THE IMPORTANCE OF HUMAN LEADERSHIP WITH INTEGRITY IN A HIGHLY REGULATED AND TECH-RELIANT CORPORATE ENVIRONMENT

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Executive Summary

We are living in times of drastic change and global legal, economic, and political turmoil, hoping for the best but expecting the worst. A focus on the shareholder may drive managers toward profit maximization, often with limited incentives to include environmental, governance, and social factors into corporate decisions. Crises show the need for human leadership with integrity to realign companies with stakeholders besides the shareholder, including the wider society.

Neither the regulator nor technology can replace the need for human leadership with integrity. As to supervision and best-in-class compliance policies, overregulation may even prevent directors from seeing the forest for the trees, and hamper their abilities to make moral judgment calls, as it is impossible to regulate all possible scenarios in advance. Technology supports cost-efficiency, but an irresponsible reliance may even be dehumanizing, as programs can reflect values of software developers, and artificial intelligence may inadvertently adopt societal bias, contributing to a moral dilemma.

International corporate governance codes - as exemplarily analyzed herein - recognize the advantages of moving toward a wider stakeholder inclusion, but such codes serve as recommendations only when they are unbinding in nature. To achieve a lasting solution, it would require introducing a legal entity model, which includes all relevant stakeholders in the company’s decision-making process. However, this would require material corporate law reforms, which are difficult to achieve and implement in the short-term and in the current climate.

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As a practical solution, the elevation of the General Counsel (GC) as a strong and independent leader to the C-suite level would support the Chief Executive Officer (CEO) in achieving corporate sustainability through leadership with integrity. Such promotion would enhance the role of the GC as a proactive business partner and ultimately a protector of the corporation. The revised responsibility would still include assessing legal and compliance matters but extend toward assisting the CEO in strategy, budgeting, governance, human resources, and other key matters for the company.

I. Introduction: an apparent decline of human leadership

Many formerly leading companies experience significant complexities, often driven by a quest for revenue increase. In parallel, new technologies emerge quickly, overturning established business models. Aggressive shareholder action, unpredictable politicians in the Americas (for example, the U.S. and Brazil) or Europe, growing global competition, and digital companies like Amazon or Facebook put corporate decision-makers under unprecedented pressure. Where free world trade is in danger (for example, the U.S.-China trade conflict), corporations may find themselves paralyzed from taking necessary actions. Instead, on a quest for total clarity, managers ask for more data from the markets and want even more control of their companies, which may lead to corporate immobility. Where a need to take action is rising, but the increasing mass of data demands longer analysis and slows reaction times of corporate directors, the number of wrong commercial decisions may increase due to severe market and deadline pressures. In addition to competition on a global level and an expedient evolution of new technology, directors face substantially growing regulatory and compliance obligations.

In these times of rapid change, a corporate structure with a clear hierarchy from top to bottom no longer works. As the “Peter Principle” famously illustrates, a person rises in his or her profession until he or she has reached the position for which he or she is no longer suitable. Rather than a hierarchical model of management and control, there is a clear need for human leadership with integrity. Leadership as a process of social influence maximizes the efforts of others toward the achievement of a goal. In the view of the author, human leadership includes the creation of a work environment where employees can feel safe and valued, so that they can fully develop their natural abilities and perform at their natural best. Rather than being managed by authority, control, and hierarchy, employees follow their true leaders because they choose to do so voluntarily. Such leaders need to be credible, so that a high-performance culture emerges where employees can happily contribute toward the sustainable success of their corporation. Integrity includes, but is not limited to, compliance with laws and other mandatory rules, whether legal or commercial. It also encompasses an unwavering adherence to ethics for the entire organization in all its dealings, including voluntary rules and employee values (for example, transparency, honesty, fairness, candor, and commitment to inclusion).

3 See Ben W. Heineman Jr., High Performance with High Integrity 2 (2008).
Nowadays, human leadership with integrity appears to be on the decline in corporations as there are many corporate examples of significant integrity missteps in business. For example, a U.S. investment bank built an investment fund consisting of mortgage-backed securities, which it knew would likely lose significant value in the short-term, yet sold such products and even bet against purchasers. Their defense was that they did not break any rules, which was probably true, if there was no rule under applicable laws at the time that an investment bank could not sell products to its clients knowing that they were harmful. However, this behavior was unethical in the least. True leaders with integrity must not stop at asking if an action is “still legal.” It also needs to be “right” from an ethical perspective.

Such decline of human leadership already began in the 1990s, with speculators targeting Asian countries. Because of direct investments from foreign companies seeking cheap labor, growth from manufacturing output decelerated in these countries. Since political stability was the precondition for investments, the Asian crisis caused a global economic slowdown. In the U.S., the 1999 repeal of the Glass-Steagall Act led to investment banks pursuing high-risk financial transactions, targeting potentially high rewards, by using deposits held by their commercial units as permitted by “financial engineering”. This allowed for practices such as subprime lending, collateralized debt obligations (notably described as “weapons of mass destruction” by U.S. investor Warren Buffett⁴), and structured investment vehicles or derivatives, which excessively bundled and sold toxic assets and ultimately contributed to the financial crisis.

In parallel, acting as “last resort” lenders, international organizations such as the International Monetary Fund and the World Bank set hard conditionality policies toward increased privatization and fiscal austerity, thereby slowing down the pace of infrastructure building and contributing to a deterioration of the economies in countries such as Argentina and Russia.⁵ The situation escalated in 2008 as the subprime crisis peaked, and many economies are still recovering today. Bailing out failing banks with taxpayers’ money led to an increasing social dissatisfaction due to the perceived moral hazard. These developments resulted in a lack of trust in the global financial system. Recent examples of the June 2016 Brexit referendum in the U.K., Donald J. Trump’s victory in the U.S. presidential elections, and the “Yellow Vest” movement against rising living costs and government tax in France indicate a general social dissent on a global scale, causing a widening rift between the rich and the poor.
The above underlines a strong need for leadership with integrity to achieve sustainable corporate success and to close the apparent disconnect between companies and society at large.

II. Corporate factors contributing to the decline

This section addresses corporate factors that may contribute to the decline of human leadership, such as “shareholder primacy”⁶, stock buybacks and uncommitted investors, the capital

⁶ “[Shareholder primacy is the] idea that shareholders have the priority interest in both economics and governance of the corporation: shareholders are said to be the principal in a principal-agent relationship on whose behalf the corporate
markets’ balance sheet perspective when looking at a corporation, institutional bureaucracy, and variable pay.

A. Shareholder primacy

Whilst every shareholder is a stakeholder, stakeholders also include employees, customers, suppliers, the environment, the government, communities, and ultimately the society in which a company operates. However, many boards of directors seem to believe that they must only consider shareholders’ interests to assess what is important and material for formulating and executing their corporate strategies. When such focus on the shareholders makes corporate decision-makers seemingly indifferent to the necessities of the other stakeholders, opposing movements develop and societal dissatisfaction increases. The following section analyzes the foundations of such shareholder primacy and the components facilitating its ascent.

1. Legal foundation versus market practice

Via entrustment, the board of directors administers the company’s assets on behalf of its shareholders, which are, purely from an economic perspective, the “owners” of generally freely tradable rights (for example, the right to vote, to claim residual assets, or to receive compensation according to the business performance). Legally, shareholders are of course not “owners,” as corporations “own themselves as independent entities”. The legal term for such entrustment is “fiduciary duty”, which many believe a director can only fulfill by prioritizing the shareholder. It is unclear whether shareholder primacy has an actual legal foundation or is derived from market practice.

According to Robert J. Rhee, law professor at the University of Florida, the cause and effect of shareholder primacy has a legally binding basis. Consequently, any policy prescription that follows from a normative theory must fully comply with the doctrine of shareholder primacy. If one interprets the concept as a legal requirement, it opposes the notion of an established market view. In contrast, such a market view could be challenged and ultimately overcome, with sufficient argumentation.

Nonetheless, the maximization of shareholder value is merely an outcome of the corporation’s use of capital. Pursuant to German corporate law, for instance, profit maximization can be one objective of a company, but it is not necessarily the sole or even the main objective. In the words of Colin Mayer, professor at the University of Oxford, “shareholder value should not drive corporate policy but be treated as a product of it”. Corporations use not only financial, but also other capital, such as intellectual, human, manufacturing, natural, and social capital; and each category may relate to a different group of stakeholders. Furthermore, the concept of corporate immortality implies that stakeholders may extend to future generations.


The importance of human leadership with integrity

Stakeholders have financial and non-financial relations for the present and the future. In light thereof, it becomes apparent that directors cannot fully exercise their fiduciary tasks when the company has limited resources and competencies to deploy. As such, they must choose between “significant” and “insignificant” audiences, the former deciding what is “material” for a company to exist over a self-defined period.\(^\text{10}\)

The above indicates that shareholder primacy is not strictly a legal requirement. Directors, as fiduciary trustees of a corporation, apparently tend to concentrate on issues that are relevant for only the short-term. In doing so, they ignore the full spectrum of issues that may be relevant to achieve corporate sustainability. Therefore, they may fail to ensure the long-term existence and lasting success of the corporation. Corporate factors examined below contribute to management’s limited approach of focusing solely on the interests of the shareholders.

