PROFIT AT THE EXPENSE OF PEOPLE AND PLANET

How corporations serve shareholder interests instead of protecting the climate and human rights

Through their unilateral focus on share prices and profit maximisation, large corporations are fuelling global warming, rising inequality and the systematic violation of human rights. These companies use their financial flexibility to pay dividends or build up cash reserves instead of ensuring that their business activities protect human rights and the environment. Only if the German federal government establishes a legislative framework for sustainable corporate governance will German corporations begin systematically aligning their policies and operations with public good objectives – thereby helping to resolve the crises of our times instead of exacerbating them.

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ABSTRACT

According to estimates from the Intergovernmental Panel on Climate Change, we have a maximum of nine years to limit global warming to 1.5°C and thereby prevent the worst impacts of the climate crisis. At the same time, social inequality is steadily rising worldwide. These two crises are interdependent and mutually reinforcing.

This situation is having an enormous impact on the livelihoods of millions of people, particularly in the economically disadvantaged countries of the Global South. Many multinational corporations implement business models that contribute to violations of environmental, labour and human rights along their supply chains. At the same time, inequality is often associated with greater instability in financial markets.

The long-overdue restructuring of our national economies will require enormous investments in clean technologies and human rights due diligence. Responsibility for these changes lies to a great extent with the companies that, due to their size and geographic scope, control the technological developments and working conditions in global supply chains.

This report examines whether and how the 30 largest companies in the DAX Index lived up to this responsibility in the period 2009 to 2020. It also provides recommendations for the future German federal government, whose responsibilities will include the implementation of Germany's commitments from the Paris Climate Accords. The following is an overview of the main findings:

Companies act primarily in the interests of their shareholders.

Between 2009 and 2020, profits increased by 48 per cent. Corporations can use this financial flexibility for investing in more sustainable business models, paying employees higher wages, building up reserves or paying dividends to shareholders.

This report shows that, during the period 2009 to 2020, the investigated companies used their profits primarily for serving shareholder interests and building up cash reserves. In the same period, payments to shareholders increased by a much higher percentage (85%) than profits. Some companies (e.g. RWE and E.ON) even paid dividends in years with net losses, in spite of the need for massive investments in the ecological transformation. And a significant percentage of the funds that stayed in the company were used for building up financial reserves, which increased from a total of €122 billion in 2014 to nearly €200 billion by the end of 2020. This increase in reserves also primarily benefited the shareholders, as larger reserves increase the value of the company.

Too little investment in climate-friendly technologies

In 2020 the European Commission estimated how much additional investment would be required for each economic sector in order to achieve the **objectives on climate change mitigation** by 2030 and make the European economy carbon neutral by 2050. These estimates were used as a basis for calculating the investment requirements of the investigated DAX companies and comparing them to their respective financial flexibility. **The findings: Many of the companies would be able to cover the required investment amounts from their profits – with no government subsidies or tax breaks.**

In the transport sector, for example, it would be easily possible for the companies to finance the €13.8 billion of additional investment per year, as calculated by the EU, from their profits alone. In this case, they would still be able to pay dividends at the same level as 2009 and 2010. In the residential sector, the company Vonovia could effortlessly cover the required €100 million in additional annual expenditure from its annual profits of approx. €2 billion.

However, the situation is less comfortable for energy giants like RWE and E.ON, or the company HeidelbergCement, each of whom will have to spend a considerable share of their profits and cash reserves on the transition of their business models towards greater climate compatibility.

Inadequate implementation of human rights due diligence obligations

Although the human rights due diligence obligations of all companies were agreed by the United Nations as early as 2011 and clearly communicated to German companies as an expectation of the German government in 2016, the DAX corporations that were investigated for this report failed to fully disclose the corresponding developments and investment requirements in their annual reports. In addition, the public remained in the dark about their supply chains and production networks, in spite of the fact that transparency was one of the Guiding Principles on Business and Human Rights agreed by the United Nations.

The only exception among the investigated companies was Adidas, which, under enormous public pressure, was ultimately forced to disclose information

on its supply chains. With this data, it was possible to calculate the respective investment requirements for achieving wage-related targets. These calculations showed that it would cost the company approx. €567 million more to pay living wages along its supply chain. The additional costs could be covered from the average annual profits of €1.22 billion. If for this purpose Adidas were to decrease its shareholder payouts by 50 per cent, these payments would still be at the 2013 level, when they were among the highest in the textile industry.

