June 2010

ÖVFA Publication Series

Corporate Responsibility 2.0

From Corporate Responsibility to "General Responsibility"

The time is ripe for economic change - right now!
We all have to take comprehensive responsibility on a sustainable basis. New concepts for the economy

- 44 specific approaches to ensure improvement
- The magnitude of the crisis requires large-scale, bold measures as well as cuts and understanding
- The capital economy should not be called into question; the system has to be reformed but not over-regulated

Responsibility and crisis - measures and ideas to avoid financial, economic, and confidence crises in the future

ÖVFA
Oesterreichische Vereinigung für Finanzanalyse und Asset Management

About ÖVFA (Österreichischen Vereinigung für Finanzanalyse und Asset Management; Austrian Association for Financial Analysis and Asset Management)

Since it was founded in 1972, the objective of the Austrian Association for Financial Analysis and Asset Management has been to promote the flow of information between listed companies and investors, to provide analysts, fund managers and other investors with a platform for sharing their experiences, to better acquaint domestic and foreign investors with Austria's role as a financial centre and to represent the interests of its members to the public at large and within the scope of economic policy initiatives aimed at fostering Austria's financial market. In the complex field of asset management, which presents great opportunities but at the same time numerous risks, it is essential that the decision-making process be made as efficient and transparent as possible.

Disclaimer
The purpose of this publication is to be thought-provoking and a contribution to the ongoing debate.

Editorial information
Published and edited by (Publisher):
Austrian Association for Financial Analysis and
Asset Management (ÖVFA)
Esslinggasse 17/5, A-1010 Vienna

The author is aware of the fact that some statements may entail extraordinary or even unconventional measures. But the unprecedented financial, economic, confidence, and ultimately, debt crisis can only be overcome by extraordinary measures. Given the current situation, the fact that the existing system obviously has loopholes and does not work efficiently enough should be generally accepted knowledge that does not need to be discussed any further. Therefore only brave steps will help avoid such a deep crisis in the future and facilitate reforms. It will be necessary to take a different approach on many levels, and past behavioural patterns may sometimes have to be jettisoned. It is time to put many aspects under scrutiny. The goal of this publication series is to contribute to this new approach in a focused manner.

The statements in the discussion are not aimed at any one person or institution in particular. Instead, they are meant to support the discussion whilst focusing on the issues at hand. They are not supposed to defend the status quo, but to facilitate progress and thus serve the common good. This means they are geared towards an improvement that the world can certainly do with at the moment.

Maybe this discussion can also be construed as an exercise in "out of the box thinking". That said, we should all bear in mind the near-Armageddon scenario with its climax in February and March 2009 that would have almost caused a global collapse. And the crisis has not been fully overcome yet, as we can still see today. Therefore we need new solutions in order to be able to deal with future challenges in a more efficient way.

The German version shall be binding.

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Introduction

Based on the 1st **ÖVFA Publication on Corporate Responsibility** of **November 2004** (please refer to www.ovfa.at, www.dvfa.de, www.effas.com, or www.sustainablefinancialmarkets.net for a copy), this publication discusses the issue of how to deal with the global financial, confidence, economic, and – ultimately – debt crisis. The crisis originated in a lack of general responsibility, but in particular also in a lack of corporate responsibility, among other things; otherwise the horrendous mistakes and their drastic real consequences would not have happened. Eventually this shortcoming did not only cause enormous write-offs for directly or indirectly involved companies and financial institutions, but – much worse – it also destroyed all mutual confidence in the actions of participants of the economic and financial markets.

Business interaction and a correct way of treating one's business partner are ultimately based on trust and credibility. And exactly this trust was severely damaged. No proper controls were in place when 1) loans were granted for the US housing market, 2) structured (sophisticated?) products that defied understanding were constructed and successfully exported on a global scale on the basis of said loans, and 3) these products were promoted around the world with the help of high premiums and, basically, greed. In view of the drastic decrease in prices this also came with enormous repercussions in the real economy. These repercussions are now parked in government debt, which still necessitates substantial liquidity injections and increases in the money supply by the central banks and states.

It is precisely in these phases that cases of fraud emerge (cue Bernard Madoff), and already (known to be) high government debt rises further at a dramatic rate and is even cyclically exacerbated because of the not exactly cautious and tactically intelligent way the rating agencies handle such situations. – A vicious circle that causes the supposedly solid walls of an economic system tried and tested by time to tumble like a house of cards. And this house of cards often collapses in full, revealing the cunning ways the truth was being veiled, or pointing to the fact that nobody was paying attention due to its lack of importance. Thus the spearhead that is the loss of trust further advances towards the open flank of the financial markets and the government debt.

The fact that the principle of communist planned economy has failed and offers no feasible alternative for economic progress in spite of the forced nationalisations these days (that do in fact bring communism to mind) should be generally accepted knowledge that does not need to be discussed any further. But at the same time, the short-term approach with a time horizon of a quarter, i.e. the concept of shareholder value in its purest form, and the approach of the free neo-liberalism, i.e. the laissez-fair idea of leaving basically everything up to the market forces, have also failed miserably, as the latest financial, economic, confidence, and debt crisis would suggest. Shareholder value should represent a simple result, or a clear number, but is not supposed to replace a strategy. The fact that the crisis eventually made its way to government debt with full force and has now been parked there should make us think long and hard and keep us busy for a longer term.

The deeper a financial, economic, and confidence crisis reaches, the more the chances, opportunities, and ideas it may bring along. Many people worldwide have now come to the conclusion that we cannot continue living and conducting business the way we have been doing it in the past decades. This fact will stick around for a while because of the government debt crisis – a crisis that seems to be in deadlock for now. Government debt cannot be simply paid off in a few months. It will probably take at least three to five years for us to be able to see a clearer picture in the wake of unavoidable, far-reaching measures. Many managers, presidents, members of parliament, and politicians who carry responsibility and have to handle it wisely have recently displayed a return to an already rare behavioural pattern: humility and understanding. – A feature or insight that had been completely lost in years of boom. In said years of boom it is mainly burnouts that, resulting from too fast and furious a development, may lead to a re-evaluation.

This 2nd ÖVFA publication on (Corporate) Responsibility is not only meant to analyse how the biggest crisis since the last global economic crisis in the 1930s came about, but it is also supposed to actively contribute to pointing out mistakes clearly and remove deficits. Under the umbrella term "Corporate Responsibility 2.0", the title "Corporate Responsibility" therefore has to morph into "general comprehensive responsibility", which in every respect has to be implemented on the basis of the three aspects of ESG (Environmental, Social, Governance).

Fritz Mostböck

General comments on the implementation of the responsibility approach

Responsibility has to be understood and lived neutrally from every perspective

Responsibility should not be misinterpreted as:

- **Communist approach**
- **Religion**
- **Pseudo-moral approach**
- **"Green" concept**
- **Marketing gag (with high-gloss responsibility reports)**
- **Know-it-all approach**

-> Responsibility is an approach that should limit itself to historical facts and that should distil answers to past and current mistakes from these facts in order to avoid said mistakes in the future. Responsibility should be regarded as comprehensive approach and should not reflect any specific political spin but instead focus on goals that improve the status quo for all in economic, ecological, and social terms.

The crisis, which undoubtedly footed in the American sub-prime segment, triggers of course numerous questions and calls for extensive regulation and governmental control of the financial system. Some of the unresolved issues result from the complex mass of mistakes and misunderstandings. Therefore the following statements and recommendations require thorough thought as well as scrutiny in order to ensure an efficient, feasible, and sustainable development of the system and to avoid another collapse. The following concept is not exhaustive, nor does it claim to be right. It can be seen as a basis from which development can originate.

In the following we will suggest concepts and ideas, and maybe some day actions will follow.

A. General governmental measures that can help overcome the crisis

1. Global integration comes with advantages but also with disadvantages

Global integration ensures improved communication, but also contains higher risks

In contrast to the global economic crisis in 1929, the current degree of global integration comes with the upside that it permits a globally concerted approach to problem-solving, which in turn can help fight the "fire" from a coordinated, guided perspective. This is a clear advantage. On the other hand, the crisis was triggered by the globalised financial system in the first place. Never before had the infection spread that quickly due to the globally integrated financial system, and the aftermath in the (also, real) economy will be a lingering one. The jury is therefore out on whether it really makes sense for global companies such as financial institutions and investment banks, caught in their efforts to act globally (and some of them badly hit by the crisis), to trade structured products that often defy full comprehension at such breathtaking volumes per second on a global scale. This is the real nucleus that set off the events that almost led to the collapse of the system, as we now know. Global integration is therefore beneficial for the exchange of information and for spot transactions (government and corporate bonds, shares, foreign exchange), but in view of the longing for an ever-rising clout on the market (assets under management, turnover etc) and influence (continentally and globally) the potential default risk associated with the volumes was not taken into account anymore, nor was it under control. There is no management on earth that could weigh and control the risks involved in such a huge agglomeration of data that is a global financial institution (universal or investment banks as well as insurance companies). On the other hand, it is part of the human condition that individuals would want to do that after all, given the supranational reputation and the resulting remuneration that come with it.