2. Corporate personhood and materiality

The main objectives of a corporation, as an immortal legal person, are to exist over time and, ideally, to grow. The concept of “corporate personhood” encompasses a company’s limited liability and liquidity via freely tradable shareholder rights. The metaphor of “shareholder ownership” underlying the notion of corporate personhood may be misleading, as corporations exist as separate legal entities and, in practice, shareholders only “own” a security known as “stock”, with very limited legal rights (e.g., voting). This metaphor of shareholder ownership originates from corporations with a single shareholder or a limited number of shareholders who had used substantial management control. To better illustrate this concept, take the doctrine of “primacy duality” which exists in the U.S. and most other jurisdictions. The doctrine states that directors’ duty to a separate corporate person is equal to directors’ duty to shareholders, but in no jurisdiction is that duty higher than a duty owed to a legal person. This highlights the importance of using a materiality concept in both corporate governance codes and their application to constitute a corporation for the wider society as opposed to working toward the shareholder interest alone.

U.S. courts held that materiality should be determined on a case-by-case basis, similar to a precedent system judges follow in fraud cases.\(^\text{11}\) For example, the U.S. Supreme Court stated that materiality should consider both quantitative and qualitative factors to decide whether the problem at hand would significantly affect the total mix of information available in the reasonable judgment of a corporate investor. Given the unclear nature of what actually constitutes materiality, combined with a lack of sustainable investors that may be involved in its determination, the concept remains entity-specific. The board applies it, attempting to ascertain what a reasonable investor would want to know. Because materiality is merely a company-specific social concept, its construction should neither be subject to standards by external rule-makers, nor left without establishing clear lines of responsibility for its application.


The author believes that determining materiality is one of the key factors for the future success of the contemporary company and a pre-requisite for re-establishing the “human factor” in modern corporate leadership. This important process should commence with identifying the audiences pertinent to the corporation, their interests and conflicts, and the relative weight attached to each. Unfortunately, management often seems to have avoided this initial step for at least two reasons. First, such process does not support the customary concept of fiduciary duties toward shareholders alone, since trade-offs often may exist in the short term. Second, such trade-offs may arise not only between financial capital providers and other audiences, but also between providers of different types of capital (for example, human, intellectual, manufacturing, natural, or social capital) as well as among various audiences themselves.

To conclude, current efforts for simplification of materiality exercised by both companies’ management and their regulators appear to be outdated. Clearer guidelines for internal control systems and corporate governance standards may address the problem, tailored to the business in question. To discover why management apparently focuses on the shareholders, it is essential to identify key corporate instruments that presently facilitate shareholder primacy. These instruments include, *inter alia*, takeover laws, uncommitted investors, capital markets practices, institutional bureaucracy, variable remuneration, and non-quantifiable externalities.

### 3. Takeover laws facilitating directors’ focus on the shareholders

Friendly or hostile takeover bids can push managers toward generating maximum shareholder value by increasing performance to avoid putting their own positions at risk. One of the main reasons for M&A activity is to enhance a company’s business potential. Markets demand that businesses are equipped with abilities to outperform the competition through efficient production, effective marketing, high sales, and turnovers. Although, in the author’s opinion, takeovers usually come with an opportunity to increase such abilities, the process may also introduce measures aiming to “fix” management and commercial issues having previously hampered a company to reach its “ultimate potential”.

After a takeover, the acquiring company may replace the target’s management, whilst the target’s managers may also decide to leave if they do not have the backing of the supervisory board. There are legal and organizational strategies, by means of which management can, to a certain extent, defend itself from the consequences of such takeover. These include “greenmailing” (that is, purchasing shares in a corporation to force the target’s management to re-purchase such shares at a premium to prevent the takeover) or the implementation of a “white knight” (that is, a more favorable acquirer to save the company from the hostile takeover). Only under certain circumstances can a company try to improve the performance significantly so that existing shareholders have no strategic reason to support a merger of the business.

When the actual takeover process begins, the wider group of stakeholders often appears to lose in more than one way. Although a takeover, especially when the target operates in the same industry as the acquirer, can create certain economies of scale and broaden the target’s audiences, there is a wide range of problems, which may only occur after closing the transaction. First,

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creditors will recognize the emerging business as one “customer”, even if financial statements may depict increased income and profits. This may decrease the chances of future debt financing as a customary way of funding business operations for all stakeholders. Second, suppliers and vendors might not have the required capacities to meet post-takeover supply, service, and production demands. This may result in the company turning to cheaper sources of production that may deprioritize rights and opportunities of employers and lower the quality of the final product even further, which may in turn adversely affect the customers. A takeover might damage the existing brand or hurt the company’s new market image. Therefore, it is crucial to evaluate whether the businesses are complementary or whether there is a better prospect to keep them apart, so as not to ultimately harm the customer. Due to a lack of binding rules that include other stakeholders in corporate decision-making and the apparent focus on shareholder primacy, such evaluations may rarely happen in practice.

Furthermore, stock buybacks and uncommitted investors may have a deep impact on prices.

III. Stock buybacks and short-term focus of uncommitted investors

Apart from dividends, another example in support of shareholder primacy is stock buybacks (that is, a company purchasing its own shares), which are increasing since the mid-1980s. A study by Sheng Huang and Zhe (Joe) Zhang from Singapore Management University shows that institutions sell following the occurrence of share repurchase announcements. This mostly affects firms that experience weaker stock performance, display more information uncertainty, and have higher institutional ownership. Share repurchases became a dominant payout mode over traditional dividends. Some authors see them as a “tool for extracting value from companies and handing it to shareholders”. Executives may enrich themselves by selling their own shares, thereby enhancing the value of their largely stock-based compensation. From 2003 until 2018, certain U.S. companies used 94% of their corporate profits for buybacks and dividends. Buybacks occur via tender offer or via open-market repurchases, which have been almost unregulated since the Security and Exchange Commission adopted Rule 10b–18 of the Securities Exchange Act in 1982. A 2003 amendment of the rule brought about limited disclosure duties, which is why the recently introduced Reward Work Act would require tender offers. Stock buybacks may increase

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15 This is the case at least in the U.S., see Gustavo Grullon & Roni Michaely, Dividends, Share Repurchases, and the Substitution Hypothesis, 57, THE JOURNAL OF FIN., 1, 9 (2002).
16 Lazonick & Jacobson, supra note 13.
18 See Lazonick, supra note 12 at 2.
20 Lazonick & Jacobson, supra note 13. Beforehand, companies largely refrained from buybacks fearing potential manipulation charges.
short-term profits but may hurt other stakeholders, if corporations could have invested the funds for sustainable growth.\textsuperscript{21}

Institutional investors also seem to use rights ascribed to them under corporate law to force companies to produce short-term shareholder value, for example, through cash-outs. Such investors appear to diversify their stock portfolios excessively, when certain regulation may increasingly encourage companies to liberate their balance sheets by taking permissible corporate actions. For instance, the Basel III regulatory accord\textsuperscript{22} applicable to banks introduced reforms to improve the regulation, supervision, and risk management within the banking sector, requiring banks to maintain defined ratios and to meet minimum capital standards. The Basel III capital adequacy ratio measures a bank’s capital with respect to its risk-weighted assets. It is calculated by adding Tier 1 capital (that is, core capital, including equity capital and disclosed reserves, but excluding instruments that cannot be redeemed at the option of the holder) to Tier 2 capital (that is, supplementary capital composed of items such as revaluation reserves, undisclosed reserves, hybrid instruments, and subordinated term loans), and dividing by risk-weighted assets. As of 2017, a bank’s Tier 1 and Tier 2 capital must constitute at least 8% of its risk-weighted assets. The minimum capital adequacy ratio is 10.5%, including a conservation buffer to build sufficient capital for unpredictable economic stress.\textsuperscript{23}

Uncommitted investors often spread their investments into a large individual pool. To this end, a constant liquidity supply is necessary, which one could achieve by selling part of an investment portfolio to buy another - more valuable - product. Investors hold rather small stakes in listed companies, and the average holding span may be limited to only few bank working days. Today, institutional investors may have little incentive to engage in their investment targets because the existing regulatory framework encourages investors not to hold large stakes of shares to avoid building liquidity reserves in their balance sheets.

A limited capital markets’ perception mirrors such short-term focus of uncommitted investors.

IV. Capital markets’ vision of the company as a balance sheet

Gathering funds from some entities and redistributing them to others limit a company to a balance sheet with tradable assets and liabilities, ideally with a maximized and immediate financial outcome. Capital markets are short-term oriented and no longer perceive companies as links between business and society.\textsuperscript{24} A growing importance of monetary exchanges and profit flows may downgrade human factors such as employee morale or customer satisfaction.

