Introduction: a stakeholder perspective on the long-term investment debate

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Since the onset of the Great Financial Crisis (GFC) in 2007/8 a widespread and intensive debate has emerged regarding the existence of a serious lack of long-term investment around the world. This debate is significant for a number of reasons. Most profoundly, it raises the question of whether or not there is a fundamental mismatch between the incentives and behaviour of financial investors and companies on the one hand and the needs of society on the other. A positive answer to this question implies the need for fundamental reform across a range of institutions which influence the way economic resources are saved, distributed and invested. Secondly, it addresses the issue of responsibility for the GFC. Although much has been already written and said on this, it is important to emphasise the structural causes of the crisis, above and beyond blaming greedy bankers, corrupt politicians and weak regulators. Although widespread individual malfeasance clearly played a crucial role, showing that there is a structural bias towards 'short-term' speculative trading over long-term investment would reinforce the argument for fundamental reform. Thirdly, it is an opportunity to pose the question of what the fundamental needs of our society and economy are, and in doing so supporting the emerging view that we must do much more to promote sustainability, including massively increasing long-term investment in environmentally- and socially-friendly products, processes and infrastructure. And finally, it is a chance to contrast the 'stakeholder' approach to economic organization and regulation with its main competitor, the neo-liberal paradigm.

The debate on whether or not there is a lack of long-term investment in our economies is not a new one, nor is institutional reform aimed at promoting it.[1] In particular the Anglo-Saxon 'liberal' market economies have experienced a number of waves of soul-searching about whether or not their financial institutions and companies are making sufficient

1. On this see the contribution by Jackson and Petraki (2011) to the first Sustainable Company volume.

amounts of the kinds of investment needed to achieve economic competitiveness. For example, in the UK there has been a longstanding critical comparison of its own economy with countries like Germany and France whose industrial performance has not only 'caught up' but also overtaken. The financial institutions of the City of London have received a large share of the blame for an alleged neglect of long-term investment in British industry, a criticism shared by the Macmillan Committee set up by the British government to investigate the causes of the 1929 stock market crash and ensuing depression. This criticism led to the establishment of Industrial and Commercial Finance Corporation (ICFC) in 1945 by the Bank of England and the major British banks, which was supposed to provide long-term capital to companies, in particular to small and medium-sized companies lacking access to the stock market.[2]

In the US, the Great Depression led to a widespread belief that its market economy was characterised by a lack of demand and excessively speculative financial markets, a belief which underlay the creation of institutions such as the Federal National Mortgage Association (Fannie Mae) during the New Deal. The fear that the US economy would fall back into depression with the termination of the World War II-related demand stimulus as well as the feeling that 'command' economies like the Soviet Union did not have an investment problem led to the maintaining and in part expansion of these programs in the 1950s and 1960s (Freeman 2000). In the 1980s and 1990s a number of initiatives were established to investigate the causes of lagging industrial competitiveness relative to countries such as Germany and Japan. The most prominent of these was the Council on Competitiveness, a group of executives, academics and trade union officials which commissioned research by 25 academics. The research effort was led by the business school guru Michael Porter and summarised in the article 'Capital Disadvantage: America's Failing Capital Investment System' (Porter 1992).

Thus although this debate is not new, what is different since the GFC is how widespread the debate has become and with what intensity it has been conducted, both on national and international levels. On the national level, the most widely noted of the numerous official efforts to investigate the causes of the financial crisis was the Kay Review of Equity Markets and Long-term Decision Making (for a detailed analysis of this

2. The ICFC was subsequently renamed 3i (Investors in Industry) and floated on the stock market. It is currently one of the largest private equity groups in the world.

see the chapter by Williamson in this volume). This investigation has received widespread attention outside of the UK because of the quality of its analysis and policy recommendations. On the international level numerous publications by organizations such as the OECD have also looked at the problem of short-term (including speculative) tendencies in financial markets in conjunction with the issue of the need for long-term investments in environment, infrastructure, housing and education (see the chapter by Habbard in this volume). On the European level the problem of short-termism is also being intensively discussed, with the European Commission arguing that:

> The economic and financial crisis has affected the ability of the financial sector to channel funds to the real economy, in particular to long-term investment... The ability of the financial system to channel funds to long-term investments will be essential in securing Europe's position on a sustainable growth path (European Commission 2014:1).

Activities initiated by the Commission include consultations on the general problem of long-term financing of the European economy and on the need for a Capital Markets Union in Europe.[3] In the area of corporate governance the main policy measure for promoting long-term investment advanced by the European Commission is the Proposed Directive revising the Shareholder Rights Directive (see the chapter by Johnston and Morrow in this volume for an analysis).

