Please find herewith the answers of the "European Citizens' Seminars e.V." association <http://www.citizenseminars.eu> to the consultation that you organise on the "EU corporate governance framework", based upon the (attached) conclusions of our workshop on "Enhancing stakeholder diversity in the Board room".

Our association organised in March 2008 a 3.5 days residential workshop with the idea that this **stakeholder** diversity could be an institutional tool to improve the way how Board of Directors concretely consider their Corporate Social and Environmental Responsibility.

The participants in the workshop were of a group of **11** European professionals. The group members originate from **10** different European Union Member States (Belgium, Denmark, Finland, Hungary, Italy, the Netherlands, Poland, Slovenia, Spain, Sweden). They have an extensive experience in the issues of corporate governance, gained in positions of general management of corporations, in Boards of Directors and in Supervisory Boards, in executive search, in trade unions and as researchers and professors in business schools.

The **main conclusions** of this workshop are the following, arranged as answers to some of the questions of your Green Paper. We have no specific observation on the questions to which we do not answer.

Question 4:

Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?

YES. We believe that the recruitment of **Board members** should explicitly encourage their diversity, and more specifically what we call "**Stakeholder Diversity**".

We believe that diversity in general can promote and bring to the Board the necessary capabilities, creativity, openness and flexibility that today's strategic challenges demand. In fact, we see diversity as a source of diversified values (for identification of issues), of diversified points of views (for analysis), of diversified set of competences (for solutions) and of diversified set of finalities (for evaluation and priorities).

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What we call Stakeholder Diversity, and that we suggest should be implemented, is the following. Members should be recruited to the Board that are the **stewards** of the following **external stakeholders** (List A):

1. the **challenges** the company is facing or most probably will face in the future;
2. the scarce and valuable **resources** the company will need in the future (and specifically its human resources);
3. the **capacities** that the company needs to develop;
4. the **externalities** the company will create, i.e., the effects of its operations on the external stakeholders that should be endorsed as a citizen / responsible corporation

and in general of areas reflecting **new pressures**, demands and expectations of the society such as issues related to the company's operations in emerging countries, inequality, environment, creation and transmission of knowledge, human rights, etc. The main issue is that the entity to which these "stewards" feel **loyal** to, towards which they feel **responsible**, is this "external stakeholder".

One important reason why our association believes Stakeholder Diversity to be important is that this nature of diversity appears experimentally to be one of the **only** means to concretely change the behaviours of Boards in the direction of Corporate Social Responsibility, as illustrated by the Panalba case studied by Prof. J. S. Armstrong of the Wharton Business School in his article called "Social Irresponsibility in Management", *Journal of Business Research*, Vol. 5, Iss. 3, 5th September 1977, pp 185-213 (attached). According to Armstrong, it is only if members of the Board feel responsible towards others than the narrow and short-term interests of the shareholders that they actually change their behaviour towards a greater social and environmental responsibility.

Examples of external stakeholders relevant to firms in various sectors:

- automotive industry: urban mobility experts, oil industry
- chemical industry: main customers, environmental NGOs around the main production sites
- air transport: air safety control engineers
- pharmaceuticals: medical biology research, consumer NGOs
- banks, financial services: financial stability supervision authorities, fiscal services.

In addition, these "stewards" should share characteristics like:

- courage to challenge "one-way thinking";
- open-mindedness (capacity of "multiple way of thinking");
- integrity;
- capacity and purpose to add value to the company and to the stakeholders;
- responsibility towards the company and towards stakeholders;
- engagement;
- accountability.

We do not believe that diversity should be sought primarily in gender or in any form of "identity" feature. On the opposite, those populations that are generally discriminated against tend to over-comply with the dominant thinking (in order to compensate thereby their alleged lack of legitimacy), and, if they are recruited based on quotas, to lose technical credibility. Therefore, their presence could paradoxically tend to reduce the diversity in opinions being expressed in the Board of Directors. (see answer to Q.6 below).