The value of a transaction purely depends on the price an investor is willing to pay to achieve profitability. A primary question markets currently face is how to classify assets and liabilities to fulfill the dual purpose of profit generation and value development. However, in the

\textsuperscript{21} Stewart, supra note 19.


\textsuperscript{23} Id.

author’s opinion, answering such question becomes increasingly difficult as the focus on shareholders widens the gap between the company and its other stakeholders, including the society in which it operates. Primary products and services no longer accurately determine the valuation, when capital markets assess a corporation based on its transactional strength, thereby separating the company’s value from its operational business.

Another factor for the apparent decline of human leadership is institutional bureaucracy.

A. Institutional bureaucracy

Over the last decades, management appears to have increasingly downgraded the importance of the well-being of its employees, focusing on generating maximized returns for shareholders. Customers and employees have become two out of many means to create such shareholder value and have apparently lost the management’s main attention. A shareholder focus may exclude (as cynics might say, conveniently) ethics or morality, first from theory, then from practice of corporate administration. In “Bad Management Theories are Destroying Good Management Practices”, Sumantra Ghoshal, an Indian economist and professor at London Business School, stated that “by propagating ideologically inspired amoral theories, business schools have actively freed their students from any sense of moral responsibility”.25

Furthermore, management practices may create beliefs about acceptable corporate behavior that are even contrary to common norms of socially adequate behavior. Such an attitude could, in the author’s opinion, in another sense be compared to initial thoughts by Gary Becker, Nobel Prize Laureate in Economics, when he questions why theft could be harmful as it “merely appears to redistribute resources usually from wealthier to poor individuals”.26 Across industries, managers identify so-called “low performers” by applying “bell-curve” ratings in annual performance reviews, contributing further to institutional bureaucracy. Rationalized thinking without considering ethics and values is devastating for companies, as shown by corporate scandals such as those involving Enron and Tyco International, which resulted from directors focusing on increasing profits instead of combining performance with integrity.

Unsurprisingly, many employees feel increasingly dissatisfied with their work and may hold management in low esteem. In light thereof the emergence of new legislation, for example the Swiss constitutional amendment aimed at reducing top-level salaries, is not surprising.27 It is important to point out that management cannot simply regard human resources as tools used for production purposes. Thus, it is key for companies to reconnect with their own employees as by recognizing them as important stakeholders who need to be included in the company’s decision-making process.

However, the current system of variable pay may lead to additional problems, as there are corruption pressures hidden at the core of corporate capitalism, which may arise through a wrong

incentive setting (that is, numbers before people) and thereby may even contribute to a toxic corporate culture by potentially facilitating a “turf war” for maximum pay among employees.

**B. Variable remuneration**

Major contributing factors leading to the 2007–08 financial crisis were irresponsible remuneration policies and practices in the financial industry. These set the wrong incentives through variable pay, encouraging employees to take higher risks in the assumptions of higher gains. Following the crisis, the EU legislature recognized the problems of variable pay as it introduced regulatory remuneration arrangements following similar considerations (overpayment through false incentives).\(^{28}\) Especially in the financial services sector, variable pay has become a focus of European legislation. Most notably, the Guidelines on Sound Remuneration Policies published by the European Banking Authority based on Art. 75 of the CRD IV draw a clear distinction between “variable pay” and “fixed pay.” According to such guidelines, a “fixed” remuneration occurs where the conditions for its award and its amounts:

- “are based on predetermined criteria;
- are non-discretionary reflecting the level of professional experience and seniority of staff;
- are transparent with respect to the individual amount awarded to the individual staff member;
- are permanent, i.e. maintained over a period tied to the specific role and organizational responsibilities;
- are non-revocable; the permanent amount is only changed via collective bargaining or following renegotiation in line with national criteria on wage setting;
- cannot be reduced, suspended or cancelled by the institution;
- do not provide incentives for risk assumption; and
- do not depend on performance.”\(^{29}\)

Payments or benefits not meeting these criteria constitute “variable” remuneration, that is, payments reflecting a sustainable and risk-adjusted performance as well as performance in excess of what is required to fulfill the employee’s job description as part of his or her employment terms. Fixed remuneration, on the other hand, specifies remuneration that primarily reflects relevant professional experience and organizational responsibility set out in an employee’s job description as part of the terms of employment. It appears implicit within the CRD IV context that variable pay can still help to reward those employees who work harder to gain benefits from variable pay as opposed to those employees who don’t. This, however, could lead to irresponsible behavior, given there are corruption pressures at the center of capitalism: if there is no way for an employee to reach goals through performance with integrity, such employee may try to use other methods to do so, just to achieve targets set by management and the maximum bonus.

In the short-term, performance-based compensation may motivate employees to be more

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\(^{29}\) *Guidelines on Sound Remuneration Policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) 575/2013*, EUROPEAN BANKING AUTH., at § 7, 117.
entrepreneurial. This can result in higher profits for the company and, ultimately, higher salaries, while allowing the employers not to spend as much on employees who do not perform comparably well to others as per the agreed target system. However, there are numerous problems associated with introducing a variable pay system, mainly concerning unhealthy competition between employees. For instance, if an employee works on a commission, he or she may not be willing to share efforts with others. In turn, this could result in sub-optimal distribution of tasks and an atmosphere that not only discourages collaboration, but also generates conflicts. Another side effect of performance-based compensation is the possibility of putting excessive pressure on customers to make sales to earn commissions. Increasingly, customers value the quality of their transactional experience, so an aggressive pursuit of variable pay could have the opposite outcome to what is expected. Finally, a performance-based approach goes together with the conduct of business and the resulting profits. Employees receive commissions when the company is in good shape, but they may not receive anything, regardless of seniority, if the company’s financial goals remain unfulfilled.

*De facto* unachievable targets, an unintentional creation of incentives to cheat and internal “turf wars” may lead to a toxic work environment, thereby highlighting the dangers of variable remuneration in the long term. A study by Macquarie University in relation to the effects of variable pay held that performance-based remuneration “does not significantly improve productivity, but it does decrease compliance.” Participants would work more slowly when weighing chances of discovery against potential gains. If commissioned workers are increasingly afraid to lose money and benefits, they may look for alternative employment, thereby causing unexpected job market movements and staff deficits.

The rules on variable remuneration set by the European Banking Authority in its Guidelines on Sound Remuneration Policies seek to address such negative effects. They require that variable pay is not only granted for reaching quantitative targets which are ultimately motivated by shareholder primacy, but also includes factors such as measurement that are oriented to other elements (for example, providing for deferral periods for variable remuneration, “malus” rules, claw-backs, and remuneration caps). Most member states of the EU comply or intend to comply with the guidelines, including Germany, which has implemented the guidelines in Section 25a (1) and (5) of the German Banking Act (*Kreditwesengesetz*) and the German Regulation on Remuneration in Institutions (*Institutsvergütungsverordnung*).

Performance-based remuneration, especially among executives, for pre-set targets and benchmarks leads to an alignment with the interests of shareholders as uncommitted capital owners. Management may be tempted to exploit its position to obtain the highest possible variable pay, with processes becoming so complex that it gets very difficult to understand which corporate

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behavior is actually worthy of a reward. Suddenly, added profit becomes the business’ center of
gavity, with all other non-monetary values put in second place. However, a sustainable company
requires their employees’ peak performance because of an intrinsic passion to perform with
integrity, not to increase their chances to achieve variable pay. This is why a system of variable
pay may encourage managers, and other employees, to lie about the difficulty and the achievement
of agreed targets and whether they acted with integrity.

Thus, in the long-term, employees may perform worse due to variable remuneration,
causing an erosion of employees’ confidence in management and a lack of identification with their
company. Moreover, unconsidered externalities may also contribute to such decline.

C. Unconsidered externalities

The term externality means that a third party incurs a cost or receives a benefit without
control over how such cost or benefit arose.\(^{34}\) It can be positive or negative, and it can originate
from either production or consumption of a good or service. Externalities describe collateral effects
that shareholder primacy may have on interested stakeholders other than the shareholders.

Companies appear to maximize the sum of the various stakeholders’ surpluses toward
developing sustainable businesses simply by jointly addressing economic, environmental, and
social aspects.\(^{35}\) Various local laws support such a view, as many jurisdictions recognize that
management should prioritize the interests of the corporation as a whole (for example, the
Corporations Act 2001, s. 181 in Australia\(^{36}\); the Companies Act 2006, s. 172 in the UK\(^{37}\); the
Delaware Code Title 8, s. 121 in the U.S.\(^{38}\)).

