Chapter 1
What is the Sustainable Company?

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1. The rise of shareholder value

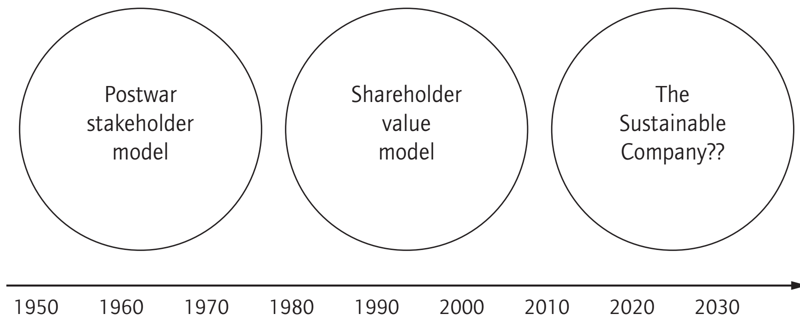
Stakeholder theory has long recognized that the company is a social organization dependent upon the contribution of different groups to the production of goods and services (Freeman and Reed 1983; Freeman 1984; Hutton 1995). Employees provide their skills and knowledge, suppliers provide raw materials, intermediate goods and machinery, and investors provide capital in the form of equity or loans. The community plays a key role in providing infrastructure, education and social services such as childcare and health care. All of these stakeholder groups are needed for the firm to function properly, and all in turn are dependent upon firms for their jobs, goods and services, tax revenues, etc.

Although there has always been a tension between the profit-making motives of owners and the interests of stakeholders, after World War II many countries (particularly continental European countries) found mechanisms for including other interests in the governance of the firm (Jackson 2001; Streeck and Yamamura 2001). In the case of labour, collective bargaining was extended and deepened universally. In many countries works councils and board level employee representation were introduced or strengthened, mainly in waves in the immediate postwar years and again in the 1970s (Rogers and Streeck 1995; HBS and ETUI 2004). In the 1990s many central and eastern European countries also introduced these institutions (SDA and ETUI 2005).

This stakeholder approach to the firm has been severely threatened in recent years by the so-called 'shareholder value' model of the firm (see Figure 1). The intellectual foundations for this approach were provided primarily by the 'law and economics' school of thought, which conceptualizes social relations as a set of contractual obligations and mechanisms to resolve conflicts and reduce uncertainty (Jensen and Meckling 1976; Lazonick and O'Sullivan 2000). In the case of corporate

governance, relations between the providers of different ‘factors of production’ are seen as hierarchical, with shareholders taking the place of undisputed ‘top dog’ in this hierarchy. The argument made to justify this special position is that shareholders are the original founders of the firm and have used their capital to hire employees and managers and to buy equipment and raw materials. As a result of this special position, shareholders are ‘residual claimants’ to the firm, i.e. after the claims of other factors of production are satisfied shareholders get the rest. Although shareholders may end up with empty pockets if the firm goes bankrupt, it also can mean unlimited profits when the firm does well.

Figure 1 **History of models of corporate governance in Europe**



The law and economics school has downplayed the tension that this approach creates between the interests of shareholders and stakeholders by claiming that the value of the firm – at least when the firm is large and listed on the stock market – correctly reflects the extent to which companies treat these stakeholders well. It is argued that the vast amount of information (public and private) which is available to millions of investors is filtered into the stock market and that share price correctly reflects the long-term prospects of the firm. As a result, the optimal corporate governance solution is to orient the operation of the firm towards share price as the best measure of company value (Rappaport 1986).

This approach has been highly successful in providing the intellectual underpinnings for much of the change in corporate governance regulation that has taken place around the world, both at the national and international level, for the past two decades. Part of the reason for this success is that the policy implications of this approach have been

compatible with the interests of a number of powerful groups, including governments trying to reduce their role in managing the economy (e.g. through privatization) and banks wanting to increase revenues from capital market-related activities. The shareholder value system of corporate governance has three key elements:

1. A *competitive market for equity capital* is needed in order to correctly reflect the value of the firm through share price and to allow for the replacement of management and restructuring of the firm through shareholder activities (e.g. through hostile takeovers or shareholder activism). This implies a whole set of practices and institutions, from a competitive market for asset managers (with capital flowing to 'better' managers) to the ability to buy and sell shares quickly with limited impact on share price (liquid markets) to 'minority shareholder rights' such as 'one share-one vote', which allow institutional investors with relatively small equity stakes to play a major role in company governance.