Lack of public-good orientation among companies

The requirement that property be used to promote the public good has constitutional status in Germany. Accordingly, the investigated corporations are required to first ensure that their respective business model is not detrimental to the public good, e.g. does not exacerbate the climate crisis or violate human rights, before paying dividends to their shareholders. However, our report shows that the companies' business activities are not in line with this guiding principle for three reasons in particular:

1. The prevailing corporate philosophy is focused on the short-term maximisation of shareholder value.
2. The remuneration packages of top executives consist largely of variable, performance-related components, such as bonus payments or equity stakes, which provide powerful incentives for business behaviours that maximise profit – with practically no relevance for issues of human rights or sustainability. During the period covered by this study, these remuneration components accounted for an average of 73% of the remuneration paid to the CEOs of the former DAX 30 companies.
3. No stakeholder groups other than shareholders and employees are able to effectively voice their interests on the companies' boards.

Exacerbation of social inequality

In addition, the shareholder payout policies and remuneration structures of companies exacerbate the already high levels of income and wealth inequality. **During crisis periods, employees are forced to accept substantial pay cuts while shareholders enjoy generous dividends, even in financially difficult years.** Only a relatively small group benefits from this system: A mere 17.5 per cent of German citizens own stocks directly or through mutual funds, and half of these stockholders have a net monthly income of more than €3,000.

Furthermore, the salaries of top executives not only are many times higher than that of the average worker in the same company, but also have grown significantly faster in recent years: e.g. by 34 per cent, in comparison to an average of 25 per cent for other employees, between 2009 and 2020. Today, the CEOs of the companies investigated for this report earn an average of €3.4 million annually, which is 48 times the amount earned by their employees. This difference is largely attributable to the variable remuneration components mentioned above.

Policy-related conclusions

A legal framework is required for ensuring that companies base their business models on climate change mitigation, respect human rights and promote social equality in their supply chains, and make decisions related to remuneration, investment and shareholder payments in the interests of all parties involved. Accordingly, the future German federal government should:

1. **Introduce effective regulations requiring companies to serve the public good:** The interests of a company, which its supervisory and management boards are required to serve, should incorporate the observance of human rights and planetary boundaries – including a power to sue for those negatively affected. The remuneration structure and any components that provide incentives for management should be aligned with these interests.
2. **Ensure that all required social and ecological investments are made, and limit shareholder payments:** Companies should be required to develop and publish concrete strategies for implementing their obligations to serve the public good, specifying the amount to be spent on the necessary investments. Pay-outs to shareholders should be subject to certain conditions and only be payable from the profits of the respective financial year.
3. **Require that the views and voices of a diverse range of stakeholders be represented at board level:** Companies should be required to ensure that important stakeholder groups are able to effectively voice public and collective interests in the context of corporate policy development. These stakeholders include suppliers, local communities and workers in the supply chains.

INTRODUCTION

The climate crisis, social inequality and a sweeping disregard for the rights of marginalised groups are among the most pressing issues of the 21st century. While the dramatic impacts of the climate crisis are becoming increasingly obvious, the international community is still a long way from achieving its goal of limiting global warming to 1.5°C: Between 1990 and 2015 the richest one per cent of the world's population pumped more than twice as much climate-damaging carbon pollution into the atmosphere as the poorest half of humanity.[1] This situation has had an enormous impact, particularly for people in the economically disadvantaged countries of the Global South. In these regions, droughts, storms and floods have already destroyed the livelihoods of millions of people – in particular the people who have contributed the least to the exacerbation of the climate crisis but are suffering the most from its effects.[2] Germany is also failing to do its part to achieve the 1.5°C goal: Its per-capita carbon emissions are even higher than those of the other populous European countries, like the United Kingdom and France.[3] Large German companies are fuelling the climate crisis with their outdated business and production models.

"[Maximising shareholder value is] the error at the heart of corporate leadership." [It is] flawed in its assumptions, confused as a matter of law, and damaging in practice."