Companies’ interest to remain in existence may urge them into growing, while having to
address the competition and the increasing regulatory changes and challenges with limited
resources. To create value and maximize performance, several collateral factors become apparent.
These may include environmental deterioration, natural resource exhaustion, or employee
relocation, all of which have no easy cure without affecting value creation.\(^{39}\) Even if regulation
could address these externalities (for example, the European Commission’s legislative proposals
on sustainable finance)\(^{40}\) or the market itself, many are still not considered.\(^{41}\)

\(^{35}\) Business Roundtable Redefines the Purpose of a Corporation to Promote ‘An Economy That Serves All
Americans’, Business Roundtable (August 19, 2019), https://www.businessroundtable.org/business-roundtable-
redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.
\(^{39}\) Jeremy Galbreath & Gavin Nicholson, *Responding to Sustainability: A Model Exploring the Impacts of Boards of
Directors and Organizational Strategic Flexibility*, ANZAM, AUSTRIA AND N. Z. ACAD. OF MGMT., 2009, at 1.
\(^{40}\) See Financial Stability, Financial Services and Capital Markets Union, *Commission legislative proposals on
sustainable finance*, EUROPEAN Commission COMM’N, (May 24, 2016). The EU sustainable finance market depends
on voluntary principles. According to recent research, climate change could cost up to 19% of global GDP by the end
of 2030. In response, policymakers want to increase regulation toward a low carbon economy.
\(^{41}\) See GALBREATH, & NICHOLSON, supra note 39.
The value chain, by which a customer is the top priority, may especially cause corporate externalities. Without the customer, there would be no market for the product. Employees, who produce the final product as well as the social and natural environment enabling the production to meet the consumers’ demand, become second to the customers’ needs, as the company may not be concerned with any unregulated issues that are no longer included in its decision-making. Companies willing to find a balance between value-creation efforts and long-term development go beyond market mechanisms and voluntarily address corporate sustainability.

As Swiss entrepreneur Stephan Schmidheiny, author of Changing Course: A Global Business Perspective on Development and the Environment42, explained, this is because these aspects are intrinsically tied to ongoing, sustainable economic activity. To generate sustainable progress, a company’s entrepreneurial activities must be in line with conserving the natural environment and taking into account social developments that affect both stakeholders and non-stakeholders, rather than intentionally externalizing costs onto others. To achieve a more sustainable business development, we must reconsider three governance themes:

- First, maximizing profits for shareholders as the sole corporate objective is out of touch with modern corporate realities. Companies should internalize externalities for all stakeholders and profit maximization must not hurt environmental and social objectives. Stakeholders extend beyond shareholders and inventors to all parties that bear some form of interest, resulting from having devoted a form of capital in the company (including but not limited to financial capital).43

- Second, to be sustainable, companies should promote ethical and philanthropic actions to support social good alongside or instead of the exclusive monetary interest of such companies. Adam Smith, the grandfather of economics, as paraphrased by Jeremy Galbreath, associate professor at Curtin University, argued that, even if ‘self-interest’ is good for wealth creation, individuals should never judge outside of what is good for the commonwealth.44

- Lastly, companies should minimize their impact on, and the use of, scarce natural resources. Authors like Neil Fligstein and Jennifer Choo, scholars at Berkeley and Stanford, argue that all companies are also social public institutions, constituting the part of the society in which they exist. Thus, companies must contribute to the common welfare and help build social capital for all stakeholders.45

The above considerations clarify that to achieve long-term success, a corporation needs to address all stakeholders’ interests rather than focusing on maximizing only shareholder value.

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44 JEREMY GALBREATH, Sustainable Development in Business: A Strategic View, in THEORY AND PRACTICE OF CORPORATE SOCIAL RESPONSIBILITY 89-94 (Samuel Idowu & Céline Louche, eds., 2011).
D. Interim conclusion

The above analysis has shown that there are several corporate-specific factors facilitating a decline in human leadership, as there is no legally binding incentive for companies for further stakeholder inclusion toward sustainability. Instead, companies appear to put their focus on the shareholders, most notably stemming from the mistakenly interpreted concept of shareholder primacy, short-term investors’ limited objectives, and variable remuneration. In the case of stock buybacks, they are largely unregulated but “legal” in the U.S.; however, we should ask if they are also “right” to use, depending on the cause and effect of such buybacks. Consequently, takeover laws may potentially be one-dimensional, uncommitted investors may diversify constantly, and the capital markets may view companies only as “balance sheets”.

Ironically, shareholder primacy not only hurts other stakeholders, it may harm the shareholder as well. In Fixing the Game, Roger Martin, Dean of Rotman School of Management, stated:

Total returns on the S&P 500 for the period from the end of the Great Depression (1933) to the end of 1976, the beginning of the shareholder-value era, were 7.5 percent (compound annual). From 1977 to the end of 2010, they were 6.5 percent - suggesting that shareholders have little to celebrate, despite having been made the clear priority.\(^{46}\)

A focus on attaining financial gains overshadows a company’s true purpose to serve all interested stakeholders. A shareholder focus may create additional pressures for corruption, which may lead managers to an irresponsible use of capital just to achieve financial targets.

Apart from those corporate factors outlined above, there are also other societal factors to consider, which may contribute to a decline of human leadership in the corporate environment.

V. Supervision and technology contributing to the decline of human leadership

Overregulation may suggest a company’s inability to self-control its own business and conduct. Excessive supervision may hamper individual thinking and responsible moral judgment. Furthermore, “more-for-less” pressures may cause an overconfident reliance on technology.

A. Excessive regulation potentially hampering moral judgment

Traditionally, societies have regulated human behavior and social interaction to maintain orderly relationships and to maximize the probability of survival and human attainment of material and non-material objectives. Due to the complex structures of modern society, regulation takes place on multiple levels within a framework, for example, set by a central authority, such as the government, or an institution that has legislative and other decision-making powers. Such authorities seem to act under the assumption that societies require regulation to avoid chaos,

\(^{46}\) ROGER L. MARTIN, Fixing the Game, 30-31 (2011).
disorder, and disintegration, which may impair their chances in order to survive and prosper.

While it is difficult to summarize all types of regulation into a single mission statement, regulation appears to share a general theme: to achieve systemic stability by facilitating interested parties to move toward desired actions and away from undesired ones. However, an increasing and potentially excessive supervision by regulatory bodies on a global level may likely be a source of further conflicts and increased tension.

This section analyzes regulation emerging in many countries following the subprime financial crisis, which has led to a significant growth of external supervision and internal “best-in-class” compliance policies in corporations. It then identifies an adequate role for regulatory supervision and compliance to help a corporation in achieving sustainable commercial growth.

1. Post-crisis regulatory and compliance overload

The 2007–08 subprime financial crisis revealed structural weaknesses in financial systems and initiated substantial regulatory changes in the global banking sector, which are highly complex.\(^\text{47}\) The legislative wave toward regulation hit mostly in the U.S. and in Europe, as the regions most affected by the crisis. Now, the level of regulation of financial markets has reached an unprecedented level. While the public requires an increased oversight over credit institutions to restore its lost faith in the financial sector, high compliance costs, increased capital reserve requirements, and partially disproportionate penalties seem to have become unreasonable.

In the U.S., legislative actions include but are not limited to the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which thoroughly altered the financial industry, just like the Glass-Steagall legislation of the early 1930s, the Volcker Rule, which reduces speculative investments, and the Foreign Account Tax Compliance Act, better known as FATCA, targeting non-compliance by U.S. taxpayers.\(^\text{48}\)

In Europe, on the other hand, legislators introduced increased capital requirements (Capital Requirements Directive IV/Capital Requirements Regulation; CRD IV/CRR). Conversely, the Markets in Financial Instruments Directive II (MiFID II/MiFIR relating, in particular, to conduct rules, licensing, reporting, and transparency requirements) and the European Market Infrastructure Regulation (EMIR) facilitated consumer protection and brought in complex restrictions on financial instruments. Initially designed to improve standards, foster discipline, and promote transparency, overregulation might become a major obstacle to corporate economic growth according to a study requested by the European Parliament's Committee on Internal Market and Consumer Protection (IMCO).\(^\text{49}\)

In search of compliance with external rules and internal policies, corporate directors may

\(^{47}\) JOSÉ MANUEL CAMPA, Resolution in Europe: Pending Cross-Border Issues, in Resolution in Europe: The Unresolved Questions 87-1 (Andreas Dombret & Patrick Kenadjian, eds., 2019).

\(^{48}\) Edmund Parker & Mayank Gupta, Too Much Regulation Creates Bank Brain Drain, FIN. TIMES (Oct. 18, 2005), https://www.ft.com/content/4dfc4190-719f-11e5-9b9e-690fdae72044.

fail to see the big picture of what really matters. Despite regulatory increases, managers must maintain the ability to make judgment calls based on law, ethics, and employee values, as opposed to obediently following regulation and “best-in-class” compliance policies. Neither the regulator nor compliance policies can liberate business managers from fulfilling such a duty.