2. *Managers' interests are aligned with shareholder interests* through the heavy use of share-based compensation in executive remuneration packages. Stock options have been particularly important here, since they expire worthless if share price is not above a certain level (the 'strike price') by the end of a specified period of time, but have unlimited profit potential if share price goes up. Share-based compensation has a very direct and significant impact on the incentives and behaviour of top managers.

3. *A set of gatekeepers* are needed to keep the system 'honest'. This includes: auditors (who are supposed to certify that companies are properly reporting their financial position); rating agencies (who are supposed to help investors keep an eye on developments that might change their expected returns); securities markets regulators (who are supposed to make sure that markets are 'fair', e.g. by enforcing insider trading and market abuse regulations); and independent directors (who are supposed to monitor the behaviour of executive directors and companies from the boardroom).

One of the reasons why the shareholder value paradigm achieved hegemony is that it provides a simple but coherent framework for addressing a wide variety of policy areas (company law, securities law, financial regulation) which at the same time has been 'in tune' with the

general trend of neo-liberalism. This helps explain why this paradigm has been so successful, despite (or rather, perhaps because of) the lack of empirical evidence backing up its claims.

2. Why shareholder value doesn't work

Now that the shareholder value model has had a decade or more to function in many countries, the empirical evidence is starting to accumulate on how well the theory has worked in practice. The short answer is: not very well. This is the case for many reasons, some which are theoretical flaws in the paradigm, others which are more practical in nature. A list of these reasons includes the following:

— *Share price is only weakly correlated with company performance.* A glance at the stock chart of almost any large listed company over the past decade will illustrate this very clearly: a peak a the beginning of 2000, followed by a dramatic fall to early 2003, followed by an increase up through 2008, an almost-vertical fall to early 2009, and a partial recovery up to now. The share price of many companies is below what it was ten years ago. Does this mean that they are performing worse than a decade earlier? In most cases not: rather, the share price of individual companies is highly correlated with the general movement of the stock market. This in turn reflects the mass psychology of investors, which follows cycles from panic to euphoria and back. Especially for large companies which grow only incrementally, in the 'sideways' stock market of the past decade, share price is an extremely blunt instrument indeed for measuring improvements in company performance.

— *Share price does not reflect many social and environmental costs.* Economists use the term 'externalities' to describe the costs of actions which are borne by others than the acting person or organization. A classic example of this is pollution: a company may make profits from environmentally harmful production because the costs of this pollution are carried by society as a whole rather than by its owners. In practice there is a whole set of activities which companies may find profitable (at least in the short-term), which however come at the expense of society or the environment. Since share price reflects the financial situation and prospects of the individual firm, it will not reflect the costs of these externalities. It

is therefore a poor measure of the welfare of other stakeholders in the firm.

— *Most institutional investors are short-term and passive.* According to the theory of shareholder value, share price will reflect the long-term prospects of companies. Shareholders will look to the long-term and will exercise 'voice' in accordance with these interests. This will work most efficiently with widely-held companies, since investors with superior (public or private) information can buy or sell shares until stock price is in line with these expectations. However, the reality is that the average holding period of stocks by institutional investors has fallen to below one year. Even pension funds, which in principal have the greatest interest in and ability to invest long-term, mostly hire outside investment managers; these are generally evaluated on a yearly basis and thus have a strong financial incentive to maximize short-term results. Furthermore, most institutional investors have portfolios of stock in hundreds or even thousands of companies. As such they have little or no capacity to actively intervene in the governance of the companies they are invested in. In short, financial markets are dominated by short-term passive investment strategies.

— *Share-based incentive schemes create massive incentives for fraud.* The potential for huge gains that stock option plans represent for top managers creates great incentives for increasing share price through fraud. Enron, WorldCom, Tyco and Global Crossing are only the most spectacular examples showing how this incentive can work and how true performance can be hidden for long periods of time. Stock options are therefore no miracle cure for aligning the interests of managers and shareholders, but rather create a new instrument through which managers can exploit the company and its stakeholders.