In a nutshell: it does make sense for excellently managed and economically sound regional and national banks to exist. Of course risk is allocated on a vast number of market participants ("free competition") in a more efficient way than if global risk were to be allocated to a small number of globally operating banks and insurance companies (oligopoly). The principle of free competition has to remain untouched, but the further (exclusive) globalisation of the financial markets and financial institutions will not yield any sustainable solution. Global companies find it increasingly difficult to portray themselves as global and yet following a credibly responsible strategy. There are too many implausible alternatives with regard to the sense of responsibility around, manifesting themselves not the least as measures within the context of the entire group of companies, shifting production and services horizontally and vertically as well as internationally within the group on the basis of various parameters (wages, taxes, legal framework, human rights, environmental regulation etc).

2. Higher capital requirements for banks

Higher equity capital solves the problem only temporarily; it will be important to diversify

We would generally welcome a higher equity ratio for all companies, not only for banks. It would be difficult to find a suitable percentage, and "one size" will certainly not fit all. Equity ratios would have to be sector-specific, and they are currently set by the market. A potential regulation is an honourable cause, but would not solve the actual problem. One has to bear in mind that the crisis had grown from a financial crisis to a confidence crisis, then to an economic crisis, and has now morphed into a debt crisis. Therefore it is important to unemotionally analyse the reasons for the crisis, distil the learning points from it, and proceed to possible solutions at the root of the problem. In this respect (i.e. when it comes to (too) cheap money), it will be crucial to basically just reduce and regulate 1) the lighthearted and completely excessive granting of credit, 2) the bundling of so-called bulk risk into structured products, and 3) the trading in such products. The reason for the crisis was not a low equity ratio, but the dimensions of the turnover in "super-innovative" products, which had become excessive in relation to the equity ratio. Should such innovative transactions in structured products ever be in demand again for that sort of risk, higher capital requirements should become effective for the specific financial institutions engaging in such trading. This means that the regulator would have to follow a differentiating approach otherwise a new financial system would yet again be reduced to absurdity. Basically we believe that any high-volume trading in structured products of any sort in the future could not be dealt with on the basis of higher capital requirements either, if the traded volume were in disproportion to the balance sheet total, the relatively safe core business (credits or deposits), equity capital, holdings in government bonds etc. Higher capital requirements therefore make sense for companies that wish to assume higher levels of risk (investment banks), whereas the regulator would have to differentiate when it comes to less volatile core business (e.g. retail banks). Lumping both together and imposing the same requirements on both would mean the approach has failed.

3. Separation of investment banking from commercial and retail banking

Universal banks are less volatile

The separation of investment banking from the rest of the banking business would not be able to fight any future crises effectively either. Of course, pooling all the investment banking activities in one specific unit would lead to a better overview and probably facilitate the auditing process for the bank supervision (provided comprehensive auditing rights are granted). However, the best risk management will not prevent a collapse from happening. From a diversification point of view, the integration into the normal banking business – as it was handled in many cases anyway – is probably the most efficient solution. One also has to bear in mind the risk and return "osmosis" that is possible within the universal banking system. Basically a balanced and well-documented portfolio of banking and financing transactions should always prove more sustainable and resistant, no matter what phase the market may be in.

4. Stepped-up taxes for banks

Financial institutions fulfil a financing function – as the name would also suggest

Banks should not and cannot grant loans lightheartedly, without any standards in place; such is the nature of their business. They work with debt, i.e. depositors' money entrusted to them. This means they have to scrutinise the companies to which they grant loans from a risk and return perspective. Ultimately, a bank has to be able to work efficiently for the benefit of all its stakeholders; at the opposite end, they would have to freely give away the liquid funds entrusted to them, and this would certainly contradict the goal of stability in an economy. A new bank tax coming in the form of a standard duty would be easily introduced, but could not exactly be called innovative. As a consequence of competition and of costing procedures in place, the entire idea could (but would not necessarily have to) result in higher bank fees. This is therefore no pragmatic or sustainable solution of the problem. On top of that, this would punish the (good) banks that can afford to pay taxes. Other, badly managed and partially nationalised ones could not even afford a general banking tax. In the end, the taxpayer would pay for himself.

5. Taxation of financial trading transactions only as last resort; tenths of a per cent on financial instruments traded

Only as last resort, and only in a differentiated way

The taxation of financial trading transactions of course tends to get brought up during a financial crisis. We strongly advise against a simple, standardised tax on all financial instruments. This would indirectly throttle growth and progress that hinges on financing through capital markets. Should no other adequate way be found to reduce the meanwhile worrisome level of government debt, a financial transaction tax might make sense as a last resort. But all that only if taxes were introduced globally in a concerted manner. Financial transaction taxes, limited to specific countries, would result in clear disadvantages of location for said countries. However, traded spot products such as government and corporate bonds, shares, and currencies) would have to be exempt, given that they fulfil an essential financing function in the economy for financing projects and strengthening both equity and debt structure in the corporate sector. Other products whose trading purpose is not directly geared towards financing or hedging (selected derivatives, structured products etc) should be taxed if they are only used for speculation purposes (as tends to be frequently the case). This is yet another area where it will be important to differentiate. Such tax revenues, should they be deemed necessary, could contribute to the reduction of debt and on the other hand allow the public sector to ramp up spending and thus stimulate growth or compensate other envisaged mass tax revenues.

6. Supervision

Complexity requires global supervision

For decades, large banks (“too big to fail“) were operating successfully on a global scale – prior to the crisis, that is; during that time the supervisory authorities existed only on a national level (and they still do). The global network of financial markets, which cannot be easily undone, therefore also requires global supervision. The complex and heterogeneous organisation of national supervisory bodies, which on top of everything is based on a multitude of legal codes, comes with clear disadvantages. A consequence of the crisis should therefore be the creation of a supranational, superordinate supervisory authority with a focus on the specific requirements of global supervision and the ability to tackle issues that present themselves.

7. Supervision and bonus/malus systems

Malus payments would sometimes have exacerbating effects

Supervision should be handled from a neutral point of view. If financial institutions have to contribute to the financing of the supervision, conflicts of interest cannot be ruled out. Bonus/malus systems (mainly for companies) as the ones sometimes cropping up on the agenda may come across as “fair” to the public, but they would probably be counterproductive in different phases of the economic cycle. In difficult times (such as the current crisis) where the financial institutions are burdened by a global impact on the markets, the additional obligation to meet malus payments would be counterproductive and would intensify the cycle. In the opposite case, bonus payments of whatever sort would also fuel the cycle in a boom phase. It would therefore be crucial to find a correct and efficient way of using bonus/malus systems in order to rule out a pro-cyclical effect.

8. Rating agencies

Conflicts of interest and pro-cyclical actions need to be ruled out

Rating agencies were playing a dubious part at the outset of the financial crisis. We know for a fact that all ordinary rating agencies across the board failed the system during the credit crunch. And we all remember numerous AAA or at least good ratings of structured products right up to the financial crisis, the downgradings (or the taking into consideration thereof) of CEE countries at the climax of the crisis in February and March 2009, as well as the eventual downgrading of Greece in the thick of the turbulences etc. Such behaviour tends to have a pro-cyclical and counterproductive effect, act as counter indicators, offer little value added at hindsight, and actually just convey the image of someone pulling the ripcord. A rating agency as "for-profit" organisation will have a hard time coming across credibly or independently anyway as long as it awards ratings against money. It would be an unconventional idea to create not-for-profit agencies for the largest economic areas. In bold terms, they could be financed though government financing, by small percentages (tenths of per cents) of traded asset classes (government bonds, corporate bonds etc), or by parts of transaction taxes levied on financial instruments in a differentiating way (see above – not our favourite). A simple example: the EU and the IMF raised EUR 110bn within a short period of time to bail out Greece. How much can a rating agency cost? Realistically and ambitiously, EUR 500mn to EUR 1bn, provided such an agency would start with 2,000 to 3,000 employees in Europe. In the case of EUR 500mn, such an agency could be financed by the Greek bailout package for more than 200 years. This is actually a manageable amount in comparison, which would also be used in favour of the capital markets (company and country ratings). An independent rating agency along those lines should be related to the central bank, and it would make sense for international organisations (IMF etc) to hold a share in the organisation. Commercial banks should now, after the partially necessary nationalisations, be released into their "natural habitat" again for reasons of fair competition. Rating agencies should be managed equally independently, and they should not be quoted on the capital market on the grounds of profit maximisation. The latter goal contradicts the idea of independent ratings. Only independent rating agencies awarding ratings without monetary compensation will credibly come across as independent. This would be particularly important for the re-establishment of confidence as well as beneficial for various economies, the corporate sector, and functioning capital markets.

9. Financial products

Comprehensible and transparent

Financial products and the way they are traded or offered to the public should be as transparent as possible. As soon as clients (institutional or retail) or even advisors fail to comprehend them, the selling and trading process will not be much more credible or transparent either. Therefore the most sophisticated financial products have to be designed in a comprehensible and transparent way for the specific target group (usually by written documentation or consent to be acting at one's own risk) in order to ensure extensive controls (risk management) and a safe and liquid transaction. With many products, this was not the case especially during the crisis. On top of that, the greed of some market participants such as clients was sometimes so enormous that they failed to spot the risks. This situation should generally be avoided. Rating agencies that were prepared to go along with this development with their ratings should be held accountable, and their structure should be modified (see section 8 above). One solution could be for more complex products to be clearly identified by the supervisory authority and to be classified and certified according to various aspects of risk.

