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CORPORATE GOVERNANCE: HOW TO RECONCILE

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While the covid-19 pandemic has of course disrupted businesses and society, it has also accelerated some movements, foremost among them the climate transition. Beyond the new European regulations with obscure acronyms, soft law and reputational stakes have driven companies to embark on organizational changes. But in practice, how do they reconcile sustainability requirements with the profitability their stakeholders expect? What strategies should be put in place ?

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WHAT **IS SUSTAINABILITY?**

Carol Xueref: Sustainability is how the company will achieve its societal and environmental goals and remain viable. It creates long-term value, mitigates risk, strengthens brand reputation, increases revenue, reduces costs, attracts and retains talent and investment. It thus ensures that the company has a place in the future economy.

Sustainability strategies are a real and important concern for businesses. Beyond reputational influences and stakes, this initiative is justified by a number of reasons, foremost among which is perpetuating the undertaking. Since 2020, in the face of the various pandemics, lock-downs, inflation and military events currently unfolding, companies have had to add the concept of resilience to strategic sustainability.

AT THE END OF SEPTEMBER 2022, *ESG represented 1.3% of stocks under management in the US, compared to 19% in Europe (source Morningstar).*

Fanny Letier : The concept of sustainability has a meaning close to that of continuity - a value dear to SMEs and midcaps. And today more than ever, the continuity of the company is in line with that of social cohesion and that of the planet. Everything converges and this necessarily impacts business strategies. The covid crisis has shown that conventional CSR strategies are no longer enough. We cannot meet the challenges which have now become urgent, immediate and of which we have just become aware of the magnitude by marginally reducing our negative externalities, particularly environmental, through plans for improvement or compensation. There is an urgent need to innovate in order to create positive externalities directly and powerfully. This is why sustainability is now part of the company's strategy, of the new development models. It must be carried by its leaders: the company manager first, but also by the teams that must be on board. It does not involve changing the nature of the business. And fortunately, because very few companies have an impact "by nature". Two thirds of the ISEs are in the service or industry sector. Anchored in the regions, they are the main driver of employment in France and therefore have a usefulness in themselves. However, they will have to change the way they do business. Sustainability requires mobilizing skills, innovating, to evolve product and service offerings, processes and even business model to serve a more present, more immediate and stronger societal demand. A company that used to work in BtoB now works in BtoBtoC and "C" represents the consumer citizen.

[CAROL XUEREF

"Sustainability is how the company will achieve its societal and environmental goals and remain viable."

A company that does not assess this correctly will disappear from the market. The ones that integrate it will become leaders.

Stanislas de Laporte: For larger companies, the impetus for this sustainability strategy lies with the Board of Directors. Administrators need to be trained on sustainability, establish dedicated governance on sustainability, and define a policy that will then be implemented by managers. Sustainability governance is a key focus for shareholders of listed companies, which is reflected in exchanges and general meetings.

ANALYZE PERFORMANCE DIFFERENTLY

Patrick Bertrand: This sustainability strategy must be analyzed in terms of the definition to be given to performance. For many years, many companies have focused on their Ebitda by globalizing their supply, organizing themselves to produce at the lowest cost, in the first instance seeking short-term profitability. However, when an objectively unpredictable situation occurred, such as the pandemic, they were not spared major difficulties. Of course, Ebitda is indicative of the cash flow and thus of the financing capacities of companies, but it does not reflect the investment efforts made in terms of sustainability. I believe that our lexicon of performance analysis, which can no longer be evaluated over one, two or three years, needs to be reviewed. It must now be analyzed in the medium and long term.

Stanislas de Laporte: Between sustainability and Ebitda, we must not forget the concept of the materiality of the impacts that environmental, social or governance criteria can have on the company's activities and on its financial results. We propose to implement materiality matrices to raise awareness of these direct impacts.

Patrick Bertrand: The long-term dimension and the logic of the company's sustainability are linked. Groups with a shareholder base of people involved having a strong interest in the development of the business - beyond the financial aspect- often have a longer-term approach to governance in the context of the sustainability of the legal entity. I am thinking, for example, of family businesses or those which have developed a high level of employee ownership.