— *Gatekeepers have conflicting interests and/or limited capacity to monitor.* In theory gatekeepers should keep companies and investors honest. In practice many gatekeepers cannot or do not want to do this. The role of rating agencies, which made money from giving good ratings to junk products, is well known. However, current reforms still leave rating agencies dependent upon the financial information supplied by companies. Many regulators are understaffed or do not have the tools needed for proper

> enforcement of rules. And the expectation of shareholder value theory is that independent directors have almost superhuman qualities, i.e. have the experience, skills and time needed to watch over top management and corporations with operations around the world, in some cases employing hundreds of thousands of workers. In short, gatekeepers do not and cannot play the role that shareholder value theory assigns to them.

Recently, doubts about the efficacy of the shareholder value system have arisen, even among the 'law and economics' crowd. The argument that problems have resulted because shareholder value was only partly implemented has become less convincing, especially since the Sarbanes-Oxley Act was supposed to be the most fundamental overhaul of corporate governance in the US since the 1930s. The growing interest in Corporate Social Responsibility (CSR) is also a reflection of the recognition that shareholder value does not address social and environmental needs. However, although doubts are surfacing, in most cases the policy reforms suggested amount to a 'patching up' of the system rather than a paradigm shift.

3. Why we need an alternative to shareholder value

Quite simply, the lack of progress – and even steps backward in many areas – on the road to a sustainable world makes it clear that a new approach is needed to corporate governance. This deplorable state of affairs has been dramatized by a number of recent developments such as the financial crisis and new reports on global warming. We are currently facing a 'triple crisis' including the economic crisis, climate change and a trend towards greater inequality in income and life chances in many countries.

The financial crisis. One development which has dramatized the need for radical change in corporate governance is the recent financial crisis. The crisis was triggered by the failure of the US investment bank Lehman Brothers, but has its roots in the spread of the shareholder value paradigm and the rise of unregulated high-risk financial investors and products. Defenders of the shareholder value approach to corporate governance claim that a combination of transparency in company reporting and stock market-oriented incentives for top managers should lead to long-term value creation. However, recent experience has shown

that many banks accepted too much long-term risk for the sake of short-term gains and that rating agencies failed to adequately warn the markets about these practices.

One of the most widespread of these practices was the granting of mortgages in the US to families without the financial capacity to pay back these mortgages in the long term. Near-zero downpayment policies, the waiving of repayment for the first years of the mortgage and variable interest rates granted in a period of historically low rates lured millions of families into a financial trap out of which they had little hope to emerge from. In the short run, however, banks originating these high-risk mortgages were able to increase their revenues and share price, and many of their top managers profited handsomely. However, short-termism was not limited to the mortgage market and could be seen in many other credit markets, such as credit cards, auto finance and leasing, mergers and acquisitions (frequently involving private equity funds) and leverage for hedge funds. Although in many cases banks hedged their risks through the purchase of credit insurance, the sellers of this insurance were frequently other financial institutions whose own solvency was threatened in during the financial crisis.

The extent of this crisis has made clear the need for a deep and multifaceted reform of the way we regulate our financial system. Part of the solution is to bring unregulated portions of the financial system, such as hedge funds and credit derivatives markets, under the regulatory umbrella. Another part of the solution will be to align the incentives of banks and their top managers towards long-term sustainable policies (see Chapters 7 and 12 in this book for solutions on remuneration policy and financial reform, respectively).

Climate change. Recently, the lack of progress on environmental goals has been dramatically demonstrated, in particular through the reports released in 2007 by working groups within the United Nations Intergovernmental Panel on Climate Change. These reports showed that, over the past century, global temperatures have increased, that northern hemisphere snow cover has significantly decreased, and that the sea level has significantly increased. These trends have accelerated in the recent past. These changes are linked to a massive increase in the emission of greenhouse gases, e.g. an increase of 70 percent annually between 1970 and 2004. Particularly shocking in the reports were different scenarios for the future, including a ‘worst case’ scenario whereby global

temperatures would increase an average of 4 degrees centigrade by 2100. Consequences of this worst case scenario include not only climate effects, like more frequent coastal flooding and storms in some areas and intensification of drought conditions in others, but also social consequences, such as increased migration and risk of spreading of water- and food-based diseases.

The dramatic messages in these reports regarding climate change have been confirmed by other important reports by governmental agencies or commissions. The first and second progress reports on the European Union Sustainable Development Strategy and the accompanying statistical reports from Eurostat, published in 2007 and 2009, clearly showed unfavourable developments on two key sustainability indicators: targets for climate change (i.e. greenhouse gas emissions) and increased use of renewable energy sources have not been met (Eurostat 2007; Eurostat 2009). Part of the solution will be to require our companies to provide comprehensive reports on their environmental and social impact. Another part of the solution will be to reshape our markets so that environmental and social costs are more accurately reflected in prices, e.g. through a carbon tax or more developed emissions trading scheme (see Chapter 13 for a discussion of these alternatives).