10. Transparent allocation of fees beneficial to efficient capital markets

Avoidance of one-off effects

Sometimes financial markets cannot even work efficiently enough from a technical point of view, because they are based on principles that hinge on traditional trade practice. The fees charged by various financial institutions are a case in point, more specifically, the load (e.g. on funds). The load is a fee that is charged at issue (or selling). The internal sales departments of financial institutions have to pass on the load when for example a fund is issued, and of course they have sales targets which spur their zealousness to sell as much as possible (as only the selling transaction counts). This situation could be improved by splitting the load 50:50 between buying and selling transactions. This would not only increase the level of transparency on the capital markets, but it would also come with the side effect of advisors regarding both buying and selling as equal. This would further the neutrality with regard to the handling of the transactions on the financial institutions' and advisors' side, and it would also promote a more active management of client portfolios in different phases of the market and countersteer extreme boom phases. In simpler terms, there are not only incentives to buy shares in a fund, but also to sell them. Similar thoughts (beneficial to the capital or financial market) in connection with the improved fee allocation should apply to all financial products (including derivates)

11. Financial Reporting

Smooth volatilities, promote sustainable development

The reporting of quarterly figures is an appreciated practice that contributes to transparency throughout the business year. However, an excessive focus on, and capital market guidance taken from, the quarterly figures (EPS guidance) can generate a lopsided and dangerous effect, because it cannot ensure a sustainable angle on the development of the quoted company; let alone the internal stock option programmes that are geared to the quarterly results. The reporting of quarterly figures often triggers an increase in share price volatilities because investors take profits; or the publication causes irritation, especially if investors and analysts misinterpret non-recurring items or seasonalities, or under/overvalue details. The strong focus and obedience to more frequent reporting can therefore also come with disadvantages and this is not necessarily supportive to an efficient and functioning capital market and the sustainable development of a company. Needless to say, short-term traders will tell you differently. Often companies are almost forced by investors to react quickly to quarterly results. As a result, managers and investors have to take unwanted, hasty steps and take decisions that are in line with these short-term requirements. There are investment bank units that pay out bonuses on a quarterly basis. It comes as no surprise that this focus on quarterly results causes volatility to rise on the markets; it is also not conducive to a smoothing of trading volumes. For example, Porsche – while certainly not the top dog in this context – shows that companies do not have to rely on quarterly reporting and that in the long run this strategy does not harm the building of company value. An excessive focus on quarterly results (benchmarks, stock option programmes, bonuses etc) should be avoided at all costs so as not to amplify cyclical swings.

12. Integrated reporting

Differentiated access to capital with regard to quality created by improved transparency

A new, comprehensively expanded form of annual reporting taking into account extra-financial factors (ESG = environmental, social, governance Issues) will also be essential in dealing with the crisis. In the competition for access to the international capital markets it will become necessary to fulfil a comprehensive set of requirements and standards. This also means that e.g. any large company, no matter from what continent, will only be granted efficient access to the international capital markets (and investors) if it reports extensive and transparent information. Only then will it be possible for said company to attain a good international investor structure and to achieve a "better and more sustainable quality" in the allocation of capital. This way seems already sketched out in view of numerous global initiatives. It is mainly international organisations that would launch initiatives; for example, the one by the United Nations / Global Compact (www.unglobalcompact.org), the publication of the book "One Report" (R. Eccles / M. Krzus, USA 2010), www.accountingforsustainability.com, EFFAS (The European Federation of Financial Analysts Societies, www.effas.com) etc. It will be necessary to provide detailed information on the foot prints of companies and countries (emissions of all sorts, e.g. energy consumption, mobility, forest, water etc), but also to dwell on other aspects such as supply chain and corruption. To summarise: the access to high-quality capital has to be achieved in a more differentiated and transparent fashion, and it has to be hard earned.

13. Due lending process as necessary engine of the financial system

More control and transparency required

Lending by financial institutions has to be based on the creditworthiness of companies and private clients. The principle of a prudent businessman has to be applied. Lax lending practices that are only geared to generating volumes have to be kept at bay. Especially if an asset is debt-financed, it should not be eligible as collateral for further credit, or only in very limited cases. As we know, the crisis was triggered by the sub-prime market, among other things. The lax lending gave way to a domino effect, which was exported by global trading into the financial markets as a result of the packaging of bulk risk into structured products. In the end, the decline in US property prices led to a scenario where the low-rate loans could not be serviced by rising property prices anymore (as had been the plan). And the domino effect from re-mortgaging collateral that had already been financed by debt and the global trading in these structured products were dealing the final blow to the house of cards (or bubble). The question remains how such a trivial game could have gone unnoticed and amid general silent consent, and even guided by the supervisory authorities and the rating agencies. Interestingly, Alan Greenspan, the predecessor of the chairman of the Federal Reserve, Ben Bernanke, stopped giving advice to his successor in public around that time. It was quite obvious that he stepped out of the limelight in autumn 2007.

In a nutshell: one has to analyse economic situations on the basis of their context, and avoid such enormous problems and potential trouble spots from the start. Before mulling over relatively unoriginal and unified bank taxes or increased capital requirements, one may want to tackle the regulatory framework of countries first where lending is based on lax (or inadequate) standards. And most certainly, bulk risks should not be bundled and traded at such volumes. Any future supervisory body will also have to deal with this aspect. Supervisory authorities should carefully check whether any risks associated with the underlying instrument hinge on highly frequented one-way streets (e.g. property prices). But it is still a fact that credit financing is a must in the real economy in order to ensure further growth and prosperity. Credit crunches can also be produced by overregulation. In either case, the future credit policies will have to take their lead from economic feasibilities and the businessman principle. This will also require global state-of-the-art processes and auditing procedures. It makes sense to implement a credit policy that has one standardised process of valuation and awarding the credit. The economic feasibility, price policies, and ultimate pricing should be left to the free market. An approach that is basically standardised with regard to the procedure but differentiates with regard to the leeway for decision-making should be supportive to the stability and sustainable well-being of the overall industrial and financial system, especially when the bulk risks are taken into account.

14. The government and the financial institutions and listed companies have to remain separate

The government cannot ensure an efficient and credible system of financing on the basis of economic aspects in the long run

Companies and financial institutions can only be managed efficiently if the government does not hold any stakes in them and thus politics have no influence. The crisis may have illustrated that not all companies are indeed managed well (especially those companies that are considered "too big to fail"), but the political influence of the government on companies is counterproductive (see for example the aviation industry), and positions are not necessarily filled according to objective standards. This behaviour does not boost efficiency in the processes and procedures of companies, and managers are relegated to the role of henchmen, depending on the strength of characters in the political arena. This may increase employment (regardless of what party benefits from it), but it is not efficient. Given that the shareholder value approach in its purest form ended up in excessive behaviour and caused more economic damage than progress, we have to focus our attention on a comprehensive stakeholder approach. Only functioning capital markets and re-emerging confidence in these markets can be beneficial and create sustainable welfare and public wealth on the basis of uncompromising stakeholder orientation.

In summing up we would like to point out that full (i.e. 100%) privatisation and the listing of 100% of the equity capital does not necessarily create maximum added value either. From an economic point of view, and in order to fend off hostile takeovers – which have indeed destroyed economic net worth in the past – a minority stake held by the government, a foundation, or a strategic partner may in fact make sense for some companies (e.g. for the maintenance of regional infrastructure or energy production/distribution). Only this approach hinging on an expanded stakeholder principle can contribute to a more stable and sustainable development on the basis of a well-balanced ownership structure and lead to the adequate allocation of shareholder rights and corporate strategy.

15. Clearing of mutual long-term government debt

Could ensure a radical yet effective new start, if feasible

We have somewhat overcome the subprime, financial, and real economic crisis because the financial burden of these crises have basically just turned into enormous debt for many countries. Both new debt and aggregate debt have reached a distressing magnitude. It is obvious that some countries are facing particular challenges with regard to their financial and budgetary policies. However, this is not limited to Greece or Europe. It would be the easy way out. Even the rating agencies will not be able to make us accept this as a fact, regardless of their trivial gamesmanship.

Mass taxes at a standardised, undifferentiating rate are not very innovative but populist and easy to impose (such as banking taxes and financial transaction taxes), but the government should steer clear of those steps, as it should of slightly less popular measures (tax hikes for VAT and income taxes). If this is the road the government wishes to go take, a certain degree of sophistication and differentiation is advisable. If taxes were levied on the basis of mass and consumption, the short-term tax revenues would be of a considerable magnitude, but the few positive effects would eat into future growth. The reduction of the enormous debt in the coming five to ten years will probably represent the biggest challenge for the governments in the 21st century. It will also demand sacrifices from all of us for years to come, since we cannot carry on globally as if nothing had happened. This will be clearly the order of the day. Of course, the reduction can also be achieved through tax hikes and radical saving, but this would throttle economic growth.