In terms of **implementation**:

- the Commission could publish **advice** and **guidelines** for the nature of external stakeholders relevant for specific sectors, for which it considers would be advisable to recruit stewards in the Board;
- we propose for Boards to **pilot** and make the experience of diversity;
- the dissemination of the experience of Board diversity that is already implemented in the business practice should be promoted by relevant institutions such as Board associations, business associations, academics, etc.
- we do not recommend enhancing diversity by imposing quotas; it is about balance;
- Board accountability for diversity can be attained by requiring the Board to **report** on the implementation of stakeholder diversity in the **annual report** on a "comply or explain" basis.

The annual report of firms could therefore contain the following information, on a "comply or explain" basis:

- the **external stakeholders** (among those categories provided in the List A above) that the firm considers as important for its further long-term development and insertion in the broader society, and the **justification** for having chosen these and not others
- the **individuals** that were proposed in the General Assembly of shareholders for recruitment to the Board as "**stewards**" of these "external stakeholders", with their professional and personal **experience** and the **justification** why they should be the appropriate "stewards" of the "external stakeholders" described.

The association also believes that specific **training** measures should be implemented by firms for the Board members being recruited as the "stewards" of "external stakeholders", in order for their action in the Board to be credible and effective. This training would be **paid for** by the firm, be of a meaningful **duration**, and encompass:

- **legal** issues on the roles and responsibilities of the Board
- basic **accounting**
- the main industrial, technical and commercial issues faced by the firm, including if necessary a few on-site visits.

Considering that this regulation mainly is relevant for large, powerful firms with multinational activities, the level of implementation should be the **European Union** to start with. Indeed, the European Union has the institutions that allow for majority-based, and therefore efficient, decision-making. International level implementation is desirable, but only once it is achieved at European Union scale.

The firms being requested to implement a policy of Stakeholder Diversity in the Board room should be **large listed companies**, i.e. those whose decisions have the greatest potential consequences, and therefore where the procedures ensuring the highest level of corporate responsibility should be implemented. The threshold where "large" firms start remains to be determined, but a minimum would be that all those firms included in the narrow Stock Exchange indexes such as EuroStoxx 50, FTSE 100, CAC 40, DAX 30 be included at a first stage.

Question 5:

Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?

YES. We believe that listed companies should be requested to disclose their diversity policy for the Board, and more specifically their Stakeholder Diversity policy.

Concretely, the public annual report of firms should contain the following information, on a "comply or explain" basis:

- the **external stakeholders** (among those categories provided in the List A above) that the firm considers as important for its further long-term development and insertion in the broader society, and the **justification** for having chosen these and not others
- the **individuals** that were proposed in the General Assembly of shareholders for recruitment to the Board as **stewards** of these external stakeholders, with their professional and personal **experience** and the **justification** why they should be the appropriate stewards of the external stakeholders described
- the **training** being provided to these persons being recruited as "stewards" of "external stakeholders".

The **progress** towards the target of recruiting "stewards" of the relevant "external stakeholders" should also be **disclosed** on a **yearly** basis in the annual report to shareholders, and explanations should be given on: (1) the means used for the recruitment of these stewards of external stakeholder, (2) the reasons why the objectives were not reached and (3) the means proposed for the objectives to be reached in the future.

The firms being requested to implement a policy of stakeholder diversity in the Board room should be **large listed companies**, i.e. those whose decisions have the greatest potential consequences, and therefore where the procedures ensuring the highest level of corporate responsibility should be implemented. The threshold where "large" firms start remains to be determined, but a minimum would be that all those firms included in the narrow Stock Exchange indexes such as EuroStoxx 50, FTSE 100, CAC 40, DAX 30 be included at a first stage.

Question 6:

Should listed companies be required to ensure a better gender balance on boards? If so, how?

NO. We believe that gender diversity (as any form of diversity based on a fixed "identity" such as ethnic origin, sexual orientation, disabilities, etc...) is not the mode of diversity most effective at changing the behaviours and decisions of Boards.