Social inequality. A third problem which is receiving more and more attention in the media and public perception is the increasing degree of inequality in income and life chances in Europe. According to one study, between the mid-1980s and mid-2000s there was an increase in market income inequality between households in every EU country examined except France and the Netherlands (Franzini 2011). According to the 2009 Monitoring Report on Sustainable Development in the EU the ratio of income of the top 20% of households in the EU-27 was five times that of the bottom 20% of households by income (Eurostat 2009: 204). In 2007 one in six households in the EU-25 was at risk of poverty (Eurostat 2009: 200) and this figure may very well have increased due to the economic crisis (ETUI 2011).

Most dramatic is the explosion in the remuneration of top managers in large European companies over the past decade. In many European companies the total pay of the top manager (CEO) now exceeds the pay of the average worker by more than 100 times. As detailed in the contribution to this book by Rainald Thannisch, between 1987 and 2005 the average remuneration of executive managers in the largest 30

German listed companies increased by 445 percent. Even in the crisis year of 2009 the CEOs of these companies earned on average about 3.7 million Euros, not including pensions. CEO remuneration in comparable companies is even higher in other countries (e.g. the UK). According to the Forbes billionaire list, the top hedge fund managers have done even better, with the estimated wealth of one manager growing an astounding USD 4 billion in 2010.[1]

Responsibility of the company sector. A large proportion of the responsibility for this triple crisis lies with our company sector. Solving this triple crisis will thus require a major change in company behaviour:

— Companies account for the bulk of global warming and pollution, including the spread of dangerous chemicals. Therefore, a new approach to environmental policy clearly needs to include a reorientation of company behaviour in this area.

— Companies also account for the vast bulk of employment and labour income, in addition to providing on-the-job training and skills development. Concerns about the quality and quantity of jobs created, the ability to combine family and work concerns and increasing income inequality also point to the need for a change in companies' employment policies.

— Company policies on debt levels, dividend levels and remuneration (including top executive pay) influence the financial stability of the corporate sector and the ability to invest in R&D for innovation for the future. In Europe spending on R&D is far behind the '3 percent of GDP' goal originally set in the Lisbon strategy.

— The behaviour of other sectors (household and government) is also greatly influenced by the types of goods and services supplied by the company sector.

The lack of progress in solving these problems, and the fact that time is running out on the issue of climate change, clearly illustrate the need for a new approach to corporate governance.

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1. For a list of top paid hedge fund managers see: http://www.insidermonkey.com/blog/2011/03/14/highest-paid-hedge-fund-managers-in-2010/.

4. What are the key elements of the Sustainable Company?

In contrast with the shareholder value model of the firm, the Sustainable Company[2] has the following six key elements (see Figure 2):

— A multi-dimensional concept of *sustainability and stakeholder value* is the central guiding principle of the Sustainable Company.

— In accordance with this guiding principle the Sustainable Company has a *set of sustainability goals and a detailed strategy* for achieving these goals.

— *Stakeholders, in particular employees, are involved in decision making* in the Sustainable Company. This can occur through a number of mechanisms, including board level employee representation (BLER), European Works Councils (EWCs), collective bargaining and stakeholder advisory boards at companies.

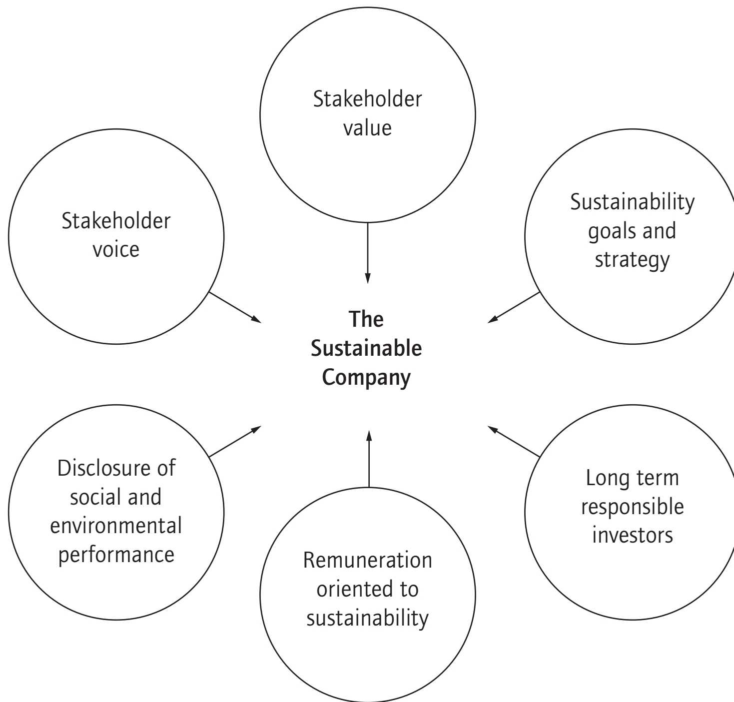
— The Sustainable Company has an *externally verifiable reporting system* on both financial and nonfinancial (environmental, social, etc.) performance which allows for measuring progress on the achievement of sustainability goals.