From the point of view of economic sustainability we should not kid ourselves: such a reduction of debt would only be of generally limited nature, because the measures are dwarfed by the current enormous size of debt and would only help plug the odd hole. If all efforts in the tax and savings area were to fail, another approach would have to be taken into consideration: the clearing of mutual government debt. It is a fact that the European governments are mutually indebted for the largest part of their debt (albeit via financial institutions). Therefore it could be an idea to just offset equal amounts on both ends. A zero-sum-game that should not harm the banks (write-offs) and at the same time reduce overall debt.

All countries financing their debt by issuing government bonds are integrated via the global financial market and both debtors and creditors. On the other hand, the aggregate debt of some countries includes debt that has been in existence for a number of years and that has been quasi-categorised as bad debt. The respective country would be held liable, but usually rolls this debt over with the issue of new government bonds – hoping that some day a budget surplus might help reduce this debt again.

A completely unconventional yet pragmatic approach would be to establish within the network of mutual obligations the net debt after mutual clearing. A country/government would thus be rid of parts of its debt, which is difficult or impossible to collect anyway and has been around for decades, and would get a fresh start. This would help current and future generations who, realistically speaking, could not service this debt anyway. And the economies would be less burdened by measures like mass taxes and could focus on more targeted tax models and practical solutions.

B. Environmental Issues (E)

Biggest global challenge – biggest potential

As far as our future is concerned, we have been quite wasteful in our consumption of energy from non-renewable sources in the past. The situation has taken a very cautious turn for the better in recent years. But if the energy consumption were to rise at the same rate as before, not only would prices increase massively in view of the rising world population, but we would be heading for decades of economic and social conflicts over commodities. This struggle for commodities will be accompanied by an almost unpredictable pattern of regional population shifts.

The only way out of this gridlock is through a new approach to our resource consumption and to our environment in general. While from an economic point of view it will be necessary to generate economic growth, on the socio-political front, this will have to be achieved by a maximum level of employment. Those two goals are not necessarily mutually exclusive, but substantial growth potential can only be tapped on the basis of a comprehensive willingness to accept changes in the economic and political arena. The increasing pressure from the public will necessarily provoke a change of perspective. The fact that growth and employment will also result in stability with regard to security policy is another positive effect.

A change in perspectives can therefore create substantial potential for progress in the long run both in energy and environmental politics. Bearing in mind the global government debt problem, we find that there is no way around change. How else should new stimuli for revenues and expenditure be developed?

We have braved the final economic and ecological frontier many a time

16. Basic strategy for the future: Conventional forms of energy production be gone!

There is a clear trend that big energy groups with strong financial clout have partially sketched out: the transformation of new forms of energy generation will proceed with irresistible force. Alternative energy carriers such as wind (both on land and on water), tides thermal energy resources, solar power, sea currents etc will be gradually replacing classic forms of energy production such as oil, gas, and coal. In view of this enormous and as of yet untapped potential, which on the other hand will require vast amounts of capital expenditure, the shift will create jobs directly and indirectly (in supplying industries as well as downstream industries such as automotive). The current environmental disaster in the Gulf of Mexico, where a powerful oil group like BP is desperately trying to contain the damage – not the least to its own reputation – can only be beneficial to the cause of renewables. The pioneering project of the giant solar park in the African desert, announced by the likes of Siemens, RWE, E.ON, Münchner Rück and others will be pioneering in the area, while only representing a first step towards change. Big energy groups will therefore be under massive pressure to develop these new business segments quickly and efficiently. Energy companies currently still relying on traditional forms of energy (but also car manufacturers) should shift their capital expenditure towards alternative forms of energy (and engines), because the race for innovation, reputation, and the securing of market share has been on for quite a while. The traditional oil and gas sector will rather sooner than later be classified as "old economy". The current debacle in the Gulf of Mexico is only a small part of the whole picture.

17. Automotive industry

Mobility has to become more efficient

Now is the right time to think about really alternative forms of engines and sophisticated forms of energy efficiency. BMW has shown very decent (and serious) signs of development in the area of energy efficiency. The enormous government debt will in the long run lead to a situation where taxpayers' money will be used very focused and efficiently anymore – if at all – for the subsidies and the maintenance of some industrial sites. "Too big to fail" will not cut it anymore. Rather, taxpayers' money should only be used for useful innovations in the automotive industry.

Toyota was actually on the right track – had it not been for the global recall. That said, the industry still manufactures highly inefficient vehicles which score for the space they provide (SUVs), but not for the drag coefficient, fuel consumption, or extras; they are relatively unattractive and do not appeal to the mass market anymore – rightly so. Manufacturers were dragging their feet for too long and failed to react to modern market trends, hoping for the eternal customer who would always swear by large and shiny "antiques". This may be true for motorcycles that are used occasionally in the spare time, but it is not true anymore for the largest part of car buyers. Governmental guarantees and subsidies (scrappage premiums etc) may therefore bring temporary relief to economic crises, but they are no real answer in terms of future growth potential. The government should therefore be very selective about its spending and only finance innovations and alternative forms of vehicles (hybrids, electric cars). It would be a shame to waste future tax revenues without an adequate degree of indirect returns. The Third World should only be required to comply with minimum technological standards for now (e.g. catalysts, annual vehicle inspection etc). This would directly result in a substantial decrease in emissions.

18. Aviation industry

The same goes for aviation: we need utmost efficiency

In this sector, too, real development, alternative forms of propulsion, and energy efficiency are long overdue. The old aviation industry has generally not reacted to low rates of profitability, pretending that tomorrow never comes. Talking facts, this means that the companies were hoping for perennially rising passenger numbers who would generate enough sales revenue in order to be able to cover costs. Aircraft types have seen some development in terms of propulsion and efficiency, but the design remained almost unchanged in the past decades. This has been the gold standard of procrastination. The well-known fuselage of the Boeing 747 jumbo jet has been untouched since its introduction in 1970, i.e. for 40 years. And nobody has even managed to replace an efficient supersonic long-haul aircraft in the same period (i.e. the Concorde, introduced in 1976). That is actually evidence of failure for the global aviation industry and its R&D efforts, because in the past four decades we have, with precious few exceptions, not seen any real progress, only rising numbers of passengers transported in traditional aircraft. In view of our global technology potential, the Airbus 380 and the Boeing Dreamliner 787 can therefore only be a well-intended beginning. The aviation industry has definitely failed to come up with any quantum leaps in the past decades. Here, too, corporate, political, and governmental efforts will be important to develop a sustainable mobility concept in the global aviation industry. This will require massive R&D capacities and yield many positive effects for economies, aviation companies, supplying industries, and airport locations, and it will also take a huge weight off the environment.

Energy efficiency has enormous potential

19. Stand-by regulation for household appliances and office machinery

Simple, good idea with big effect

The EU stand-by regulation for electronic household appliances and office machinery would definitely make sense, but would have to be implemented worldwide. It is well worth considering the obligatory inclusion of an electronic function that switches off the appliance (preferably altogether) after a certain period of time (e.g. 10-20 minutes). This would probably cause a considerable reduction in power consumption worldwide in idle periods (i.e. at nights, weekends, during holidays etc). In our welfare society it is often the little things that make the big difference. It is not the consumers' fault if they do not pay attention to details. At the same time, however, it is the fault of the manufacturing industry and the energy sector (which are of course not best pleased with the idea) for not implementing such trivial solutions. Regardless of the lobbying on various ends: stand-by causes enormous volumes of unnecessary power consumption worldwide contradicts any idea of energy efficiency, and therefore has to stop.

20. Regulation of public and corporate lighting and heating

Easily feasible, but decisive responsibility required

Energy efficiency and the handling of available resources continue to play a very subordinate role in daily business routine and in the majority of households. Energy efficiency describes the most efficient use of all resources and sources of energy. Therefore we should do everything in our power to cut back on the use of energy that is unnecessary or unessential to business operations. Yet again we find that we have not really been given this issue a thorough thought yet in many respects and globally, and that we are living beyond our means as far as efficiency goes. And it would be so easy to see the interdependencies. For example, we are wasting energy in public buildings across the board. The lights may well be dimmed when employees are absent (night, weekends, holidays), but they are not centrally controlled. Anyone strolling at night through the financial and business centre of various cities will clearly see the waste of light and power. In times of modern technology electronic controls (this time we are not talking about the financial markets) should be no problem. The central use and control of time switches and thermostats (for heating) should be required for every modern enterprise – as is indeed the state – and they would create enormous cost savings within the shortest period of time on a sustainable basis. Cost savings that companies and governments could certainly do with. Also, the design of the building has to allow easy access to employees who work cross-shifts, on holidays or weekends to access e.g. via electronic access systems. We will discuss insulation measures that contribute sustainably to energy efficiency further down.

21. Taking into account energy efficiency when accepting tenders in the public or private construction sector

Responsibility involves global thought processes

When awarding a contract in the construction sector it is mainly the architectural achievements that are hailed on the basis of aesthetics, but this also means that the sector is not open to changes, and it has certainly nothing to do with sustainable energy efficiency. Public buildings (universities etc) as well as office buildings are still being built at this day and age whose rooms (e.g. lecture halls, seminar rooms) have no access to daylight whatsoever. Such rooms consume energy on a 24/7 basis, and money is thrown down the drain. In both public and office construction the focus will therefore have to shift towards energy efficiency.