Fanny Letier: Governance is the guardian of a space for the long term. At GENEO Capital Entrepreneur, we work with SMEs and ISEs, which are essentially unlisted, family-owned and proprietary companies and have always had the goal of making the company sustainable.

Carol Xueref: Businesses have learned a lot over the last three years from these exogenous events. They had to do some introspection to better organize their internal processes, structures and procedures. They have developed strategies to remain both resilient and competitive. The pandemic has forced them to ask themselves what they are >

doing and how they can do even better. This new context means not only being guided by the Ebitda. The conduct of the company requires the management team to have a mindset that is long-term and multi-level and therefore inclusive, but disruptive and with confidence in the company and its ecosystem. Leadership requires hunting in packs, working in teams.

Patrick Bertrand: It would also appear necessary that the information produced by the board of directors, or by the management, should include, in addition to the financial results, the company's sustainability goals: the investments in innovation that make it possible to prepare for the future, the process of making the Ebitda "clean", etc.

CHANGING THE WAY WE RELATE TO TIME

Fanny Letier: We need to change the way we related to time. You don't transform your business model, you don't become a sustainable business if you don't situate yourself in a timeline. This is a challenge for listed and unlisted companies operating in a regulatory environment that pushes to urgency, that is unstable, and encourages businesses to be reactive rather than proactive. Today, it is necessary to be able to superimpose timelines: in the short term, the data must be structured to produce precise extra-financial reports for customers, financiers and public authorities, and to analyze them in order to forge a suitable CSR strategy. In the long term, there is the strategic direction, including a reflection on the company's offer and positioning at ten years to directly create a positive societal impact. You can adopt any raison d'être or produce big slogans, this work involves a heavy investment, particularly in human capital, and leads to a real transformation of the company. GENEO Capital Entrepreneur has chosen to be an evergreen investment company to demonstrate that in order to reconcile performance and meaning, time must not be a problem and we must have the ability to superimpose the short, medium and long term. The medium-term linking the two phases comprises regularly updated operational innovation and transformation action plans, which must be implemented in a timely fashion, to enable agility. This is the most difficult aspect, and our teams are there to support ambitious leaders in this direction.

FOR THE TIME BEING, *a dozen French groups have been brought before the courts by NGOs, in particular for failure to comply with the due diligence obligation.*

Stanislas de Laporte: In the markets, large asset managers have a more complex approach because they have short- and medium-term constraints. Yves Perrier, former president of Amundi, said that (absolute) performance levels could no longer be as high as they had been in the past if the carbon revolution were to be incorporated. However, the majority of institutional investors believe that sustainability can be integrated into a competitive strategy. According to our survey, more than 60% consider attention to climate constraints to be an investment criterion, followed by the composition of the board and human capital. That said, it must be acknowledged that the markets are currently operating more on the basis of sanctions. Investments that are not sustainable are removed from the portfolios.

Fanny Letier: Long-term investors have been shown to perform better than others. Precisely because they have no time constraint, they can make investments for the future. The fact that we invest in the long term does not mean that we lower our ambitions for profitability. The family offices are a reflection of this.

Stanislas de Laporte: Customers need to be forewarned and educated that their performance could be worse in the short and medium term with an ESG fund. This was the case in 2022 when ESG shares underperformed. Similarly, issuers must educate their investors on this subject. On the other hand, in the very long term, there is every reason to believe that performance will be as good.

Patrick Bertrand: If managers do not incorporate CSR into their strategy, there is a risk that their company will face real short- and long-term challenges. For several reasons. Firstly, because they will have difficulty with financing. They will find virtually no investors or bankers who will be willing to accompany them financing. Similarly, the battle is lost in advance in this famous "war of talents". If the company does not create meaning by committing itself resolutely to CSR, and in particular to the green transition, it will find it extremely difficult to recruit or retain its employees. Within its supply chain, the company will also be under pressure from its contractors to deliver products with an acceptable climate footprint. And lastly, consumer customers

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"The fact that we invest in the long term does not mean that we lower our ambitions for profitability.»

will be attentive to these commitments and, if they are not convinced, they will move towards a product they feel is more in line with this idea of sustainability. So, in any case, sustainability drives performance, even beyond the virtue and/or conviction of the leaders.
Today, companies have no choice: they must be engaged to be successful.