Indeed, those populations that are generally discriminated against to reach positions of power (e.g. women, people of suppressed ethnic / sexual orientation groups, or with disabilities) tend to **over-comply** with the dominant thinking (in order to compensate thereby their alleged lack of legitimacy), and, if they are recruited based on quotas, to lose technical credibility. Therefore, their presence could paradoxically tend to reduce the diversity in opinions being expressed in the Board of Directors.

The observed correlation between higher proportion of women in Boards and better performance of firms should be interpreted with caution as regards the causal relationship between the two phenomena. It may be that a single cultural factor (e.g. higher openness to diverging opinions, greater capacity to support talent irrespective of

"identity" features) be the common cause for both a higher proportion of women in Boards and better corporate performance.

Since the purpose of diversity in the Board room is, in our perspective, to bring in diversified values (for identification of issues), diversified points of views (for analysis), diversified set of competences (for solutions) and diversified set of finalities (for evaluation and priorities), we believe that this diversity stems from the **personal, social and professional experience** of the members: in what environment they grew up, made their studies, worked, and what they **learnt** over their whole life experience - much more than what they "are".

Question 7:

Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?

YES. We believe that a Board should be a real institution, taking real decisions with real and concrete consequences by firms that have a real and concrete activity. Therefore, being a Board member requires professional skills and experience, both from within the firm and from outside, as detailed in our answers to questions 4 to 6 inclusive. Being a Board member also requires **time** to prepare the meeting and the decisions, to consider with a critical eye the options proposed and to build one's opinion.

Therefore, we believe that a long-term objective of the European Union, in order to improve the quality and responsibility of decision-making in Boards of directors, should be to explicitly **limit** the number of mandates that a non-executive director may hold. This upper limit should decrease over time, with a long-term target of no more than **10** (ten) mandates per non-executive director.

This cap placed on the number of mandates may also have the correlated long-term advantage of reducing the number of purely formal entities with no operational reality, and therefore to improve the transparency of the EU economic system.

Question 8:

Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?

YES. Whatever their nature, procedures need to be actually implemented to have any form of reality. This is true of Quality Assurance in industry as it is for governance in public bodies or (in the case of this consultation) for firms. If procedures are merely written down but never implemented, they are at best a figleaf, at worst a tool to claim undeserved innocence when problems arise.

Therefore, the **control** of the actual implementation of good governance procedures should be requested from all listed firms above a given size threshold . This should take the form of a **annual audit** of:

- the **recruitment** procedure of Board members, and specifically of those considered as the "**stewards**" of "external stakeholders", as described below, to ensure that their experience and qualification indeed match the knowledge, courage, independence and conviction necessary to be the steward of these external stakeholders being targeted
- the **training** provided to the Board members being recruited as "stewards" of "external stakeholders"
- the **quality** and **timeliness** of **information** provided to the Board members
- the number and quality of **alternative courses** of action being proposed

- the existence and quality of **justifications** for the action being supported by the management
- the speed and quality of **responses** made by the management to requests for clarification from Board members.

The firms being requested to conduct an external evaluation of Board operations should be **large listed companies**, i.e. those whose decisions have the greatest potential consequences, and therefore where the procedures ensuring the highest level of corporate responsibility should be implemented. The threshold where "large" firms start remains to be determined, but a minimum would be all those firms included in the narrow Stock Exchange indexes such as EuroStoxx 50, FTSE 100, CAC 40, DAX 30 be included at a first stage.

We believe that members should be recruited to the Board that are the "**stewards**" of the following "**external stakeholders**":

1. the **challenges** the company is facing or most probably will face in the future;
2. the scarce and valuable **resources** the company will need in the future (and specifically its human resources);
3. the **capacities** that the company needs to develop;
4. the **externalities** the company will create, i.e., the effects of its operations on the external stakeholders that should be endorsed as a citizen / responsible corporation

and in general of areas reflecting **new pressures**, demands and expectations of the society such as issues related to the company's operations in emerging countries, inequality, environment, creation and transmission of knowledge, human rights, etc.