It is also a fact that many shops are brightly lit until late at night, most often for PR reasons. Crime considerations tend to be a welcome excuse, but state-of-the-art burglar alarms would not require such measures. It is crucial to give the question a good thought of how to limit and regulate office and shop lighting to a bare minimum. The global energy and cost savings potential is gigantic.

22. Excursus: A real example of energy efficiency that works

It can be this simple

One example of energy efficiency taken from real life that people may be laughing at but that works can be seen in Germany. Stadtwerke Lemgo (the municipal utility in Lemgo, Germany; see www.stadtwerke-lemgo.de) rely on the product "Dial4Light®" (see www.dial4light.de). It avoids the useless constant lighting of scarcely frequented streets. Lighting periods are reduced and optimised by the easily implemented solution. The cost pressure on many cities and municipalities is rising. Registered consumers can implement the energy concept by pushing a button on their mobile phone. Local infrastructure (streets, paths, parking lots, sports grounds, shop windows etc) can be temporarily lit. This is a really straightforward, easy-to-implement principle that would seem of practical use especially in the peripheral areas. However, it is dubious whether it could be used in areas with high population density. But even there it could be implemented on service roads and other less densely frequented areas. Either way, "Dial4Light®" could tap an enormous savings potential worldwide. (A recent globally accessible BBC report shows a keen interest in this matter: http://news.bbc.co.uk/2/hi/europe/7796800.stm).

23. Insulation and energy efficiency has enormous global potential

A classic win-win situation: positive effects with sustainable growth potential

Even the most cutting-edge approach to architecture will come to the conclusion that a building does not have to consist only of steel, glass, and concrete. Many public buildings as well as private office buildings convey the impression that the only goal was an extraordinary and catchy design. Many companies build their own monuments and in fact even go beyond that: they also build their own theme parks. This may be the right and honourable thing to do from a marketing aspect, but it certainly is not efficient or sustainable. In other words: the actual purpose is relegated to the sidelines by flashy appearance. Size matters.

Nowadays technological progress in the construction industry permits the most efficient designs from an economic and ecological point of view. The insulation of walls and windows both for heating and cooling purposes holds enormous growth potential for the construction and replacement industry in the decades to come. This applies of course especially to the emerging markets, but also to developed Western countries. Whoever has seen houses in the Anglo-Saxon region (simple bricks, often single-glazed windows) will know what we are talking about here. The same is true for most of the South-East European countries, where energy of all forms eludes in-house use and is literally blown out of the window.

One should also look at the facts in the context of the leading industrial nations, e.g. the USA. Take New York as example: many of the famous skyscrapers date back a couple of decades in terms of design and energy supply. It comes therefore as no surprise that the energy consumption in summer is sometimes higher than in winter due to the high demand for air conditioning. Why else would the infamous power black outs occur mostly in summer and not in winter?

Others may do the numbers on what cost savings per year could be achieved in a city like New York; one would of course need a state-of-the-art set of buildings and infrastructure as basis for comparison. But it is a fact that the financial amount would reach enormous sums every year.

As always, a lot of catching up and investing is to be done, even for the leading industrial nations. This should not be misinterpreted as burden that only affects the expense side. The opposite is the case. Sustainable investment in the future will trigger positive economic effects and create the famous “green jobs”. The resulting cost savings in energy will also have a positive impact in terms of expenditure on the consolidation of the public budgets of countries, cities, and municipalities.

24. The height of buildings and architectural masterpieces are a beauty to behold, but not sustainably relevant in terms of energy efficiency

A change in attitude is needed

In the past years and decades we have seen a global race especially in times of cyclical highs for the planning and execution of ever higher office and commercial buildings. Many a time the hidden agenda was for the cities or regions, financial institutions or other companies to secure worldwide publicity. This phenomenon may come with a human, even trivial explanation: the higher, more powerful, and more spectacular a building (maybe headquarter) is, the better, bigger, more powerful, and more innovative (wrong!) is the image the company conveys. The race for the highest building in the world for example has been mocked in the international papers and is increasingly being looked upon as pubertal. Whether such behaviour will contribute to a positive and innovative image in the future is at least up for discussion. From an economic and ecological point of view this quest for mere size makes no sense and is difficult to comprehend. A change in attitude is needed, and the race should be on for real innovations and a design that maximises economic and ecological aspects. This area will offer enough opportunities to constantly outrun each other. There are no limits to creativity and innovation in the construction industry, which will be beneficial for global progress. The newly emerging trend of green buildings is a first cautious step. But in the medium term, this trend will turn mainstream, which will come with advantages for the economy, jobs, cost savings, and ultimately for the environment (please see the following examples: www.banking-on-green.com; research report “Green buildings“/ Deutsche Bank Research, April 2010; www.dpn-online.com: “Green Buildings gehört die Zukunft (“Green buildings are the future”); www.kurier.at: “Unabhängige Selbstversorger“ (“Independent self-supporters”)).

Putting on the capital market’s hat for a bit, we find that all these measures will sustainably improve the cost basis of quoted companies. Also, in the long run a prosperous alternative industry will form (providers and producers of alternative forms of energy, energy consultants, suppliers etc) which will also require financing from the capital markets. Cost reductions from green buildings will be generated in the areas of energy costs (power, heating), emissions (CO_2), water consumption, material inputs (due to the use of recycled materials), and improved utilisation rates and employment figures. Traditional energy providers (especially those based on thermic, fossil, and nuclear power) will have to get to grips with temporary declines in sales and income. A stepped-up re-orientation of the corporate strategy – if the company is not already operating in the area of renewables – and the provision of information and communication with regard to the right use of efficient forms of energy (as is already offered by Austrian energy companies as well as other) will accelerate the process.

25. Reforestation and expansion of adequate cultivation of land as intelligent counter-strategy

"Producing air" would make sense in this case

The reforestation and large-scale cultivation of deserts with plant life could be an effective strategy to reduce carbon dioxide (CO_2), as it may lead to the most cost-efficient way of storing CO_2 in the long run. However, this requires financing or access to risk capital on the capital markets. Governmental subsidies could be another way to go. However, especially the latter have run dry due to the debt crisis. It will be important to act against climate change and also water shortages, especially in developing countries. Given the increasing world population, the size of arable areas will have to be stepped up sooner or later. On the one hand this should help food production, on the other hand the climate. This topic also ties in with the sustainable cultivation of our planet, together with the measures taken to avoid global warming. The efficient allocation of capital is therefore a crucial issue to be taken into account, and the government will have to play a role in the process as well. Desalination projects could become important, not only to satisfy the rising demand for water among the population, but also to provide water for the irrigation of deserts close to coastal regions. There are numerous of such coastal regions worldwide. The transport of the water requires infrastructure. Regions have to be cultivated in large scales and turned efficiently into fertile soil. The innovation of technologies, the food situation in the world, employment in general (especially in the crisis regions) and the climate will benefit from it. The often-used term "win-win situation" would apply many times over in this respect. Developing countries could for the first time benefit substantially and sustainably from the required investments in developed economies, and it would be in everybody's favour.

26. Selective consumer demand is fuelled and will reduce global exports

Traditional behaviour patterns may change

In phases of general recession and stagnation, national protectionism will assert itself in global trade. International trade has been globalised in the past decades – many times to levels that may be considered "over the top" (e.g. it is dubious whether the availability of South American blueberries in the winter season in European supermarkets makes sense). The increasing trend towards selective consumptions in the shape of higher, ecologically aware demand for local/regional products will automatically fuel this protectionist tendency (product labelling to this effect has already started in some countries). Protectionism is basically bad for any countermeasures taken to alleviate recessions on a global basis, because exports are too well established in some markets or continents. This will presumably not contribute to a quick overcoming of economic crises and will instead end up in stagnation for an increasing number of cases.

From the consumer perspective the trend towards local/regional products is understandable. The public pressure to buy local/regional products is therefore likely to rise. Companies, also global ones, in touch with their customer base will react to this scenario. This affects mainly the area of food (including luxury food) and beverages and other low-cost items (e.g. flowers and plants, clothes etc). High-grade products (cars, electronics etc) and luxury and designer goods will be rather less severely hit by this development. Overall however, countries with low wages will continue to account for a large piece of production, which is why a complete shift towards regional production and thus to a complete independence of regions and continents seems illusory.

27. Introduction of so called eco-taxes

Speeds up the necessary education process

The introduction of eco-taxes can make sense in order to jump-start and promote a sustainable shift towards the consumption of recyclable products on a broad basis. Such taxes and the question of whether to introduce them are questions that are currently subject to a heated debate in Austria. The concept seems simple and plausible: existing taxes on traditional i.e. non-renewable energy carriers (oil, fossil fuels, coal) are raised and thus the consumer gets punished for using them in order to curb the use in the future. On the other hand, renewable energies and the consumption of sustainable products should be promoted through tax breaks in order to ensure a heightened awareness of the issues at hand and to push the use of such products. With the help of these taxes, the efficient allocation of resources can be gradually implemented in a focused way. Overall, it would probably take drastic changes in the tax policies to set off this necessary trend reversal, which should also come with positive effects for the real economy. In order to ensure a smooth adjustment in the economy, the changes should not be radical or implemented in one step, but they should be introduced in a number of clearly defined milestones. But this approach would further the focused introduction of a new era of consumption of sustainable mass products and a new way of using resources, which should also have a positive impact on the budget consolidation of many countries. The current ecological catastrophe in the Gulf of Mexico, which will unfortunately also have long-term consequences, was an eye-opener and showed us that the traditional way of producing energy has reached its limits. US President Barack Obama has so far reacted correctly to it, and this can be taken as basis to start approaching issues differently and to leave the “Old (Boy) Economy” behind. A number of oil and gas groups are already on the right path into the future, launching pioneering projects such as funds that invest in energy efficiency and energies of the future.