In particular, corporate directors need to show human leadership with integrity to accomplish their mission of driving the corporation forward in a sustainable fashion. Despite greatly increasing regulation, supervision, and compliance policies, there can never be an ideal regulatory system, which would have to anticipate and regulate all potential outcomes to avoid any crisis.

2. The illusion of an ideal regulatory system

Not only is regulatory compliance costly, it may also give a false sense of security as managers can lose focus due to increasing rules and regulations. Regulatory rules include supervision imposed by the EU legislature, leading to increasing compliance policies in corporations, often with an ambition to become “best-in-class” compliant. However, with an increasing number of these policies, paradoxically, business managers may become even less responsible. There is a difference between liability in the legal sense and actual assumption of responsibility by managers in the day-to-day business. Managers may think that if they act in compliance with pre-set rules, regulations, and guidelines, their responsibility may end. With increased regulation and compliance policies, managers may believe they are only responsible for compliance with such existing regulatory norms and policies, and not for all the consequences of their behavior. However, as regulation can never predict when a new crisis will hit, it also cannot regulate all events and circumstances in advance. Regulation is a means to encourage companies to implement leadership with integrity to make sustainable decisions. No employee can just follow existing rules and thereby completely fulfill her responsibilities. Employees still have to make moral judgments, especially about consequences of unregulated behavior.

Legal examples of detailed frameworks are the CRD IV/CRR, which require financial institutions, in particular banks, to have a certain amount of capital (of a certain quality) in their balance sheets to conduct their business. If financial institutions conduct business with greater risk exposure, they have to reserve more capital for such business. The directive also deals with governance elements of financial institutions. With respect to the implementation of the MiFID II and PSD2 in companies, the costs are high and the effect is questionable. The more documents and policies companies must follow and observe, the lesser the inclination to do so, which weakens the intended effect.

As Article 91 (12) lit. c of the CRD IV, the European Banking Authority (together with the European Securities and Markets Authority) issued Guidelines on the Assessment of the Suitability

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of Members of the Management Body and Key Function Holders of Institutions. Such guidelines are aimed less at regulating honesty and integrity in itself, but rather focus on ensuring that these factors are considered as key criteria when selecting management. This confirms the importance of personal factors such as integrity and independence. Of course, relevant factors to take into account under the guidelines are only indicative and not exhaustive, and it would be very bizarre to regulate honesty and integrity. Rather than just following rules to “tick the box”, we have to be virtuous in situations that we cannot predict. There cannot be a rule for being honest and having integrity in all situations. Nevertheless, the mere creation of guidelines for honesty and integrity shows how excessive regulation may have become. Apparently, we need guidelines for such behavior, similar to the IFRS for accounting, aimed at creating a system for assessing value based on assets and liabilities.

There are still unregulated issues as well as areas where supervision offers a certain discretion and scope for interpretation. Increasing regulation may lead management to think that if a behavior was wrong, appropriate regulation would exist. Otherwise, management may consider themselves free to take any decision at all. Using such flawed rationale, they may think that they do not have to use their own morality anymore when outsourcing responsibility to the system of regulation and policies. This leads to an illusion of an ideal regulatory system, which cannot exist but in turn contributes to an even greater decline of human leadership in the company.

Thus, overregulation may actually destroy moral qualities when more control leads to the assumption of less individual responsibility. We can no longer make sound judgments when we do not have a trained morality. We appear to believe that the regulator and compliance teams can build an ideal regulatory system. However, it is not only impossible to do this, it is also dangerous, as it may prevent business managers from training their moral judgment-making, taking difficult decisions whilst also considering the implications for all stakeholders.

Consequently, companies may become further dehumanized due to excessive regulation and compliance policies. Instead of using moral skills to make judgment calls with integrity, corporate directors only want to follow the existing rules and get their key performance indicators right, which is what the capital markets demand to generate the value that is expected.

Overly stringent regulation may hamper exercising leadership with integrity, which is of course not the raison d'etre for supervisory institutions such as the European Central Bank.

3. An argument for a less invasive supervision practice

Looking for potential failures and unnoticed risks, the EU legislature appears to be on a mission of overly detailed supervision in a quest of being prepared for when the next crisis hits. The regulator’s objective is to achieve systemic stability. However, since we cannot fully anticipate

a crisis, an adequate role of supervision should aim to remove harmful elements or developments from the system. Overregulation may have the paradoxical effect of eliminating responsibility. Rather than organizing each institution perfectly with no room for human error, the regulator should target issues and processes preventing any decent risk management system.

As an example of an adequate role of regulatory supervision, the U.S. Financial Choice Act prescribes that, if a bank has higher ratios - that is if its debt is less in comparison with its capital - the U.S. Federal Reserve will step back in supervising such a bank. If an institution with a healthy balance sheet and risk management is less likely to default, the supervisor should not interfere too much. Under EU law, there are already certain legal elements that go in a similar direction.

Pursuant to Article 104 (1) lit. a of the CRD IV, the competent authorities in the EU member states shall have the power to require institutions to hold their own funds in excess of the minimum capital requirements for risks not covered by such requirements (for example, taking account for riskier business activities or an inadequate risk management). In their supervisory role, the authorities typically focus on business activities or organizational shortcomings considered to entail increased risks for the examined institution.

Business managers contributed to the subprime crisis by exercising single-minded decision making with no integrity, and in many cases were driven by greed and motivated by variable pay. Instead of seeing regulatory compliance as the sole solution, companies need managers to employ human leadership with integrity so that companies can have a sustainable future.

**B. The dangers of an irresponsible reliance on technology**

Another element leading to a potential dehumanization may be an excessive reliance on technology, which has begun to evolve more rapidly than many human-beings can handle, above all, mentally. Still, facing corporate “more-for-less” pressures, managers may embrace an implementation of technology to stay within their budgets and to reach agreed performance goals. As the World Economic Forum predicts, machines will perform more than half of workplace tasks by 2022. However, technology is merely a tool and clearly does not make human leadership obsolete. This section examines how legal tech, artificial intelligence, and big data affect the legal sector.

**1. New technology affecting the legal sector**

The evolution of technology and the trend toward digitalization is affecting all businesses in every sector, including the transformation and innovation of the in-house legal function.
Traditionally conservative, many law firms and legal departments even resisted implementing simple technological communications media, like email, until the early 2000s. However, increasingly complex legal work meant that old communication systems were becoming obsolete. Lawyers realized that they needed to adopt agile practices and change their professional approach to keep up with the latest trends and requirements affecting the industry.

Digital innovation (for example, e-justice systems) and rules for data processing and protection (for example, provisions of the General Data Protection Regulation of 2016 and PSD2 of 2015) created pressures on lawyers to transform their tools but also created new business opportunities.

a) Legal tech

From an in-house legal perspective, the common understanding seems to be that legal tech encompasses digital tools that may help many companies make efficiency gains and adapt to a more agile working culture. Across many industries, teams use legal tech tools aimed at cutting spending, improving predictability, and achieving better outcomes. For example, pharmaceutical company AbbVie uses legal tech to minimize its data processing spend, which had been growing at an unsustainable rate. It took all data collection, processing, and hosting in-house, saving approximately four million USD per year. Mining company Anglo American, which lost 60% of its in-house staff following the 2015 collapse of commodity prices in the mining sector, moved low-value, high-volume work to Exigent, a legal-outsourcing service, allowing the in-house team to handle more complex issues. Contract turnaround time dropped 86%. Exigent also developed a customized legal spending tool supporting Anglo American to establish a law firm panel and to manage better pricing, resulting in a 35% reduction of external counsel spending over three years. The Australia-Asia legal team of Hatch, a global engineering firm, used design thinking in collaboration with Lexvoco, a legal services company, to set up a global legal information platform. This empowered clients to self-serve for routine legal tasks, leading to a drop in response time for document requests from an average of a week to a few hours. The legal team also implemented key management techniques as part of design thinking, including enhanced visual communication and training practices. Sonae, a shopping center company headquartered in Portugal, teamed up with IT, a Portuguese telecommunications company, to develop a software solution streamlining communication with 970 interlocutors, registering and tracking all labor and social security proceedings, complying with GDPR, and integrating a knowledge management platform with enterprise resource planning. Costs fell by 90% and duration of proceedings by 30%.