From a stakeholder point of view, while many of these official investigations have done a good job of identifying the root causes of short-termism, the policy recommendations and proposed measures have generally fallen short of what would be needed to fundamentally alter the behaviour of financial investors and companies. As Williamson points out, although the Kay Review provides an excellent analysis of underlying problems, the recommendations made for the most part are based on a voluntarist approach rather than advocating the passage of 'hard law' measures. Furthermore, policy recommendations focus on investors and companies, to the exclusion of stakeholders such as employees who could also play a significant role in promoting long-term investment.

3. For documentation of these activities see the Commission website on long-term financing: http://ec.europa.eu/finance/general-policy/financing-growth/long-term/index_en.htm#maincontentSec5

Given that the presence of an adequate amount of long-term investors and investment is a key component of the Sustainable Company, the GOODCORP network of academic and trade union experts on corporate governance and company law decided to dedicate a third volume in the Sustainable Company book series to this specific topic. As discussed in the introduction to the first Sustainable Company volume (Vitols and Kluge 2011) and elaborated in the second book (Vitols and Heuschmid 2012), the GOODCORP network is dedicated to promoting a stakeholder approach to key issues in corporate governance and company law. Following the same methodology used for the first two volumes, members of the network working on this specific issue were invited to provide contributions to this volume; their proposals were discussed at meetings of the network. In a couple of cases new members working on the issue were invited to join the group and contribute.

Based on this work, as well as on some of the contributions to the previous volumes (in particular Jackson and Petraki 2011), a number of key principles for a stakeholder approach to the long-term investment debate have been developed:

1. **The promotion of long-term investment is more than a question of investment time horizons, as sustainability is also crucial.** Although this point may seem obvious to some, it is important to emphasise this since it is necessary to do more than encourage a lengthening of the duration of investments. For example, one official definition of 'long-term investment' is investments with maturities of at least five years (by the Financial Stability Board) (FSB 2013: 2). From a stakeholder perspective, holding the shares of a company which does not respect basic labour and human rights for over five years would be viewed quite critically. Thus although short-term investments by their nature are generally 'speculative', the long-term investment debate needs to focus as much on the types of investments made and whether or not they fulfil societal needs as on the issue of time horizons itself.

2. **As there is no 'silver bullet' which will encourage long-term investment, a package of policy measures is needed.** The official inquiries have for the most part identified multiple causes for 'short-termism', so almost by definition they must proscribe a set of measures rather than a single solution. One of the most wide-reaching academic analysis of the problem to date (Jackson

and Petraki 2011) is quite sobering insofar as it identifies short-termism as a deeply-embedded set of mutually-reinforcing behaviours and expectations on the part of a multiplicity of actors – not only on the part of investors and companies, but also of 'gatekeepers' such as auditing firms and rating agencies. This analysis suggests that the incentives and behaviour of all key actors must be changed to break out of the trap of short-termism. Having said this, financial transactions taxes (FTT) would arguably be the single most effective measure to deter much speculative short-term behaviour by financial investors with a 'trading' mentality (see the chapter by Botsch in this volume on this issue).

3. **Stakeholders should be empowered to help promote long-term sustainable investment.** The official inquiries at the most pay lip service to the involvement of actors other than investors, companies and regulators. However, stakeholders generally have a greater interest in promoting the long-term sustainability of companies than investors and managers. In particular workers have a stake in the future of the company they work for and in the sustainability of their working conditions and of the products and services they produce. Through their daily activities they are also uniquely qualified to identify problems and possible solutions within the production process and organization. Companies with stronger worker involvement on average are more sustainable than those without worker participation (ETUI/ETUC 2014: 110). Thus a key measure to promoting long-term sustainable investment is the strengthening of worker involvement in the company (see Kowalsky chapter in this volume), for example through board level employee representation and European Works Councils. These workers also need to be properly informed and consulted on sustainability issues (see the chapter by Cremers here). NGOs can also play a key role, for example in monitoring company performance and compliance with environmental standards, supply chain organization, etc.

4. **Policy measures need to address more than publicly-traded equity investments.** At the European level in particular much of the discussion is focused on publicly-traded companies and their securities. This is in part because internationalised stock markets more clearly fall under the European Commission's authorization to propose regulatory measures for issues that have a

strong cross-border dimension. However, privately-owned (for the most part small and medium-sized) companies account for the bulk of employment and economic activity, and thus also should be addressed by policy measures. Furthermore, much cross-border investment is accounted for by intra-firm investment in subsidiaries, joint ventures, etc. in other countries (see Mückenberger chapter in this book). The debate on and policy measures for long-term sustainable investment thus also need to cover non-listed and intra-firm investments.

5. **Pension funds can play a leading role in promoting long-term sustainable investment.** It is one of the strongest indicators of the failures of our current system that many pension funds, which in principle administer one of the most long-term sources of capital (workers' retirement savings), invest a large proportion of their funds in a short-term manner. Most pension funds delegate the management their funds to investment intermediaries which typically have a high 'churn rate' (i.e. they buy and sell their securities frequently) and invest in short-term oriented investors such as many classes of hedge funds. The fact that pension funds own a significant proportion of equity capital and have worker representatives on their boards mean that they have a particularly large potential for long-term sustainable investment. The role that pension funds could play are discussed in particular in the chapters by Klec and Mum, Habbard and van den Burg in this volume.