28. Correction of the consumer culture we have been following in the past

New concepts for the economy

The example given above about the availability of South American blueberries in European supermarkets during winter was real. The global trade of goods has undoubtedly reached excessive volumes. In terms of facts, calculations show that in terms of economic and ecological footprints the current world population is currently already consuming 1.3 times the earth and its resources. In other words, we are living beyond our "area and resources" means. Should the world population and especially the consumption of the emerging markets grow at a rate aimed at attaining the consumption pattern of Western industrialised countries, we would be consuming four times the earth (please refer to the interview with Prof. Ernst-Ulrich von Weizsäcker, National Geographic, http://video.google.com or www.worldwatch.org). Thus it is a fact that our operating range is already limited. Steps will therefore have to be taken through politics and via the capital markets, and we will have to resort to the allocation of capital in order to take countermeasures. This is why the aforementioned integrated reporting makes sense. Only a provoked change of heart and values, away from the almost publicly imposed urge to consume and towards a sustainable economy can be the key to success. It is easy to see that we were living beyond our means even before the burden was taken over from the financial crisis and parked in government debt. Life on credit is relatively unproblematic as long as government bonds can be issued on the capital markets and the debt can be carried away into the future. But who will honour this debt? Probably future generations, and they will not only carry our financial burden, but also the ecological one. We should not expect much gratitude unless we quickly take action. There are actually only two alternatives: closing our eyes and hoping for the best – this would involve no changes whatsoever. Or: leaving everything behind and setting sail to a new economic and ecological era – this would entail the transparent implementation of the necessary political, economic, and ecological measures on the back of comprehensive and responsible action. These measures would also have to affect consumption by making it more responsible. This does not mean that global trade should be banned (unless regional products are available in suitable quality); e.g. bananas, apples, or melons, i.e. every-day life. But it is a fact that very often the global transport of mass goods is completely redundant and thus does not come across as necessary (especially a number of foods, plants etc). A clear labelling would help identification and would sensitise consumer behaviour.

29. Protection of endangered animals and plants: Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)

Base actions on facts

The Washington Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) (www.cites.org), which represents an international agreement signed by 175 countries, regulates the international trade of endangered animals and plants as well as their products. The implementation of the convention protects more than 3,000 animal and 30,000 plant species that are threatened by international trade. The most recent example of the failed attempt to put the Atlantic bluefin tuna under protection has shown that the organisation, which mostly relies on compromise, does not intermediate efficiently enough between the various nations. It is actually scandalous that species, which are threatened by extinction – as proven by facts – are considered good to fish. Such an organisation makes sense, but would have to be managed independently and act objectively, would have to be able to rule out any form of compromise in many cases, and should not get distracted by lobbying in the run-up to possible, fact-based decisions. This is where a global association of countries (to be specified) has to step in and prevent further damage by imposing increased taxes and punitive tariffs. In the area of financing, fishing and logistics companies responsible for the catch and its transportation could be easily punished. After all, demand sets quantities and prices, and these can be targeted and capped.

C. Social/ Ethical Issues (S)

30. Microfinance

New concepts for the economy, part 2

Microfinance is basically an important instrument of development policies. Microfinance products (loans, savings books, insurance contracts, transfers) for clients who for whatever reasons are not served by ordinary banks anymore should also be obligatorily offered by global commercial banks in order to support emerging markets and the financial requirements of their population and to fulfil their role as comprehensive provider of financial services. Especially in economically challenging times unemployment remains high or even continues to rise also in Western countries. The concept of microfinance is therefore increasingly suited to the needs of developed economic regions and helps close financing gaps efficiently. People would frequently come up with ideas and can bring their own labour to the table, but they cannot turn their ideas into reality due to a lack of financing. Microfinance can close this gap and for example secure micro-loans with ideas and know-how. Financial institutions offering microfinance should command a premium in their valuation son the capital market.

31. Paid out bonuses vs. distributed dividend

Dividend and bonus payments have to be in an adequate relation to the company's parameters

On the basis of the 1st ÖVFA publication on Corporate Responsibility of November 2004 (please refer to chapter Ad 3, Management remuneration), we wish to point out that the management remuneration is not excessive with regard to the parameters of the company and its stakeholders. The fact that the packages of managers are receiving a lot of press in the wake of the crisis suggests a high degree of transparency. Our statements made in the 1st publication of November 2004 have remained fully valid. To complement said statements, we also want to mention that the aggregate bonus payments of companies (especially investment banks but also commercial banks) are equal in size to the distributed dividend or even the net profit for the year. In other words: dividends distributed could sometimes be twice as high. And so could profitability ratios such as the ROE – if the paid out bonuses for the full year were to be included in the calculations. The fact that no stakeholder and especially no shareholder feels ripped off is actually remarkable, not the least as they could get up to twice the dividend in good years. In any case, such bonus payments that are out of proportion with the company should not be possible. Shareholders who also bear the business risk have a right to a dividend from the actually achieved earnings. This right should not be curtailed in such a substantial way by internal bonuses. Managers who focus on sustainability should also be responsible for a reasonable relation of bonuses to earnings. 15-20% p.a. in terms of earnings would probably be acceptable.

32. Remuneration CEO and management board vs. average wage per employee

Exorbitant ratios should be avoided

We discussed this aspect in the 1st ÖVFA publication on Corporate Responsibility of November 2004 at length. The ratio of the fixed average salary of the entire company to the fixed salary of the top-level management is a meaningful parameter. This is no communist approach, but a transparent and legitimate one, which is supposed to indicate whether the salary of the management is still in synch with the average salary in the company. For example, a situation where management earns 20 to 25 times the average salary as fixed part of the remuneration package would still be acceptable. CEOs whose fixed salary exceeds the average salary by a factor of 100 will have to deal with accusations of receiving an irresponsible, excessive, and absolutely unrealistic remuneration. This is where regulations would have to step in and cap the package at acceptable values. There is no doubt that the principle of achievement and responsibility in the company has to remain untouched especially for management. And a structure where the top management earns up to 100 times the average salary of the company is difficult to put into a realistic context.

33. Full internal and external transparency of trading transactions in all financial products

Global supervision needed

An essential aspect in overcoming the financial and confidence crisis is to regain the confidence in the markets. The level of transparency that companies and governments have to provide (although in fact Greece's transparency was of a limited nature) has to be demanded in full from all people and companies on the financial markets who in turn expect the aforementioned transparency from companies. Apparently the transparency of the structured products on bundled securitised US mortgages (subprime) and of derivatives traded on said products was not satisfying in their global dimension. By the end of 2007 the total volume of derivatives traded worldwide amounted to USD 600 trillion. This is about ten times the worldwide GDP (source: Bloomberg), and there is no denying that this is also a number that has somewhat lost touch with reality. We want to point out again that derivatives are important for hedging purposes and should therefore be kept for that purpose. They should also be allowed within an investment portfolio up to a certain percentage (10-15%) to generate additional performance through speculation. However, if they are only used for trading purposes without any underlying instruments backing them up (i.e. only as derivatives), they do not really deserve the term "investment" anymore. This sort of transactions is actually tantamount to bets, and the term "gambling" (a term we do not particularly like) comes to mind. In this case the activities actually only aggravate upwards and downwards movements (i.e. volatilities). Actually when derivatives were introduced decades ago, one argument in their favour was that they would smooth prices and thus prevent extreme fluctuations, as a result of which they would also help avoid crises and panicking on the back of their hedging characteristics. Unfortunately this has turned out an illusion, with the trade taking on a life of its own in many cases. It is a fact that the supervisory authorities and regulators are overwhelmed by the barrage and complexity of global trading products. Internal risk management units of financial institutions, too, never saw the bursting of a bubble this size coming; at the time, the bubble had lost touch with the actual underlying, i.e. the US housing market. This market had been financed by a flood of loans as a result of the low interest rates back in the days when it was still very straightforward to get a loan. The game of getting cheap financing and bagging the difference on rising house prices led to a dead end and to the abrupt collapse and chaos. The official statistics of the BIS (Bank for International Settlements, see http://www.bis.org/statistics/derivatives) show that the volume of derivatives traded worldwide still amounts to 10.6 times the global GDP, i.e. the real economic output. Let us reduce this to a statement from the probably most respectable and successful investor in the world, Warren Buffet, made back in March 2003 on BBC (http://news.bbc.co.uk/2/hi/2817995.stm): "Derivatives are financial weapons of mass destruction whose risks cannot be monitored or controlled by the central banks and whose effects could be lethal for the financial system."