From an external law firm perspective, legal tech enables smaller firms and sole practitioners in particular to level the playing field vis-à-vis the established professional service
providers and to protect their positions within the increasingly competitive market traditionally dominated by the big law firms. The rise of a 24/7 client demand culture means that being able to meet a client at an office location between 9:00 a.m. and 8:00 p.m. on any given business day may no longer be sufficient for any external lawyer. Clients often expect a more flexible approach with options to contact counsel at any time outside regular working hours and to access online case management tools where they can view the progress and leave their own comments in real-time. Similarly, legal experts themselves ask for a more flexible working schedule, where successful transactions and clients’ giving positive feedback determine rewards, as opposed to face time at the workplace. Unlike the established players who use big law firms, new market players may favor more cost-efficient legal solutions.60

The next step is the creation and use of advanced artificial intelligence solutions.

b) Artificial intelligence

In a legal context, artificial intelligence (AI) may encompass “teaching” machines to carry out routine tasks and searching through vast quantities of data. Machine learning is an application of AI that provides systems with the possibility to automatically learn and improve from experience without being explicitly programmed. We use it to explain the human world to machines in order to make them interact with us. However, machine learning also replicates societal bias, which the data feed may contain. For instance, Amazon stopped using a recruitment tool that discriminated against women.61

Perhaps the most noteworthy practical application of AI has been predictive coding and pattern recognition, which describe a form of technology-assisted review process, used to assess the relevance of documents for the purpose of e-discovery and to predict future behaviour. Predictive coding uses a combination of keyword searches and computer learning to rank any relevant document, which has already proven successful, for example, in U.K. cases following Brown v. BCA Trading and Others.62

As an example for a practical implementation of AI, Deutsche Bank used QuisLex, a legal process outsourcing company, to create standardized e-discovery processes and implement AI-enabled solutions to find relevant documents, automate redactions, and translate foreign-language documents. This practice led to costs decreasing over a one and a half year period by 49%, 90% of which were completed on time and within budget.63

On May 22, 2019, the Organisation for Economic Cooperation and Development (OECD) adopted principles on the regulation of AI, which was the first set of international standards agreed

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61 Jeffrey Dastin, Amazon scraps secret AI recruiting tool that showed bias against women, REUTERS (Oct. 9, 2018), https://www.reuters.com/article/us-amazon-com-jobs-automation-insight/amazon-scrapes-secret-ai-recruiting-tool-that-showed-bias-against-women-idUSKCN1MK08G.
62 See Brown v. BCA Trading Ltd. [2016] EWHC 1464 (Ch).
63 Examples and figures with respect to the use of legal tech in practice, see Get Inspired by the ACC Value Champions, ASSOCIATION OF CORPORATE COUNSEL (Jun. 16, 2019),https://www.acc.com/services-initiatives/value-challenge/acc-value-champions/meet-the-champions.
upon by governments for the responsible handling of AI.\textsuperscript{64} Such principles include specific recommendations for public policy and strategy to apply generally to AI development around the world. In addition, the OECD intends to launch a policy observatory in 2019, ensuring the beneficial use of AI.\textsuperscript{65} The OECD AI Policy Observatory highlights the importance of a multi-stakeholder partnership, which reflects the importance of bringing various interest groups together, affirming this article’s overarching thesis of the necessity of addressing all relevant stakeholders through leadership with integrity.

The creation of the OECD principles is an important step for the regulation of AI. Although broad in nature, the principles provide guidance on cardinal issues, which are important from a legal perspective (for example, creating transparency and responsible disclosure, which are necessary to understand AI-based decisions and, whenever required, challenge them). The adoption of these value-based principles also aims to ensure responsibility, highlighting the importance of both organizations and individuals being liable for their use of AI.

Although not legally binding, the principles are influential, as other recommendations by the OECD have often contributed to the creation of international standards and national legislation.\textsuperscript{66}

c) \textbf{Big data}

To the extent legally permissible, companies record information and upload it to databases for future use. They store and process large sets of data to analyze and extract relevant value. Legal research tools, such as Lex Machina, offer a legal analytics platform that support lawyers in deciding on the best litigation strategies by looking for trends in the outcomes of previously applicable case law.

As a practical example, Rabo AgriFinance LLC, a U.S. agricultural lender, and Rabobank, a Dutch agricultural lender, engaged Thompson Coburn, a U.S. law firm, to handle its large agricultural loans. Using a data model to predict how long review and revision of data should take, they managed to drop turnaround time by 70\%.\textsuperscript{67}

2. \textbf{Notable impacts on the legal market}

From an efficiency perspective, using legal tech may be advantageous to both the in-house


\textsuperscript{66} See generally \textbf{ARTIFICIAL INTELLIGENCE > OECD PRINCIPLES ON AI}, https://www.oecd.org/going-digital/ai/principles/ (last visited Dec. 19, 2019). For example, the 1980 adopted OECD Privacy Guidelines, which underlined limits to the collection of personal data, were a starting point for many privacy laws and frameworks in the United States, Europe and Asia.

\textsuperscript{67} Examples and figures with respect to the use of legal tech in practice are taken from \textbf{GET INSPIRED BY THE ACC VALUE CHAMPIONS}, https://www.acc.com/services-initiatives/value-challenge/acc-value-champions/meet-the-champions (last visited Jun. 16, 2019).
community and external law firms. In the U.K., since the enactment of the Legal Services Act 2007, even non-lawyers may own and invest in law firms and provide legal services by setting up alternative business structures (ABSs)\(^{68}\). Until today, traditional law firms provide the lion’s share of all legal services. The introduction of ABSs constitutes the biggest change in the profession since the mid-1980s, when lawyers obtained permission to advertise. Legal tech plays a large role in activities of ABSs, offering cost-efficient legal products to individuals and smaller companies, which might have otherwise not sought legal advice at all. Examples of do-it-yourself law include document templates (for example, Rocket Lawyer) and chatbots (for example, DoNotPay).\(^{69}\)

Today, internal legal counsel face significant challenges and increasing demands that make them appreciate the advantages of legal tech. The challenges include a need for and expectation of alignment of legal teams with the wider organizational strategy, the expectation of increasingly sophisticated service, and the never-ending quest for cost efficiency. The *New Law Journal* reported that 57% of GCs believe that legal tech tools have already increased productivity, while more than 60% of GCs saying that technology will help them improve the accuracy of their work within the next 5 years.\(^{70}\)

Paul Cummins, Head of Legal Services at Milton Keynes Council, commented that engaging the internal information technology (IT) service early in the implementation process of a new technology ensures that the proposed tool fits into the overall IT infrastructure of the corporation.\(^{71}\) Until now, in-house counsel have felt most comfortable with testing insight tools, used for legal research such as Lexis Library or Lexis PSL. Other developments have been less popular (for example, only 4% of those surveyed have adopted a proofreading technology). Nonetheless, to adopt processes and governance to meet efficiency expectations, some corporations showed significant efforts toward legal tech implementation. For example, the John Lewis Partnership, a consumer retailer, decided to use technology to improve legal document creation, and to streamline its reviewing process by lowering administrative overheads and operational risk. Following successful experiences during trials, the John Lewis legal team decided to adopt the Lexis Draft tool.\(^{72}\)

### C. Interim conclusion

Legal tech, AI, and big data may be beneficial, in particular from a cost and efficiency perspective. Whilst the regulation of these technologies is yet unclear, we may soon live in a world with AI all around us. AI causes disruption of business models and legal work practiced today. Fifty to sixty percent of legal jobs may change in the future, once some form of AI takes over. We will no longer have to look at cases anymore and study them at the library because some system will give us all the relevant court decisions at a simple mouse click. In addition, technology will

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71 *Id.*
72 *Id.*
do the research much more quickly and comprehensively than a human ever could.

However, with regard to the dangers of technology, programs may reflect the morals and values of the programmers. Machine learning depends on the data fed. Without free will or self-consciousness, machines have no ethics or morality. AI is based on algorithms which learn from previous decisions and become better and better at what they do. Data reflects society’s bias, leading to a moral dilemma. Eventually humans will no longer understand anymore how the algorithms will reach a decision, as it will be too complex to do so. If there are biases in the decision-making process, we no longer know where such biases are in the algorithm, as it is too complex. As mentioned above, Amazon stopped using an artificial intelligence recruiting system, as it could not find out why their tool favored male candidates.73 Moreover, Facebook assesses people based on what posts they like which determines for what kind of insurances such people would qualify. Humans may choose to rely on technology instead of making their own deliberate decisions.74 Such an attitude fails to see that technology should always serve the people and not vice-versa, as technology is a tool and not the master.

With machine learning, we can better understand big data and complex systems by structuring previously unorganized data through machines to identify clusters and irregularities. However, we should avoid becoming a resource for a production process driven by technology. We already have a human resource department for which we serve as bundles of data. We excessively rationalize to avoid inefficiencies. For example, in accounting IFRS, there is an example for excessive rationalization in search of a value, assets, and liabilities. However, value is always subjective. Nevertheless, we have a whole profession working on an accounting documentation searching for the perfect understanding of assets and liabilities. We pursue something, which through rational sense, we cannot understand. Humanity must remain at the center and in full control of technology, however difficult that may appear. We need to avoid overly relying on technology, as we need to understand it to know when and where it fails. To remain in control, human leadership with integrity is key for a humane and sustainable implementation of technology.

The following section examines international corporate governance codes from the U.S., the UK, Germany, and South Africa, which all recognize a need for an all-stakeholder inclusion.

VI. International corporate governance codes recognize but do not fix the problem

By empowering leaders and enhancing their responsibilities toward all relevant stakeholders, corporate governance codes seek to increase the acceptability of a corporation by society.