The GOODCORP group has thus outlined an ambitious agenda for the promotion of long-term sustainable investment which goes far beyond what is currently proposed by the European Commission, the OECD and other international organizations. As discussed in the concluding chapter to this volume, this type of investment is one of the key components of the Sustainable Company. This agenda thus complements many of the other policy measures that have been proposed in the previous two volumes in this series, such as worker participation and sustainability/non-financial reporting by companies.

The following briefly summarises the individual contributions to this volume. In Chapter 1 Andrew Johnston and Paige Morrow analyse the justification for and features of the Proposed EU Directive on Shareholder Rights, which has been the major policy proposal by the European Commission aimed at addressing short-termism in European financial markets. Although the Proposed Directive does contain some positive features, for the most part it takes a rather narrow approach to the issue. Johnston and Morrow thus argue that a much broader agenda 'beyond shareholder empowerment' is needed to promote long-term sustainable investment. In the next chapter Janet Williamson provides a detailed analysis of the influential UK-based Kay Review of Equity Markets and Long-term Decision Making as well as the British Trades Union Congress' response to this. Williamson is for the most part supportive of the Review's analysis of the problems with the short-term orientation of British companies and investors. However, the policy recommendations coming out of the Review are based too much on a voluntarist approach and fall short of trade union demands for binding regulation. Although the UK is arguably the most extreme case of short-termism in the world today, the Review has clear relevance outside of the UK because of the similarity of structural problems in many other countries. Chapter 3 by Andreas Botsch reviews the rationale for and current state of play of proposals for financial transaction taxes (FTT) at the European level. Although FTT would only add up to a very small fraction of the total transaction value, they could have a major impact in discouraging short-term trading strategies by reducing the profits that can be derived from such speculative investment approaches. As such, it could be a very effective measure in extending the time horizons of financial investors.

The next two chapters focus on the potential role of pension funds in promoting long-term sustainable investment. Pierre Habbard in Chapter 4 identifies the 'lengthening of the investment chain' as one of the primary causes of short-termism in the financial system, as the final investors are frequently a number of steps removed from the ultimate owner, the workers. This problem must be addressed if workers are to exercise effective voice in corporate governance. Finally, the great potential for investment in environmentally-friendly infrastructure and technologies is discussed. In the next chapter, Klec and Mum review the literature on the potential for strengthening worker voice through pension fund activism as well as the current state of trade union activism through pension funds throughout the world. In their conclusion they draw up a balanced picture of the current problems with as well as the future potential for closing the gap between factual ownership and actual control of workers' capital.

The following three chapters address topics which are outside the scope of the narrow debate on short-termism, but which can be seen as key areas for action in terms of a broader stakeholder approach to long-term sustainable investment. Jan Cremers in Chapter 6 summarises the results of a study done by the ETUI's SEEurope Network on the state of worker involvement in sustainability reporting throughout Europe. Strong rights to information on aspects of sustainability such as workplace conditions and environmental performance are needed so that workers can be an 'adequately informed' stakeholder. Although there are some interesting national, sectoral and company-based examples of strong information rights and practices, generally worker rights in Europe fall short of what would be needed for adequate information. In Chapter 7 Ulrich Mückenberger addresses the issue of the potential of international investment agreements (IIA's) to promote long-term sustainable investment. Although previous IIA's have focused on the rights of investors in 'host' countries, a newer trend is the inclusion of social and environmental obligations on these investors. Through new competencies defined through the Treaty on the Functioning of the European Union, the EU has an increased potential for encouraging sustainable investment through negotiating IIA's with strong sustainability requirements with other countries. In the following chapter Wolfgang Kowalsky outlines the current tools available for employee involvement in supporting Sustainable Companies. Although some tools are available, such as European Works Councils and board level employee representation in SEs (European Companies), the current state of legislation in the EU is not adequate for supporting the level of worker involvement needed. The ETUC has thus taken a historic step forward in demanding board level employee representation in European companies and is formulating further demands for minimum standards for employee involvement.

Chapter 9 is based on a presentation made by Ieke van den Burg at the 2011 meeting of the Transatlantic Social Dialogue, which is organised annually by the European Trade Union Institute, the Worker Institute at Cornell University and the Hans Böckler Foundation. In this presentation she outlined what she called her 'ten plus one commandments' for action regarding the nexus between pension funds, corporate governance and social responsibility. These commandments were based on her many years of experience as a trade unionist, member of the European Parliament, member of company boards and a pension fund board of trustees as well as other initiatives. They provide an excellent summary of the challenges as well as the need for specific actions to more effectively exercise worker voice in corporate governance. The final chapter summarises the results to date of the Sustainable Company project as well as the 'road ahead' in terms of further activities to realise the Sustainable Company.

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