34. Comprehensive compliance

This should go without saying

Transparency has to be integral to every activity on the capital market. For example, a research report (or update) should no be known internally prior to its publication or any transaction so as not to influence the price or market on the back of the client volumes it may have created and to ultimately benefit by trading on one's own account. A transaction can involve any long or short position in shares, bonds, derivatives, currencies, commodities etc. It is always possible to execute a transaction prior to the publication of research reports in order to exploit the expected performance of the market that may follow the opinion and expectations created by the report. Internal compliance units and supervisory bodies have to persecute such misconduct, which should be punished by a complete suspension of trading privileges for the financial institution involved for example one month. The responsible employees lose their jobs for a temporary period of time (1-2 years) and their licence. Research has to be produced on a completely independent basis and has to be separated from all trading and sales activities (such Chinese Walls should be implemented in all markets consistently and without compromise). Therefore any transaction by financial institutions on the capital market has to serve the interest of the client. If these transactions are executed in an orderly fashion, the respective bank has to be permitted to derive a certain stream of income from said transactions, especially if the quality of the research spawns good ideas, movements in the market and liquidity.

35. Corruption and bribery have to be eliminated

This, too, should go without saying

As it turns out, corruption and bribery are a thriving business regardless of the economic cycle. However, the situation can take a turn for the worse in times of crises. Two recent examples: 1) Greece: Apparently corrupt civil servants and other employees in the public sector (see also www.handelsblatt.com) have prevented a transparent recording of tax revenues for years. According to a study by the industrial association SEV the volume of tax fraud amounted to about EUR 30bn per year, i.e. roughly 12% of the current GDP – exactly the amounts that were hidden in total debt every year and that currently constitute the new debt taken out per year. It has meanwhile become quite clear as to what situation Greece has manoeuvred itself into. This is actually not worthy of a member state of the EU in the 21st century, i.e. a state being unable to assess its potential tax revenue. Should this scheming continue, Greece would have a hard time ever getting out of this deadlock situation. The mass of orderly taxpayers are now called upon to foot the bill, as are the taxpaying EU citizens. 2) The current ecological disaster in the Gulf of Mexico: yet again it becomes blatantly clear that as a result of corruption and other practices governmental supervisory bodies failed to exert the kind of comprehensive, consistent control they were expected impose on oil production. Gifts and other favours also played a decisive role (see also www.thurgauerzeitung.ch). A core issue in avoiding crises will be the fight against corruption and bribery on an internal level. Should the persons and institutions in question turn out guilty, not only would they have to lose their jobs and functions as well as all claims connected with those, but the extent of the sentence would have to be increased as well.

36. Reduction (or taxation) of naked short-selling

No general condemnation, but reduction to a level that reflects reality

Short-selling is an instrument of a completely deregulated market, but the truth is that in periods of high volatility it amplifies trends both ways, i.e. upwards and downwards. Opponents of this point of view would of course illustrate the upsides, i.e. higher liquidity, an improvement in the process of arriving at the equilibrium price, and in particular, better protection and risk management. The crisis of the past months and years has accelerated risk management in particular as a result of the volatilities, but these instruments have certainly not contributed to any smoothing. Completely deregulated markets do not work efficiently, as the current crisis has revealed – in particular because the volume of this business has increased massively in the past decades especially on the large markets. The outlook on a quick profit (greed fuelled by the enormous bonuses) may be alluring, but on the other hand in the long run the risks increase also in the real economy. Short-selling in its most aloof form (i.e. naked short-selling) has nothing to do with the underlying on the spot market anymore. In other words, if it has nothing to do with the spot market anymore, it does not have anything to do with the company values and the real economy anymore either; the real economy represents these company valuations, and the sales of the companies in turn are part of the actual economy. And while others may disagree here: although naked short-selling is a sophisticated form of a liberal and self-managing market, it actually only constitutes a simple technical trade that bets on falling prices without owning (or having borrowed) anything to back it up. This actually contradicts the principle of a prudent businessman. The development of the VW shares in October 2008, which was completely unfounded from a fundamental point of view, made an impressive point about how speculative expectations were amplifying markets and their volatilities in practice. Nobody knows or can even know what this supposedly has to do with the real economy and company values. Germany may have shot forward on its own in May 2010 by banning naked short-selling, but the decision to do so was right as far as the core of the matter was concerned. Naked short-selling should therefore be globally banned in a concerted action, or it should at least be taxed.

37. OTC (over-the-counter) in the future on the stock exchange

Setting up a decent framework and structure

The financial institutions settle a large part of their transactions among each other over the counter (OTC). This is also where by far the largest portion of derivatives is traded. No institutional stock exchange acts as intermediary, which is why the trade is done outside the stock exchange. There are no stock exchange fees, and the transaction is fast and straightforward. The margins are small. These are without a doubt advantages. However, the downsides are profound. There is almost no control from outside, and the market is not transparent because there is no order book that one would have the right to look at. Therefore the proposal of the Obama administration made at the end of May 2010, to move all derivative and OTC transactions to stock exchanges, is both good and right. These sizeable volumes could then be settled on standardised markets in a transparent fashion, and the supervisory bodies could monitor them more easily. This approach should be implemented globally. Of course the transactions would become more expensive as a result of the stock exchange fees. However, the sales and especially income of the stock exchanges should increase substantially on the back of the concentration of the entire volume of derivatives and (former) OTC transactions. The higher income would ultimately lead to higher tax revenues for the government. Maybe this could even help avert a global financial transaction tax and partially compensate the foregone revenues should said transaction tax not be imposed.

38. No bonus payments in periods of short-time work, massive job cuts, and partial nationalisation ("too big to fail" approach)

The action depends on the specific situation

No bonuses should be paid out in periods of short-time work, massive job cuts, and when it has become necessary for the government to take over a share in the company's equity. A situation where taxpayers have to foot the bill and where then parts of their financial consideration that is keeping the company alive in the first place are paid out as bonuses is unacceptable. Full transparency as well as fairness in the allocation of funds has to be applied. This also has to be linked to specific facts:

1. The relatively easy decisions to impose short-time or to cut a substantial number of jobs are no convincing or sustainable managerial achievements that would justify bonuses in the

same fiscal year. There are undoubtedly more intelligent – albeit more difficult – decisions to reduce the cost basis.

2. It is important to analyse whether a company has to be nationalised via its equity capital in order to ensure its operations before the government actually takes over a stake in the company's capital. If this is the case, no bonuses should be paid out. Anything else would be an insult to the government and the taxpayers. Even if certain units of the company were to generate a sort of income that would justify bonuses, the aggregate picture prevents the company from doing so. These jobs would not exist anymore if it had not been for the governmental support. It is a different case where companies only resort to public funds in order to fulfil equity criteria and boost liquidity. These companies should be fair and skip bonuses in the year the transfer of funds is made.

D. Governance issues (G)

39. Over-the-top management remuneration packages should be ruled out

"Golden handshakes only for golden performance, otherwise not even a golden finger"

Management remuneration systems should be based on sustainable criteria that can be linked to the success of a company, as we discussed in the 1st ÖVFA publication (please refer to chapter Ad 16). Extremely high salary components and bonuses (fixed salary, bonus, stock options) that mainly hinge on quarterly reporting and financial figures should be made impossible. Managers receiving in relatively short periods of time (quarters, 1-2 years) double or triple-digit amounts of millions of euros or US dollars in fixed salaries and bonuses will find it difficult to argue that this is in the best (and sustainable) interest of the company. Overly high remunerations should be ruled out. Total annual remuneration should be in line with the table suggested in the 1st ÖVFA publication (see chapter Ad 3), with the performance-based, variable part staggered and rolled over 3-5 years. In either case, there needs to be a clear connection to the performance of the business. In the absence of a successful performance, there should be no golden handshakes. In most of the cases of the companies bailed out by the government during the crisis, the top management would have not qualified for a bonus. The "too big to fail" approach was also prominently adhered to when the management of certain companies left (N.B. golden handshakes were given to the CEOs of Citigroup, Merrill Lynch etc). The managers were effectively carrying zero personal risk, especially in the context of the billions of losses of those companies. The public pressure had become so enormous that they had to be let go. This has nothing to do with performance anymore. The public did not understand the events either. Salary components that permit excessive payments should therefore be banned.

40. Caps on remunerations in state-held companies (direct holding in the company's capital)

Responsibility has to be compensated

It would be logical and right to cap the management remuneration in formerly nationalised companies. This would also show responsibility vis-à-vis the taxpayers. However, we do not think that a cap on the salary of a CEO or board member at EUR 500,000 (or USD) would be particularly helpful to the proceedings. Going on experience, we would say the amount is too low. Large successful companies would usually pay an average fixed management salary of EUR 700,000 (or USD). Hence EUR/USD 700,000 could be a plausible fixed salary for the CEOs of nationalised companies. On the other hand, it would be difficult to find suitable candidates. The amount would have to be reduced accordingly for small- and mid-sized enterprises. A cap at EUR/USD 700,000 would not be excessive or obscene even from the point of view of sustainability. Performance has to pay off. It should be possible to find excellent and suitable managers to fill this sort of responsible jobs at this price. In boom years, additional bonuses should be possible in order to incentivise management to participate in the success of the company. For large-caps (as defined by market capitalisation) a factor of 4-5 of the annual fixed salary should be a reasonable cap. More (5-10 times or even more in terms of one fixed salary) should be ruled out, as this amount would not come across to the public as in the best interest of the company anymore. In any case, fixed salaries should depend on parameters such as responsibility and thus probably market capitalisation (small/medium/large cap), whereas variable components should be determined by more long-term success measures (e.g. earnings of the past three years). The latter should also take into account malus components in case of losses caused by the manager in question. Companies should not be allowed to deviate from the aforementioned concept without consequences if they have taken disproportionately high risks, and a financial parachute should not be an option.