A. United States of America

U.S. corporate governance regulation stems from state law as well as federal statutory rules and regulations from various governmental agencies, including the U.S. Securities and Exchange Commission (SEC). Whilst each state features its own code (most prominently Delaware, as it is the site of incorporation of most public companies), common features are the basic purpose of corporations, the definition and measurement of corporate success, and the appropriate weight to be ascribed to stock prices to reflect their intrinsic value. Moreover, the various state codes inform how to balance a wider range of stakeholder interests beyond the investor (including the interests of employees, customers, communities, and the economy and society as a whole), which have become issues that may concern corporate boardrooms, policymakers, and also (long-term) investors. The U.S. Corporate Governance system is still CEO-centric. For example, other relevant stakeholders such as taxpayers and workers are unrepresented at the board level.75

Nevertheless, key governance discussions recognize that inclusive boards and corporate cultures are valuable assets, sources of competitive advantage, and fundamental to creating and protecting long-term value. The inclusive boards and corporate cultures have features of self-regulation set by the company.

B. United Kingdom

The Financial Reporting Council published a revised UK Corporate Governance Code on July 16, 2018, applicable to accounting periods beginning on or after January 1, 2019. Rather than a strict rule set, the UK Code offers flexibility through application of principles, “comply or explain” provisions and supporting guidance, which boards shall use wisely.76 According to the UK Code, the board’s main mission is to achieve sustainability by creating shareholder value whilst serving the wider community.77

Cardinal principles of the UK Code are about board leadership and the company’s purpose: an effective and entrepreneurial board, whose role is to promote the long-term success of the company, through generating value for shareholders and contributing to wider society. The board should define the corporation’s purpose, strategy, and values, and then align these with the corporate culture. Directors should be role models, promoting corporate culture whilst acting with integrity and leading by example. The UK Code now contains an updated set of principles, emphasizing a greater focus toward stakeholder inclusion and corporate sustainability. Vis-à-vis the 2016 Code, the fundamental changes in the revised 2019 UK Code are set out below:

- Section 1 – Board Leadership and Company Purpose:
  - boards shall more clearly establish the purpose, values, and strategy;
  - directors shall increasingly engage with and listen to views of all employees;

77 Id. at 4.
The importance of human leadership with integrity

- possibility for the employees to raise their concerns anonymously if required;
- increased stakeholder engagement / board obligation to understand views; 78
- board is responsible for identifying and managing all arising conflicts of interest;
- required shareholder revolt procedure if 20% or more unfavorable votes are made.

- **Section 2 – Division of Responsibilities:**
  - board approval requirement for additional external director appointment;
  - reversal of independence provision changes to the April 2016 Code position.

- **Section 3 – Composition, Succession and Evaluation:**
  - succession plans for boards/senior management, including a diversity focus;
  - chair tenure limited to nine years from the date of the first board appointment.

- **Section 4 – Audit, Risk and Internal Control:** Risk focus by the board on the company’s principal as well as emerging risks.

- **Section 5 – Remuneration:**
  - independent discretion is allowed for remuneration policies and schemes;
  - senior management pay is established by the remuneration committee; 79
  - employee remuneration and explanation provided in annual board report;
  - share awards released for sale on a phased basis subject to a total vesting;
  - pension contribution alignment between executive directors and employees;
  - further reporting requirements as to the remuneration committee’s work;
  - Committee chair must have at least 12-months of remuneration committee experience.

By introducing these changes, the UK Code further recognizes that companies do not exist in isolation. Instead, successful and sustainable businesses underpin both the economy and society by providing employment and creating prosperity. To succeed in the long-term, directors and their companies need to build and maintain successful relationships with a wide range of stakeholders, which will be enduring if based on respect, trust, and mutual benefit.

**C. Germany**

A commission of the Federal Government (Regierungskommission) issued the German Corporate Governance Code (as amended on February 7, 2017). The German Code aims to make corporate governance more transparent and easier to understand. It intends to promote trust in the management and the supervision of publicly listed companies in Germany by international and national investors, employees, customers, and the wider society. Like other corporate governance codes, the German Code was not passed by parliament. Therefore, it is not “hard law” (as it would

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78 The annual report must show how the board considered key stakeholders’ interests and factors in Section 172 of the Companies Act 2006 (duty to promote the company’s success for the benefit of all of its members). See id.

79 Under the 2016 Code, the committee only monitored and recommended senior management remuneration. See id. at 13.
undermine the sovereignty of the people as the decision-maker when electing the parliament). Nevertheless, the German Code does have a legal basis through the Declaration of Compliance (Entsprechenserklärung) as required by section 161 of the German stock corporation law (AktG). Recommendations and suggestions are nonbinding, but deviations from the recommendations have to be set out yearly in the Declaration of Compliance and noncompliance with recommendations and suggestions must be explained (“comply or explain”).

The German Code highlights the management and supervisory board’s obligation to ensure the continued existence of the company and its sustainable value creation that is in line with the principles of the social market economy. These principles not only require compliance with the law, but also sound and responsible behavior (“reputable businessperson” model – Leitbild des Ehrbaren Kaufmanns). Management should closely cooperate with the board to benefit the company and its affiliates, as the board adopts values for the company and its affiliated enterprises, thereby contributing to a corporate culture focused on the long-term value creation.

The commission of the Federal Government adopted the latest version of the German Code on May 9, 2019, which will only enter into force once it is published by the German Federal Ministry of Justice and Consumer Protection in the German Federal Gazette, replacing the existing German Code as amended on February 7, 2017. Such publication will occur after the German Act on the Transposition of the Second Shareholder Rights Directive (ARUG II) has entered into force, which has been approved on November 14, 2019 by the German Parliament. Nevertheless, German companies may already follow the revised code as best practice.

The revised German Code aims to make the German dual corporate governance system transparent and comprehensible in order to benefit foreign investors in particular. It continues to provide sustainable governance recommendations for companies (such as self-evaluation by the supervisory board for disclosure in the corporate governance statement). The revised code cuts the initial term of management board members’ appointments from a maximum of five years to three years and requires further explanation for management and supervisory board remuneration. As to management board remuneration, the revised code stipulates the supervisory board set the remuneration each management board member may receive by way of target and maximum remuneration. After each financial year, the supervisory board determines the value of the individually awarded variable remuneration depending on target achievement. As to supervisory board remuneration, the revised code promotes a fixed remuneration. If members are to be remunerated based on performance, remuneration scheme must be in line with the company’s long-term development.

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81 Id.
83 Id.
D. South Africa

As to South Africa, the Institute of Directors published the King IV Report on Corporate Governance in 2016. The framework of the South African Code moved from “apply or explain” to “apply and explain.” This allows stakeholders to make informed decisions as to whether or not the company acts sustainably as stipulated by the Code. It codifies the country’s transition from a purely shareholder-oriented capitalism to stakeholder-oriented capitalism. In other words, it became clear that the employment, transformation, and provision of financial capital only represents a limited spectrum of a company. Instead, inclusive capitalism takes account of the employment, transformation, and provision of all capital sources to reestablish capitalism as a means of creating shared prosperity. The South African Code aims for equal treatment of value creation sources.

The overarching objective is sustainable development, which should meet present requirements without impairing future generations in the process. It recognizes relevant stakeholders, the company as an integral part of society and its status as a corporate citizen. The board should adopt an inclusive approach, balancing needs, interests, and expectations of society.

The South African Code recognizes that sustainable success depends on an efficient and productive management of not only financial capital, but also of human, intellectual, social, relational, and natural capital. It also recognizes that the financial capital market system is insufficiently equipped to guard against multi-layered and interconnected risks. Hence, the South African Code favors an approach to creating value in a sustainable manner by moving companies from a short-term to a long-term capital market. As per the provisions of the Code, the time required by “long-term” or an even “longer-term” would depend on the strategic objectives of the company and on the risks and opportunities provided by its external environment, including its interested stakeholders.

E. Interim conclusion

The corporate governance codes analyzed above underline the importance of integrated thinking, which recognizes the connectivity and interdependencies between factors affecting a company’s ability to create sustainable corporate success. Relevant factors may include:

- **“all relevant stakeholders” inclusion** (as the ability to create value for itself depends on its ability to do so for others, the company has a symbiotic stakeholder relationship);
- **company as an integral part of the wider society** within which it operates; and
- **corporate citizenship of the company** (with rights, obligations and responsibilities toward the societal and the natural environment on which it depends).

Each of the codes examined herein confirms that boards have to be explicit about their purpose and the values they deem relevant for conducting corporate affairs. This is a fundamental

trend reversal, stepping away from shareholder primacy and asking for corporate orientation toward wider society, including the necessity to think about human values. However, even though they recognize the problem and recommend an all-stakeholder inclusion, corporate governance codes cannot guarantee such inclusion when they are only “soft law”. As such, nonbinding corporate governance codes can only be a starting point to the creation of law, when they merely provide recommendations for taking corporate action. For a corporation to address all relevant stakeholders on a legally binding basis, significant legislation changes would be required in order to create an inclusive corporate model.