Stanislas de Laporte: Even in some industries, such as armaments or oil, sustainability is a priority. Oil companies are nevertheless managing to engage in a reconversion of their business, with long-term ambitions that are monitored by investors. They look at both the 2050 criteria, but also the intermediate stages. Some pension funds, such as the Florida or Texas pension fund, are on an anti-ESG crusade. But in reality, when sustainability is equated with a strategy to retain consumers, suppliers and employees, investors follow.

Patrick Bertrand: Wasting time defining good and evil does not change the world. All companies must commit themselves and, of course, in particular, those with significant negative externalities need to set much higher carbon footprint reduction targets than others. Rather, the logic is to make commitments, set targets, monitor and report to shareholders and stakeholders.

Fanny Letier: Making an impact is not just about investing in companies that fall under the taxonomy! I would point out that they account for less than 1% of European businesses. Otherwise, there is a risk of a whole productive economy collapsing. Middle-sized companies have created 400,000 jobs over the last ten years and I very much hope that they will be preserved. If they are cut directly or their sources of funding are increased, we are heading down a dangerous road, with further de-industrialization and unemployment. On the other hand, investors may ask them to demonstrate that sustainability is taken into account in their strategy, to ensure that they are able to transform themselves within a reasonable time. This awareness is truly strategic for businesses, and is even a matter of survival. I am thinking, for example, of a group that manufactures plastic trays for the agricultural sector. If it demonstrates that its technology is multi-material and will enable it, in the future, to switch from plastic to hemp or flax, it will convince investors. If the technology doesn't allow it, then they'll be in trouble sooner or later. GENEO Capital Entrepreneur has invested in a company in the North of France that builds mobile toilets on construction sites. A strong financial incentive has been given to develop a range of products that will

[PATRICK BERTRAND

"Wasting time defining good and evil does not change the world. «

enable local authorities to save water, to include disabled people on worksites and at music venues, and above all to recover urine and transform it into agricultural fertilizer in the future. We no longer simply assess them on the basis of what they do in terms of CSR, but we engage the teams to take a leadership role and become the innovator in their business. If there is leadership, if there is governance, CapEx, R&D, teams, commitment, our investor perspective changes. ISEs, niche companies, can take this leadership.

Carol Xueref: The transition can be financed. We note that there are also several bond issues in the form of green bonds.

Patrick Bertrand: As I mentioned, the question arises not only in terms of attracting funding, but also in terms of recruiting talent. Does the young engineer want to go and work today in a large oil company that does not have a carbon footprint reduction and/or renewable energy strategy? Those who have embarked on a massive program of investment in renewable energies to gradually transform their business will be much more attractive. The commitment of the company radiates to all stakeholders.

Stanislas de Laporte: The transition does not mean that we have to change overnight. CCO_2 emitters also have a societal responsibility. An oil tanker cannot stop producing gasoline overnight. Likewise, Brazil's coal producer cannot shut down its power plant overnight without jeopardizing its entire region. The transition needs to be started seriously, with a zero CO_2 target by 2050 and intermediate steps. I would also point out that sustainability is not just an environmental issue, even though the issue is central from the point of view of investors.

Carol Xueref: I share your opinion. If roads can no longer be built or repaired, the whole of civil society will be affected. But civil engineering must invest so that, in the future, its bitumen has a carbon-neutral balance by using, for example, plant binders and recycled materials. Similarly, cement-producing groups are making significant efforts to achieve a clinker-free environment in order to achieve a significant reduction in CO_2 emissions. So the switch must not be abrupt, but respect the evolution of species, to quote Darwin. >

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Patrick Bertrand: A company that is investing heavily in this transition and is setting itself far more ambitious targets than its competitors in terms of timing, must be judged to be more efficient than its competitors. Even if its apparent result is not, in the light of the old ways of assessing the performance of companies. There is therefore a great deal of educational work to be done, particularly with analysts, financial journalists and shareholders who comment on the results. Even if the company had expressed great intentions in the general meeting to become "clean" in X years, with an impact on its financial result in view of the investments to be made, there is still a risk that its performance will be poorly evaluated in comparison with its competitors who do not have the same investment strategy. Immediate profitability continues to focus interest even though we are now clearly on a strong trend to assess this performance by taking into account sustainability and long-term criteria. The recent amendment to the Afep-Medef Code is in line with this in that it recommends a presentation of the objectives to the General Assembly. The annual report must specify the firm's concrete objectives, whether or not they have been achieved, the timetable, etc. The plan will then be virtuous, because commentators will have all the material to analyze performance properly.