Joseph L. Bower and Lynn S. Paine – Harvard Business Review

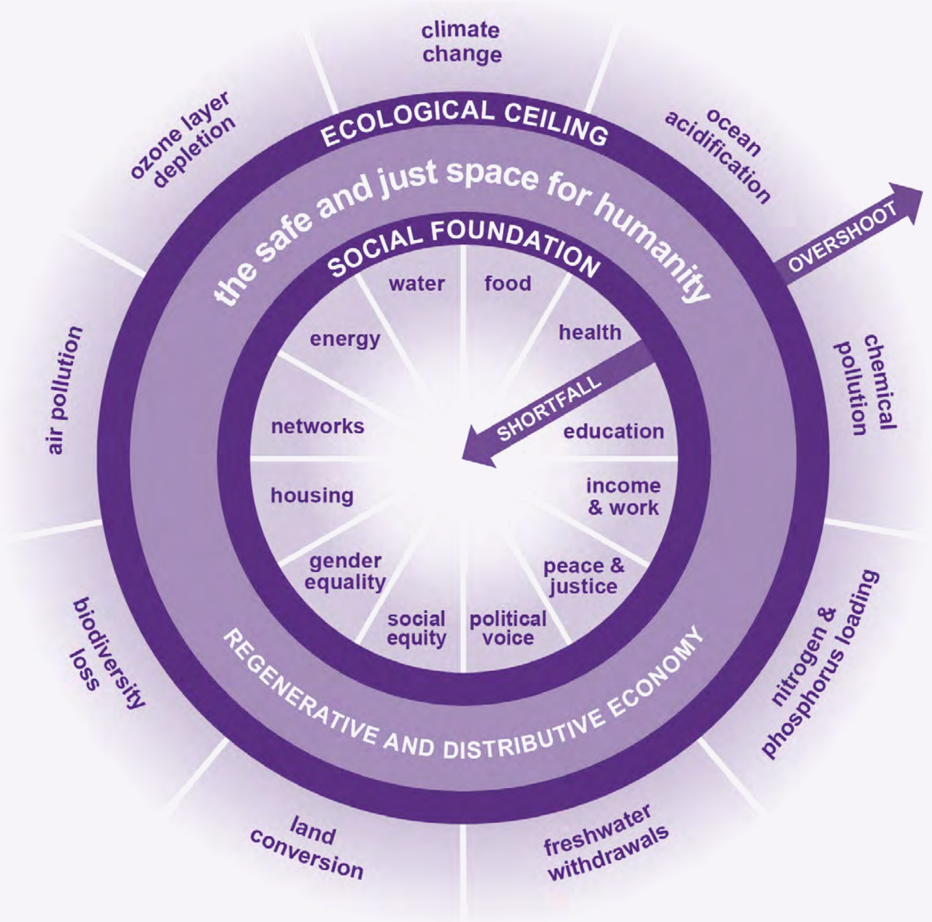
In addition, the richest one per cent of the global population own nearly half of the world's wealth. In Germany wealth inequality is very high compared to the rest of Europe. The richest one per cent of the German population hold approx. 35 per cent of the total net wealth, while the richest 10 per cent hold as much as 67 per cent of the wealth.[4] A major driver of this issue is the disproportionate growth of business assets, along with the increasing value of assets like stocks and real estate. This situation has enabled several large companies to pay out billions of euros to shareholders, even during the pandemic. As a result, the wealth of the shareholders continues to increase while employees have had to accept pay cuts and reduced working hours: E.g. for the 2020 financial year BMW paid out €1.25 billion in dividends,[5] of which nearly half went to the Klatten and Quandt families,[6] whose family members Susanne Klatten and Stefan Quandt are among the ten richest Germans.[7] In the same year, 30,000 of BMW's employees were forced to work reduced hours.[8]

The marginalised groups also suffered the most during the pandemic. While the world's 1,000 richest people were able to bounce back from their pandemic losses in a mere nine months, it could take more than a decade for the people who live in poverty to recover from the economic impacts.[9] Contributing to this situation was the fact that large companies drove down costs in their supply chains, put their pursuit of profit over the financial security of their employees and used their influence to ensure that policies and regulations are aligned to their interests.[10]

In other words, the crises are mutually reinforcing consequences of the same flawed economic system, as we will show in this report with reference to the investigated DAX corporations: The fact that the business activities of large companies are focused on profit maximisation, or shareholder value, i.e. on the interests of people who are already wealthy, has increased the existing levels of inequality to the detriment of disadvantaged people and the environment. What is needed instead is an economy that meets basic human needs and ensures that all human rights are respected without compromising the ecological limits of our planet.

British economist Kate Raworth developed a doughnut-shaped economic model that takes into consideration human rights and planetary boundaries.

FIGURE 1: THE DOUGHNUT MODEL OF A SOCIALLY AND ECOLOGICALLY JUST ECONOMY



Source: Raworth 2017

As Raworth explains, "The Doughnut's inner ring – its social foundation – sets out the basics of life on which no one should be left falling short."[11] The vast majority of these human rights have been enshrined in international standards and laws and affirmed in the Sustainable Development Goals (SDGs) adopted by all members of the United Nations in 2015 for achievement by 2030. The doughnut's outer ring – its ecological ceiling – is based on the planetary-boundaries concept consisting of nine critical processes that were identified in 2009 by an international group of earth-system scientists (see Figure 1).[12]

Analysing the economies of 151 countries, a team from the University of Leeds found that, although some countries showed better results than others, not a single one fell within the ecologically and socially just space of the doughnut. Some countries are unable to meet basic social needs and therefore violate the corresponding human rights, some dramatically overshoot the planetary boundaries – and for others, both of these circumstances apply. At the time of analysis, the German economy was already overshooting five of the seven planetary boundaries examined for this study.[13]

There are many factors that explain why the Germany economy has failed to remain within the social and ecological boundaries[14] – an important one, as we will show in this report, is the fact that large, influential companies in Germany are focused not on basic human needs or physical boundaries, but rather on profit maximisation for the benefit of their shareholders. And this is in spite of the fact that an orientation towards the public good is prescribed by Germany's Basic Law (Grundgesetz): GG Art 14 (2) "Property entails obligations. Its use shall also serve the public good." The problem is that this constitutional guideline is not sufficiently reflected in the concrete legal conditions for corporate behaviour or in economic practice.