VII. Legal solution: creating a corporate entity addressing all relevant stakeholders

One example of how to create an inclusive corporate entity by means of law is to move away from the classic corporate form where the shareholder(s) alone can dominate the governance of the company. For example, under German legal practice, the actual say that a supervisory board has in the corporation is very limited. The board cannot determine key decisions and merely constitutes a test at the end to achieve some kind of compromise. For an effective inclusion, we should change the corporate form to building an all-stakeholder entity where not only shareholders but also employees, customers, and representatives of the wider community could exercise a shared vote and, as such, have a legally binding say in the move toward sustainability. The goal would be an all-stakeholder inclusive entity, with financial members (shareholders) investing capital, employees putting in their efforts, customers having a relationship (short or long term) with the product or services of the entity, and society groups also being duly represented. Through purpose, orientation, and governance, the changed corporate entity will be more acceptable to the wider society.

Such an entity would not only focus on the shareholder, but on each relevant stakeholder. In addition to maximizing shareholder value, the company would fulfil its societal purpose by taking into account the entire context of its responsibilities, which would require innovative and binding corporate governance arrangements, including board, voting, and mediation procedures. Instead of the current system, which is very shareholder-centric as outlined at the beginning, the new corporate form should employ binding stakeholder governance.

From a legal perspective, the creation of an entity uniting all stakeholders is admittedly difficult. However sustainable the concept may be, universal and fundamental changes of applicable corporate laws would be required to achieve this multi-party entity, which are at least in the short-term hard to achieve due to current market realities. Nevertheless, despite all challenges, in the interest of achieving a sustainable solution, we should open the discussion. In this sense, when asked why we should to go to the moon, former U.S. President John F. Kennedy said “not because [it is] easy, but because [it is] difficult.”

Apart from a legal solution and as a practical way to address the problem, we should consider promoting the GC to the highest level in a corporation (C-Suite) to become a fully effective partner for the CEO.

VIII. Practical solution: promoting the GC to ensure the preservation of integrity

Creating a legally binding solution through an inclusive entity that unites all relevant stakeholders would require significant legislative changes and would likely prove too difficult to achieve in the short-term. Thus, changing the internal corporate structure seems like a more feasible practical approach.

By elevating the GC to the C-Suite level, the CEO can set up a cross-functional dialogue in a working group on corporate strategy, involving the GC in considering wider sustainability factors. The GC can play a cardinal role not only when assessing legal and compliance questions, but also support the CEO in establishing an ethical corporate culture, by providing focused input on strategic, risk, budgetary, and human resources decisions. As those who make decisions must understand the market and technology, all employees must be able to pass ideas to the top. However, the CEO needs to lead the organization by setting the tone, making performance with integrity the overall goal in the organization. The GC can strongly assist in this process by bringing her experience to the decision-making table. To be fully effective, the GC needs to be present at all the relevant activities of the corporation and must be involved in all the meetings and discussions. Looking at corporate scandals such as Enron, MCI WorldCom, and GM Ignition, the lawyers were often not even in the room when management made unethical business choices. A strong and independent GC could help the CEO in combining performance with integrity and sustainable risk management in order to create the foundation for a corporation beneficial to all relevant stakeholders. By enhancing integrity through adherence to law, ethics, and strong values such as fairness, honesty, candor, reliability, and commitment to inclusion, the GC can serve as part of a company’s moral compass. Combining performance with integrity, the corporation will gain the trust not only of its shareholders, but also of its other stakeholders such as employees, customers, creditors, partners, regulators, and wider society, which is an essential element for creating true corporate sustainability and lasting commercial success.

In order for the GC to be fully effective, the CEO needs to publicly support and establish the GC as a primary advisor (as opposed to external firms). To overcome the “more-for-less” challenge, the GC must be in charge of the legal budget, as external law firms and service providers tend to want to do less with more, given the inefficiency concept of the billable hour charged for services provided. To this extent, the CEO must allow the GC to become a proactive business partner and ultimately a protector of the corporation. As such, the CEO needs to grant the GC independence to assess legal and compliance issues as well as the possibility to exert an influence on deciding strategic, budgetary, human resources, and risk matters which are material to the corporation.

Given the increasing complexities as set out herein, in particular regarding globalized businesses, the GC needs to have a certain budgetary flexibility. This allows the GC to stay on top of handling both legal problems as they arise in a fast-paced globalized business environment and sustainable technology implementation. Richard Susskind, a professor at Oxford University, stated

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in another context that it is “better to have a fence on the top the cliff than an ambulance at the bottom.” The words also apply to legal budgeting, as it is impossible to forecast the exact legal spend particularly in a transactional environment, which is highly volatile due to factors such as general market developments, severe competition, and the overall direction and growth of the business that the GC needs to advise on a daily basis.

To become an accepted strategic partner for the CEO, the GC must meet several other criteria in addition to being a legal expert. The GC must become a trusted advisor and a business leader, gaining acceptance by making commercially-minded and pragmatic decisions with respect to business outcomes and gaining recognition within the corporation as a cross-functional team leader. Most importantly, the GC needs to be a decent human being and a role model inspiring future leader of the corporation to act in line with human values. Through leading by example, the CEO acting as Chief Responsibility Officer must set the culture of the company, and the GC must support the CEO when combining performance with integrity and sustainable risk management. By becoming a commercially-focused service provider, mastering cross-functional communication on a global level, and driving the implementation of sustainable technology solutions, the GC earns the CEO’s trust and respect. In addition, the CEO must recognize the importance of the GC and actively support the GC to act as an ambassadorial networker for the company in the international legal community and to meet her peers on a regular level, by way of, for example, (in-)formal get-togethers on conferences, workshops, or Q&A-sessions. The GC thereby enhances reputation and trust in the company, and gains an increased understanding of the market, its trends, and its challenges, and can even assist in identifying potential business opportunities.

To summarize, the GC can facilitate human leadership in the corporation through being a role model for responsible behavior. She needs to act as an assertive and credible protector of the corporation and network with GC peers by attending (international) gatherings and events to prevent potential problems from arising. She needs to foster a healthy and inclusive work environment and act at all times as a corporate brand ambassador. The GC also needs to take responsibility for the education of future leaders to ensure that she can pass on knowledge and experience, thereby safeguarding the integrity of the next generation to step up.

To achieve these objectives, it is necessary for the CEO to support the elevation of the GC to the C-Suite, since the legitimacy of the GC can be extremely difficult to establish without the public trust of the CEO. Without such trust, any GC must be prepared to resign before compromising her integrity. With the CEO believing in the GC and confirming her independence, the acceptance of the GC in the organization will increase so that she may become a fully effective strategic business partner. Considering and answering to the interests of the corporation as a whole, such GC can ultimately act as a credible protector of the company, avoiding, for example, potentially extreme legal costs and a significant loss of reputation of the organization.

IX. Conclusion

To reconnect companies with the society in which they operate, human leadership with integrity is

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key. Employing human leadership, the CEO, as the corporate leader, must build a corporation with an inclusive culture, which must come from her acting as a role model, based on a fusion of performance with integrity and sustainable risk management.  

Integrity is doing what we are supposed to be doing. We need to honor our words by doing what we promised to do. All stakeholders, including the wider society, will regard us as reliable partners acting with integrity. In business, integrity relates not only to complying with legal and regulatory requirements but with ethical standards as well as with managing business risk sustainably. The CEO must also act as Chief Responsibility Officer to set the tone from the top and to shape the corporation’s culture. Ideally, the CEO would closely collaborate with the GC as trusted advisor to benefit from her experience.

Traditionally, rules of command and control form the basis of compliance programs. However, emphasizing the importance of human leadership with integrity would make compliance much more acceptable and understandable to corporate directors, by offering a framework within which the GC can assist the CEO in reaching sustainable business decisions with a focus on integrity. Instead of assessing legal and compliance matters only, the GC should add opinions and thoughts on assessing strategy, human resources, budgetary, and risk factors, as well as being involved in environmental, governance, social, and other operational questions. The GC should become a strong and independent member of senior management. This allows the GC to collaborate with the CEO both as a proactive business partner and ultimately as a protector of the corporation.

By promoting human leadership with integrity, the contemporary corporation will reconnect to society when it re-earns its trust of all relevant stakeholders. We as lawyers can only support this effectively if we take personal accountability for this critical development. We must recognize and face the problem, perhaps let go of existing beliefs and replace them with elements that are much more suitable for an inclusive approach. Especially in the long term, focusing on human leadership with integrity will increase corporate success, as internal and external clients will regard us as desirable business partners, thus amplifying their trust in the corporation as a whole and thereby vastly enhancing the likelihood of long-term success.