— Incentives within the Sustainable Company are designed to support sustainability. A central role is played here by *tying a portion of executive remuneration the achievement of sustainability goals*.

— The ownership base of the company is dominated by *long-term responsible investors* concerned not only with financial return but also with the social and environmental impacts of their investments.

2. The term 'Sustainable Company' was used in a book by Chris Laszlo published in 2003 (Laszlo 2003). However, as will be shown in chapter 1 and elsewhere in this volume, our concept of the Sustainable Company differs significantly from his in that we stress the need for formal mechanisms of worker involvement and a binding legal framework for sustainability.

Figure 2 **Elements of the Sustainable Company**



Sustainability as the central guiding principle

In many non-Anglo-Saxon countries, company law emphasizes the responsibility of companies to a plurality of stakeholders: not only shareholders, but employees, debtors, and others dependent upon the company as well. This was part of the understanding of the responsibilities of the traditional stakeholder firm. Since the early 1990s, however, the concept of shareholder value as the central guiding principle for companies has spread beyond the Anglo-Saxon countries to continental Europe and Asia. Company law in many countries has been changed in a way which weakens this commitment by companies to a broader range of stakeholders.

The concept of sustainability, which involves generating value for stakeholders instead of just shareholders, is an alternative orienting

principle for the company. This principle builds on the older concept of the company as a community of interests and connects it with newer concerns with the interests of society and the environment as a whole.

Company sustainability goals and strategy

In order to realize the guiding principle of sustainability a concrete set of sustainability goals and a strategy for attaining these goals need to be formulated and agreed with stakeholders in the company.

Although a growing proportion of larger listed companies now have strategies for reducing greenhouse gas emissions (CDP and PriceWaterhouseCoopers 2010), strategies also need to be adopted by these companies on a greater range of sustainability issues (e.g. skills development). Furthermore, a broader set of companies (including small and medium size enterprises) need to adopt such strategies.

Stakeholder involvement

Employees are arguably the most central stakeholder in the company. One good criterion for identifying the centrality of different stakeholders is the degree to which their livelihoods are tied to the fortunes of the company.[3] In the case of large publicly-traded corporations, employees are clearly much more dependent upon the well-being of the company than portfolio investors, who generally only hold small fractions of a large number of companies to diversify risk.

Up to now, however, employee involvement in company sustainability policies has remained far below its potential. In principle the following channels are available for greater worker involvement in sustainability issues in the company:

— *Board level employee representation (BLER):* an increasing number of companies are developing sustainability strategies, and these strategies are typically discussed at the board level. One way of involving employees in these discussions is therefore

3. Thanks to Pierre Habbard from TUAC-OECD for pointing this out to me.

representation on the company board. A majority of the 28 European countries surveyed by the SEEurope Network (EU-27 plus Norway) have legal provisions for BLER (18 of the 28 countries, 12 of these including public as well as private companies above a certain threshold) (see here in particular Chapters 3 and 5 in this volume).

— *European Works Councils (EWCs):* these can be founded at large companies (over 1000 employees) with substantial operations in at least two of the member states. Currently over 900 of these are in operation. These include employee representatives from the member states in which companies have significant operations. A recent survey of management showed that CSR/sustainability issues were discussed in almost two thirds of EWCs (Jagodzinski et al. 2008: 45). This channel could be upgraded to provide stronger worker voice on sustainability issues.

— *Collective bargaining:* trade unions are negotiating agreements on sustainability issues with an increasing number of companies. International framework agreements, of which there are more than 70, have been particularly prominent in this development (see Chapter 9 on this issue). However, sustainability issues are also increasingly negotiated at the national and local level.