CREATING ENERGY FOR CHANGE

Patrick Bertrand: Why are some players in the economy sometimes accused of greenwashing? In reality, it is because few real actions are taken by the company, which has chosen to display a form of raison d'être, a semblance of a strategy, without associating concrete objectives, financial means and the steps to achieve them. In this case, the penalty is inevitable.

Fanny Letier: Critics focused on groups that had announced extremely broad targets. The backlash was then swift. Concrete objectives must be directly related to the business and strategy of the company. We need to build on what we are and what we have to offer, and then define how we can contribute to one of the sustainable development goals of the United Nations. GENEO Capital Entrepreneur has incorporated its raison d'être into its articles of association, which contain nine statutory objectives that we are in the process of translating into operational objectives. We have a stakeholder committee, which advises our General Assembly every year on how we implement our raison d'être. We do not necessarily impose the definition of a raison d'être in every company we invest in, but they must have a positive impact plan comprising one to three sustainable development goals, between five to ten actions to be implemented within a specific timeframe. We try to blend quick wins and long-term actions to create the energy for change in the company. To provide adequate support, two people are fully dedicated to each firm to provide them with the method and expertise they need to set the plans in motion, and to be able to communicate on the milestones. The transition requires consistency in objectives and agility in resources.

«IT IS NOT REASONABLE *to ask us to take measures that would in practice lead to an immediate exit from a sector which must effectively be wound-down, but in an orderly fashion," BNP Paribas replied to three NGOs under the Climate Risk Due Diligence Act.*

Carol Xueref: The upcoming implementation of harmonized sustainability reporting will probably clarify a little more what is meant by greenwashing or a real increase in the company's commitments over time. Several regulators are reflecting on the topic of ESG reporting. It seems to me that it is complicated for companies to follow all these regulations and to be internationally compliant at first.

Patrick Bertrand: That is even worrying! Ultra-regulation to specify in detail how to define and calculate eco-responsibility criteria and KPI's is not desirable. I fear this transformation of an essential debate into a political tool, as was done in the taxonomy debate between France and Germany on whether nuclear power was "clean" or not. Regulations may/must require the display of carbon footprint reduction goals (targets, monitoring, means, timing), or face penalties. But it seems dangerous to me that it also specifies the nature of the display details, as the business world is so diverse in terms of business activity and business models.

Fanny Letier: On the whole regulatory side, we advise companies to equip themselves with consultants to produce their extra-financial performance statement or to draft their adopted climate trajectory. It would be a pity if all the energy of the company were focused on defensive issues, to report compliance, when the transition will be made more quickly if everyone plays on their strengths to be a solution provider. What is needed today is innovation. And that is what funding must focus on: funding for innovation, CapEx and, more generally, supporting these business model transformations.

Stanislas de Laporte: Companies are not judged in the same way depending on their sector. Some initiatives, such as Climate Action 100+, target only the largest emitters. Understanding investor expectations, internal and external rating systems, is also a way forward for companies, especially to obtain the necessary financing.

Fanny Letier: Preserving investment time and resources for these topics will be a real challenge for corporate governance and for management teams. Businesses must devise an organization to focus on the most differentiated innovation challenges, enabling them to reconcile performance and meaning.

Patrick Bertrand: The *body* of regulations that has been put in place is very complicated, but it must not frighten businesses. The important thing is to define a strategy and really start implementing it. Companies and organizations should not simply tick compliance boxes, without seeking the effectiveness of sustainability actions.

Fanny Letier: Sustainability is an opportunity. And it is perhaps Europe's, we must not miss this. We can recreate very different comparative advantages in the world, because European culture, the way in which managers see business as responsible and the innovative capacity of our companies, are important assets. If we can seize this movement, we can regain leadership. The key issue is time and the long term. Evergreen investment is much more developed in North America and Asia, sovereign wealth funds and governments' strategic plans are much longer than in Europe, which has for some time been moving towards a short-termist economy and policy. There is an urgent need to extend the time-frame for reflection by public and private actors.

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