In addition, they should share characteristics like:

- courage to challenge "one-way thinking";
- open-mindedness (capacity of "multiple way of thinking");
- integrity;
- capacity and purpose to add value to the company and to the stakeholders;
- responsibility towards the company and towards stakeholders;
- engagement;
- accountability.

The audit of the Board procedures should be implemented along classical methods: consultation of randomly selected documents, evaluation and certification by a third-party organisation. This organisation should be distinct from the one performing the audit of the firm's accounts, and should also be prohibited from engaging in consultancy work for the Board or the firm (or its subsidiaries or other related companies).

Question 11:

Do you agree that the board should approve and take responsibility for the company's 'risk appetite' and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?

YES. "Risk" is a narrow view of the broader concept of "external stakeholders" that we believe should be considered with particular care by the Board, and deserve being represented in it by specific "stewards". So indeed we believe that the way these "external stakeholders" are taken care of deserves being reported to the shareholders and to supervisory authorities.

The **external stakeholders** that we believe should be represented in the Board by dedicated **stewards** (as described in answer to Q.4) are the following:

1. the **challenges** the company is facing or most probably will face in the future;
2. the scarce and valuable **resources** the company will need in the future (and specifically its human resources);
3. the **capacities** that the company needs to develop;
4. the **externalities** the company will create, i.e., the effects of its operations on the external stakeholders that should be endorsed as a citizen / responsible corporation

and in general areas reflecting **new pressures**, demands and expectations of the society such as issues related to the company's operations in emerging countries, inequality, environment, creation and transmission of knowledge, human rights, etc.

The way these "external stakeholders" were considered by Board decisions should be the purpose of a specific **public report** made by the Board to the **shareholders** and to the **supervisory authorities**. This report will therefore also include risks, and specifically **societal risks**. This report should be written by the member(s) of the Board designated as the specific "steward(s)" of the "external stakeholder(s)" being considered, except if a compelling reason argues in the opposite direction ("comply or explain" principle).

Question 12:

Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?

YES. "Risk" is a narrow view of the broader concept of "external stakeholders" that we believe should be considered with particular care by the Board, and deserve being represented in it by specific "stewards" (see below). So indeed we believe that an important responsibility of the Board is to ensure that these "external stakeholders" are properly and appropriately being taken care of in the firm's policies and procedures.

The **external stakeholders** that we believe should be represented in the Board by dedicated **stewards** (as described in answer to Q.4) are the following:

1. the **challenges** the company is facing or most probably will face in the future;
2. the scarce and valuable **resources** the company will need in the future (and specifically its human resources);
3. the **capacities** that the company needs to develop;
4. the **externalities** the company will create, i.e., the effects of its operations on the external stakeholders that should be endorsed as a citizen / responsible corporation

and in general areas reflecting **new pressures**, demands and expectations of the society such as issues related to the company's operations in emerging countries, inequality, environment, creation and transmission of knowledge, human rights, etc.

Question 24:

Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?

YES. We believe that the very credibility of the "comply or explain" principle is at stake here. If the "explain" alternative is reduced to writing a few meaningless sentences with

no further questions asked, then the pressure to "comply" is reduced to nothing, and the very substance of the regulation is lost.

Question 25:

Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?

YES. We believe that the very credibility of the "comply or explain" principle is at stake here. If no external force is exerted to give a cost to the "explain" alternative, then the pressure to "comply" is reduced to nothing, and the very substance of the regulation is lost.

In order to reinforce the value and concrete meaning of corporate governance codes, the decision concerning the validity of the explanations given for non-compliance should reside in the supervision bodies only. As a deterrent inciting firms to actually comply with the regulation, the regulatory body should impose an *a priori*, heavy, fine for non-compliance and a mandatory mention of this fine in the firm's annual report to shareholders. It is only if the firm actually convinces independent judges of the validity of their explanation that the fine and the penalty would be reverted - as would be the case in any normal jurisdiction after an appeal.