41. Corporate governance – far more than this

Corporate governance means credibility. The company has to identify with it and live it

We talked about many aspects of corporate governance in the 1st ÖVFA publication (see chapter D and from Ad 13). The aspect of an orderly corporate management is highly important. Most European countries have effective Company Laws in place, which clearly define the roles and tasks of company bodies (especially Germany and Austria). It is also important to distinguish between two-board systems and one-board systems. On top of that, there are local corporate governance codes. These make sense, as do the rules laid down by them and the compliance with them in order to increase the level of transparency in areas where the Company Law is not effective enough. As self-regulating measure, corporate governance is part of corporate responsibility and thus a welcome vehicle to demand responsibility from company management in even more detail. But it is impossible to force management to be responsible, even if companies have independent auditors, lawyers etc scrutinise their compliance with numerous codes. Could a better corporate governance code have helped overcome the global financial, economic, and confidence crisis more effectively, or even avoid it altogether? – A clear "no" to that one. The volume of mortgages granted on the US housing market and of the products traded on top of those on the financial market had become too large, and a better corporate governance code would not have made a difference here. However, an institution that was aware of the economic interdependencies and that had capped the trade in these products could have prevented the crisis. On the one hand, there need to be clear rules and regulations on the financial markets, as pointed out above. A gigantic trade volume that is completely left to the devices of the free market and that not even the supervisory bodies or the financial institutions have any control over is evidently not efficient enough. On the other hand, confidence/trust also depends on simple psychological sentiments of people acting in the market and also the entire population. This trust and complete transparency are particularly important in the context of something as sensitive as money in order to maintain global money circulation and liquidity. And this trust was severely damaged and partially destroyed in the crisis. The excessive salaries that we have seen cropping up again right after the crisis are not only completely irresponsible. In such phases, they are bordering on aloofness and show a lack of sensitivity towards what is essential. And lastly, they are a testament to a narrow mind that completely neglects global dependencies. Responsibility therefore has to be lived and implemented more comprehensively and should not be reduced to the existence of audited documents. These additional aspects of comprehensive responsibility are the central issues of this 2nd ÖVFA publication on "Corporate Responsibility 2.0: From Corporate Responsibility to General Responsibility".

42. Upgrading of the role of non-executive or supervisory board members

Supervisory board – not only supervision

In the Continental European two-tier board system the operating executive board, or management board, is separate from the non-executive controlling body, the supervisory board. On the surface, this system is more suitable for laying down competences precisely and avoiding possible mistakes, because both boards are independent of each other and the power is divided between two bodies. This means that the CEO / executive board has to deal with a critical panel on the opposite end. However, the Continental European system comes with the deficit that the supervisory board really is reduced to controlling functions. The supervisory board should assume an expanded function as consultant/partner/coach vis-à-vis the executive board; this upgrade should facilitate a functioning and more effective control and coaching of the executive board. The combination of the role of the CEO and the chairman of the supervisory board in one person (e.g. in the USA, Switzerland etc) should be avoided as it is less trustworthy than the two-tier board system. It does not look good if the same person takes decisions and consults himself following a "two-eye principle". An executive board (in the optimal case fully independent) is best and most effectively controlled by an independent supervisory board (again, in an optimal case fully independent). The CEO and the executive management board remain essentially responsible for the operative implementation of the company goals. Therefore the remuneration should largely go to the executive part of the bodies.

43. Risk management

Quantity does not equal quality

The partial lack of adequate and efficient risk management systems became obvious as a result of the risks taken especially by global banks, investment banks, and insurance companies. This does not mean that an improved risk management would necessarily entail a higher headcount. 100 people can mess up as much as 1,000. Quantity does not equal quality. On the one hand there is a lack of suitable systems, on the other hand the "independent" CRO (chief risk officer) may simply not have it in him to assert himself, and may lack leadership skills. Some of the people in charge realised the potential danger of the subprime crisis but failed to assert themselves after the business had been going so well for years. Subprime engagements and products traded on top of them increased by a disproportionate amount in relation to other areas. This practice had clearly been yielding very good results for years, but the risk was still too high in most of the cases. The independence of internal risk systems is a central point for future business practices. Therefore the CRO, while member of the executive board, should ultimately also report to the independent supervisory board (while balancing his reporting duties) in order to rule out right from the outset potential conflicts of interest with the members of the executive board who are responsible for the respective business area. This is just one reason why the two-tier board system is superior to the one-tier board one when it comes to solving problems.

44. Hedge funds

Not all hedge funds are the same

It is easy to blame "the speculator". But we definitely want to warn against blaming hedge funds as the only ones responsible. Not all hedge funds are the same. There is a vast array of different hedge funds and indeed so-called alternative investments that come with an equally vast range of different investment approaches. Maybe this variety constitutes a deficit and is at odds with the actual definition of a hedge fund. Many hedge funds act as strategic long-only investors. But at the same time there are those funds that try to exploit market imbalances or, at the other end of the spectrum, almost exclusively run short strategies. Here the investment strategy and the extent of the invested derivative volumes have to be established. This will increase the transparency – undoubtedly a plausible act in these times – and it will help distinguish between more and less speculative hedge funds. Of course the transparency of hedge funds has been rather limited so far. Governmental bodies would have to demand a higher level of transparency, much like from other financial institutions. However, it would be wrong to condemn hedge funds as evil, because in many cases they just exploit the overshooting of the market on both ends. Whether or not they amplify those trends has to be found out on the basis of thorough analysis and by applying stringent transparency.

E. Summary, conclusion

It makes sense to assume that the trigger for the current crisis was actually very trivial. At the same time, we will feel its aftermath for quite some time due to the enormously high government debt.

Burying the head in the sand and pretending that nothing has happened will not help us reclaim the trust that was lost. We need a new progressive regulatory framework for the financial markets in general. However, the legal codes and regulatory measures alone will not make for a better financial system in the future. We strongly advise against overregulation. Experience shows that overregulation tends to cause inefficient, rigid behaviour and high administrative costs. Stringent regulation may create additional administration jobs, but this would not foster the development. And at the opposite end we have the completely free market, which of course has proven at length that it does not have all the answers either.

What we now need in a functioning system is trust. Boom years spawn greed, whereas recessions create fear and panic. Because of these states of exaggeration, a comprehensive sense of responsibility will have to produce more transparency and re-establish a balance between the two extremes. A state of trust. The media will have a decisive role in this as well, because much of what – and how – they report, paints an overly dark picture and creates fear. What we need is an objective style of news reporting that focuses on facts. What we do not need is tabloid journalism.

Trust can only be regained if it is based on a comprehensive approach to responsibility that transcends the actions of individuals and institutions in the shape of bodies and employees of listed and non-listed companies and enterprises, governments and NGOs. The generally right principle of the stakeholder approach (basically the extremely important circle of shareholders, clients, employees, and suppliers) has to be defined anew and more comprehensively. All of this requires a concerted effort of different states, governments, central banks, NGOs and other participants acting responsibly in the economy such as enterprises, corporate bodies, and public as well as private persons. The focus cannot only be on the well-being of listed and non-listed companies. It has to include a fair and responsible interaction with business partners as well as competitors of all sorts. At the same time, this is not supposed to query, nor must it compromise, a healthy degree of competition in favour of the client.

This situation therefore will only allow us to learn "pro-actively". The signs bode well for extensive change. The more powerful and deeper the crisis is, the more compact the required measures and corrective steps have to be. This process cleanses, and it might in fact bring about remarkably good results for the future development.

The necessary reduction of the, for some countries, extremely high debt will bring further strain to the financial and foreign exchange markets. The investors will strongly differentiate between countries and asset classes. Only a fact-based analysis of fundamental data instead of superficial generalisations can lead the way out of the crisis.

The discussed topics and measures are meant to help find the right way and above all push for a better working financial system. – The right way to a renewed and safe state of trust, which used to be taken for granted but is now badly wanted and yet not easily found.

The currently high annual deficits and levels of total debt should not be exclusively tackled by new, stringent tax packages, nor by even more severe spending cuts. Saving is basically a good approach, but it can also exacerbate the situation dramatically. This would be a wrong and fatal strategy that would nip any economic growth in the bud. What we need are completely new concepts for the future. The consistent implementation of a global ESG strategy (environmental, social, governance) could generate sustainable growth for decades due to a change in value drivers. It could create new employment and could thus contribute positively to the well-being of the general public and the environment. At the same time an increased level of transparency for the corporate sector and the capital markets would re-establish lost trust and credibility.

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