— *Stakeholder boards:* a few companies have founded formal stakeholder boards including representatives of different interest groups in the company. If these boards are given substantial rights, e.g. the right to comment on and criticize sustainability reporting and strategies, this could be a mechanism to increase labour voice on sustainability issues in the firm, particularly in companies without BLER.

Sustainability reporting systems

Another key element of the Sustainable Company is a well-functioning sustainability reporting system. These systems have undergone intensive development over the past decade, and vary widely in content and process. However, a consensus on ‘best practice’ in sustainability reporting systems is emerging with regard to a number of characteristics:

1. *Multidimensional sustainability definition and indicators*. One criterion for best practice is a broad definition of sustainability and the inclusion of indicators covering the different relevant areas of the Sustainable Company. Current best practice is defined by the Global Reporting Initiative (GRI), which is a multi-stakeholder non-profit organization founded to create comprehensive standards for sustainability reporting. Trade union representatives are included in the governing bodies of GRI and in the development of reporting standards. The latest comprehensive revision of the standards was completed in October 2006, resulting in the issuance of the third generation (G3) of GRI standards. Indicators are defined and operationalized for the areas 'economic', 'environmental', and 'social', with the latter being further broken down by the subcategories of 'labour practices and decent work', 'human rights', 'society' and 'product responsibility'.

2. *External verification/assurance*. It is increasingly being recognized that the credibility of sustainability reporting systems depends on the verification of the quantitative and qualitative data they produce through external agents, e.g. through a formalized audit process. Sustainability reporting should not be just 'box ticking' and limited to formal policies. However, it is important that these auditors have the skills and capacity to properly audit environmental and social impacts. Depending on the area, it may also be important to include trade unions in the monitoring process, e.g. in supply chains.

3. *Universal and standardized reporting:* It is important that 'best practice' in reporting not be limited to a small number of companies; all companies should report on sustainability and these reports should be easily accessible (though exceptions should be made in some areas for very small companies). Reporting should also be standardized so that results are comparable over time and across companies.

Aligning company incentives with sustainability goals

A key element of the shareholder value approach which has been brought into the discussion on corporate governance reform is the aligning of management interests with the interests of shareholders through the redesign of management remuneration systems. In particular, stock

options and other stock-related incentives (e.g. virtual stock options, grant of stock under the achievement of particular conditions, incentives for the relative performance of a company's stock against a benchmark index) have been increasingly used in order to achieve this goal. The growing power of short-term oriented investors in conjunction with the relatively short realization periods of many stock-related forms of management compensation have raised the question of the extent to which these practices really lead to long-term value creation. Furthermore, the granting of significant stock-related remuneration creates a great incentive for top managers to misreport company finances in order to boost share prices (e.g. the wave of company scandals around the year 2000) or to corrupt the integrity of company board practices (e.g. the option back-dating scandal).

One possible corrective to this tendency is to tie a portion of management pay to the achievement of sustainability goals, such as the reduction of workplace accidents or the reduction of pollution. When a portion of managements' variable pay is directly linked to sustainability indicators, this helps ensures that management will pay greater attention to the realization of company sustainability goals, and that the need to review management performance in the context of the pay review process will also focus the company board's attention on these goals. Although examples of such explicit tying of variable pay to these goals are still relatively rare, they do exist in a number of companies, and generally have been reported to have achieved good results. Some of the more interesting examples found in a survey of the SEEurope network in 2008 included the following companies TNT, Royal Dutch Shell, and DSM.[4]

As detailed in Chapter 7, Germany recently took a big step forward with the approval of a new law regulating executive management remuneration. One of the requirements is that remuneration be tied to the long-term sustainability of the company. Examples of German companies with innovative applications of the new law include the following:

— *Volkswagen* (VW) has completely done away with stock options. This has been replaced by a long-term bonus for executive directors based on the achievement of specific goals, two of which include improving the satisfaction of employees and also of customers.

4. Thanks to Robbert van het Kaar and Lionel Fulton for help in identifying these examples. On the SEEurope network see: www.worker-participation.eu/European-Company/SEEurope-network.

— *RWE*, Germany's second largest energy concern, has also introduced a long-term bonus for executive directors, based on a number of components including the achievement of environmental goals, employee satisfaction and customer loyalty.

Long-term responsible investors

One of the main pillars of the traditional stakeholder model of capitalism is (along with worker voice) 'patient' capital, which traditionally was provided by large, long-term owners such as families, the state and (in countries such as Germany) banks. In recent decades, however, the magnitude of patient capital from these sources has been decreasing:

— Some families are pulling out of ownership of companies, in part since post-founder generations may have little interest in running the family company.

— Governments in many countries have been actively pursuing privatization programs, either for ideological reasons (rise of liberal ideologies/political parties) or due to pressure on public budgets. In France, for example, roughly half of the top 40 (CAC) publicly-listed companies were wholly or partially privatized in the past two decades.

— Large banks in some countries, such as Germany and Japan, were also long-term shareholders in companies. In part this happened involuntarily, as companies became bankrupt and frozen credits were converted to equity. Many of these banks have been selling their shareholdings (Höpner and Krempel 2004).

An important supportive element for the Sustainable Company, however, is that capital markets should not penalize – and in the ideal case even reward – companies which transparently and systematically implement sustainability policies. In particular equity markets are most central, since shareholders (as owners) most directly influence company policies. The section below on 'sustainability-friendly capital markets' discusses some solutions for increasing the number and weight of long-term responsible investors (see also Habbard 2011, van den Burg 2011 and Vitols 2011).

5. The way forward to the sustainable company: a supportive framework

In extending the Sustainable Company from a few isolated cases of partial implementation of a few elements to a broad-based full implementation, a number of key changes need to take place. This section discusses these changes, including the following:

— The need for binding legislation creating a supporting framework for the Sustainable Company

— Transforming capital markets from short-term financially-oriented to long-term sustainability-oriented investment orientations

— An extended role for trade unions, including expanded expert capacities on sustainability and on working with other stakeholders (e.g. NGOs)

The need for binding legislation

A key issue in the development of the Sustainable Company is the degree to which a binding legislative framework is necessary. On the one hand, the argument that the government cannot simply legislate sustainability has some merit. On the other hand, the argument made by a portion of the sustainability community that sustainability is in the (enlightened) self-interest of companies, and thus can for the most part be supported by voluntary initiatives, is not plausible. The question therefore is where binding legislation is necessary and desirable to support the proliferation of the Sustainable Company. These measures include:

— A clear statement in company law that the primary purpose and responsibility of the company is not only to the shareholders to increase shareholder value, but that the company is a social entity obligated to pay attention to the interests of and increase the welfare of a broad range of stakeholder groups. Such an understanding is already embedded in the company law of a number of countries, but is not universal (most notably lacking in the Anglo-American countries).

- A legislative mandate on companies to extend their reporting beyond financial matters to include the whole range of sustainability indicators. Such a mandate already exists in a few countries, but generally only extends to a few indicators (e.g. employment levels or environmental impact). This mandate should be tied to some generally-recognized standard which significantly includes trade unions in the development of indicators, such as the GRI (Global Reporting Initiative), and to a standard which includes stakeholders (including workers) in the development and implementation of this reporting system.

- In countries where permissible topics of negotiation in collective bargaining or workers participation are spelled out in detail in law, this catalogue of bargaining issues should be clearly extended to include sustainability issues. For example, in countries with two-tier board systems, a catalogue of mandatory items to be discussed and approved by the supervisory board (including sustainability goals and strategies) should be embedded in law.

Sustainability-friendly capital markets

On the one hand it is reported that sustainability is increasingly important as an investment theme on capital markets. This is a positive sign that more and more investors are concerned with where their money is ultimately going, and may be willing to sacrifice some of their financial return in the interests of 'doing good'. For example:

- There has been a continual increase in the proportion of assets under control of institutional investors that use one or more sustainability-related criteria for determining their investments. One estimate for the US is that such institutional investors now account for about one-tenth of assets under management. Such funds are readily available to the retail investor.[5]

- The sophistication of sustainability rating agencies has increased significantly. A number of these agencies have developed detailed methodologies for rating which are comparable across companies

5. See for example the websites http://www.socialfunds.com/ or http://www.ethibel.org/pdf/Forum%20ETHIBEL%20labels%20ENG.pdf

and can be administered on a relatively economical basis. Leading sustainability raters in Europe include vigeo and Sustainable Asset Management (SAM).

— An increasing number of financial investors are signing up to initiatives such as the Principles for Responsible Investment (a UN initiative to commit institutional investors to considering ESG criteria in their investment decisions) and the Equator Principles (social and environmental principles especially relevant for bank lending in the context of project financing).

On the other hand many or even most of these funds may be using a rather limited number of criteria (e.g. no investment in companies that manufacture tobacco, alcohol or weapons), and only might screen out the 'worst offenders'. The positive incentives (in terms of easier access to capital) for adoption of sustainable company policies may thus be rather weak. At the same time, it is reported that the total amount of assets under control of investors which pursue short-term strategies is also continually rising. An examination of the turnover of shares of large companies (e.g. the German DAX 30) shows that the average holding period for shares of large publicly-traded companies has fallen to significantly less than one year. For many of these companies, shares may even be turned over a number of times per year on average. These investors base their decisions on buying and selling shares on quite short-term financial considerations, and have no interest in the long-term future of the company.

Furthermore, some of these short-term investors (such as the 'activist' hedge funds) actively use their power to try to force management to pursue policies that may not be in the company's long-run interests (e.g. increasing share dividends, share buy-backs, some mergers). Although these activist investors may hold relatively small equity stakes (sometimes even less than 5 percent, the 'standard' definition of a significant shareholding), they can nevertheless have significant influence. The voting power of a five percent stake may be multiplied through the fact that many or even most other shareholders don't vote on their shares, or through the 'borrowing' of voting rights from other shareholders. In addition, management may feel blackmailed by the willingness of activist shareholders to wage public relations campaigns against them, and thus may cave in to their demands, even if there is no clear majority of shareholders in favour of the policy.

A list of measures that could help create a more sustainability-friendly capital market environment for companies includes the following (see also Chapter 12 in this volume):

— Mandatory reporting requirements for institutional investors (including hedge funds and private equity funds) on the companies they invest in and the extent to which these companies have sustainability policies. (Reporting requirements should also be extended to the corporate governance of institutional investors, such as management remuneration, etc.).

— Constraints on short-term behaviour of investors, such as differentiated voting rights, dividend policies, and taxation rates for investors based on their length of investment (e.g. dividends only after a one year holding period, or double dividends for at least a one year holding period, and so forth).

— Encouraging more 'patient' capital, such as employee shareholding, and ensuring that employee shareholders have a voice in corporate governance (e.g. in France, where employee shareholders can elect a representative to the board when they hold at least 3 percent of shares) (see Chapter 6 on this issue).

— Strengthening the weight of various sustainability elements, such as workers' rights, in the major socially responsible investment indexes.

Extending the role of trade unions

Important dimensions of sustainability, such as employment conditions and occupational health and safety, have long been core issues for trade unions. Other dimensions, such as the finances of the firm, have also been longstanding concerns of works councils and employee board level representatives. Nevertheless, many elements of the multi-dimensional concept of sustainability stretch beyond the traditional core concerns of trade unions. In this respect the Sustainable Company represents a challenge to current trade union capacities to take positions on these issues and to advise trade union and/or works council representatives on a decentralized level. Taking an active role in the Sustainable Company would thus require trade unions to build up their expertise in new areas,

either through further training and education for their officials and members, or through hiring experts or consultants for advice on specific issues. The negotiation of framework agreements on sustainability also represents an extension of trade union capacities to a new area, and will certainly involve an accumulation of learning experiences.

A recent example where trade unions are stepping into this new role is the case of Umicore, an international materials-technology group with headquarters in Belgium.[6] In September 2007 the company signed a wide-ranging Sustainable Development Agreement with the International Metalworkers' Federation and the International Federation of Chemical, Energy, Mine and General Workers' Unions. This agreement contains a commitment of company management to a coherent economic, social and environmental strategy. The agreement is the start of a process of including trade unions in the formulation, implementation and monitoring of the sustainability strategy. Chapters 8 and 10 detail other cases where trade unions have introduced innovations here, including creating alliances with NGOs and other actors.

6. Conclusion

Just as Rome was not built in a day, new corporate governance paradigms are not implemented overnight. The rise of shareholder value took many decades, starting from the US and spreading from country to country. The diffusion of the model can be explained by both its conceptual simplicity as well as the overlap of its policy recommendations with the practical interests of powerful actors. The realization of the Sustainable Company will also depend upon conceptual work (i.e. the elaboration of its framework and policy prescriptions) as well as publicity work to diffuse the concept among potential supportive actors. This book is intended to contribute to this process.

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6. Thanks to Luc Triangle for providing me with information on this example.

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