The trends in this area are also mutually reinforcing: Misguided political regulation makes the unbridled profit maximisation of large corporations possible, increasing market power and wealth inequality. At the same time, this situation strengthens the political influence of large corporations, their associations and their shareholder families, who in turn often lobby against clear and universally applicable political guidelines for the protection of humans and the environment.

Due to the lack of mandatory guidelines, along with low carbon prices and the misconception that a company's best interests are served solely through profit maximisation, companies have no reason to invest in the socio-ecological restructuring of their business models. Accordingly, these investments are not being made, as was shown by the research on which this report is based. This is how companies are allowed to shirk their responsibilities in spite of the fact that, from a societal standpoint, investments in climate protection would pay for themselves many times over when compared to the costs of an unmitigated climate disaster. By the same token, the observance of human rights is not a barrier to healthy economic development, but rather a precondition for the development of a socially sustainable economy..

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LACK OF CORPORATE RESPONSIBILITY

This shirking of responsibilities can be readily observed in the automotive industry's transition to electric vehicles, where German subsidies for alternative powertrains are likely to be in the tens of billions of euros by 2025,[15] in spite of the fact that their environmental benefit is still dubious.[16] Off the record, automotive industry executives themselves are describing their sector as "massively oversubsidised".[17] At the same time, sales and profits are booming again in the first half of 2021.[18] This system of "burden sharing" whereby governments – and ultimately taxpayers – foot the bill for necessary social and environmental investments is unjust and completely ignores the fact that, with their activities to date, corporations have been major historical contributors to the climate crisis. In this report, we will show that the automotive industry, with their large profits, could easily cover the costs of investments required for the ecological transition without government support.

The phenomenon of one-sided burden sharing can also be observed in companies' wage policies. After every crisis there are calls for wage moderation – and the statistics on income and wealth distribution reveal the consequences. The share of national value added that goes to wages for low-skilled workers has fallen by a significant amount.[19]

These examples illustrate how in periods of crisis companies exhibit a lack of willingness to act with solidarity and to take responsibility for the negative external effects of their own actions, e.g. with respect to the climate crisis. Moreover, in debates on crisis situations, the business sector is often heard arguing that companies should be protected from any kind of financial burden and that no changes are possible without the help of state financing, which is ultimately borne by society as a whole.

This is where our study comes in. It is clear that the German economy, contrary to all warning cries, has performed very well in recent years and is on a very solid financial footing. In fact, for the 30 largest DAX companies we can show that the years since 2009 have brought hefty profit increases. This success has made it possible for the companies to significantly increase their annual payments to shareholders – the total of these payments rose from €20.3 billion in 2009 to €41.97 billion in 2020. In addition, between 2014 and 2020 the companies' cash holdings and bank balances increased by an impressive €75.8 billion, or 61.8%, to €198.38 billion.[20] Although companies consistently argue the need for state support, these facts tell a different story.

In order to develop recommendations for solutions, we first have to consider the prevailing doctrine of corporate governance. This doctrine is dominated by the shareholder-value approach, which focuses on the interests of the shareholders. According to this approach, a company's business policies should maximise its value and only take the interests of other stakeholders into consideration when they are relevant to profit maximisation. The term *financialisation* is also important in this context.

Accordingly, our recommendations are focused on a broader definition of the aims of corporate governance. Public good aspects should be taken into consideration, and executive remuneration structures should be reformed. This will also require a restructuring of companies' supervisory and management bodies.

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FINANCIALISATION

Broadly speaking, the term financialisation refers to the "increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operation of the economy and its governing institutions, both at the national and international levels."[21] A key driver of this development in the corporate sector has been the growing importance of large institutional investors, like pension funds or sovereign wealth funds, which are dominant today as shareholders of large companies.[22, 23] The phenomenon of financialisation is closely connected to the increasing importance of the shareholder-value approach, which focuses on profit maximisation. Studies conducted on joint stock corporations in the US and UK have already shown that, with increasing financialisation.[24, 25]

METHODOLOGY

The analysis of corporate conduct is based in large part on a study conducted by the research institute BASIC on behalf of Oxfam and Finanzwende that mainly examines the profit performance, investment willingness and dividend behaviour of the investigated DAX companies between 2009 and 2020.[26] Other references included previously published studies and media coverage, as well as a legal opinion commissioned by Oxfam on the regulatory issues associated with sustainable corporate governance.[27]

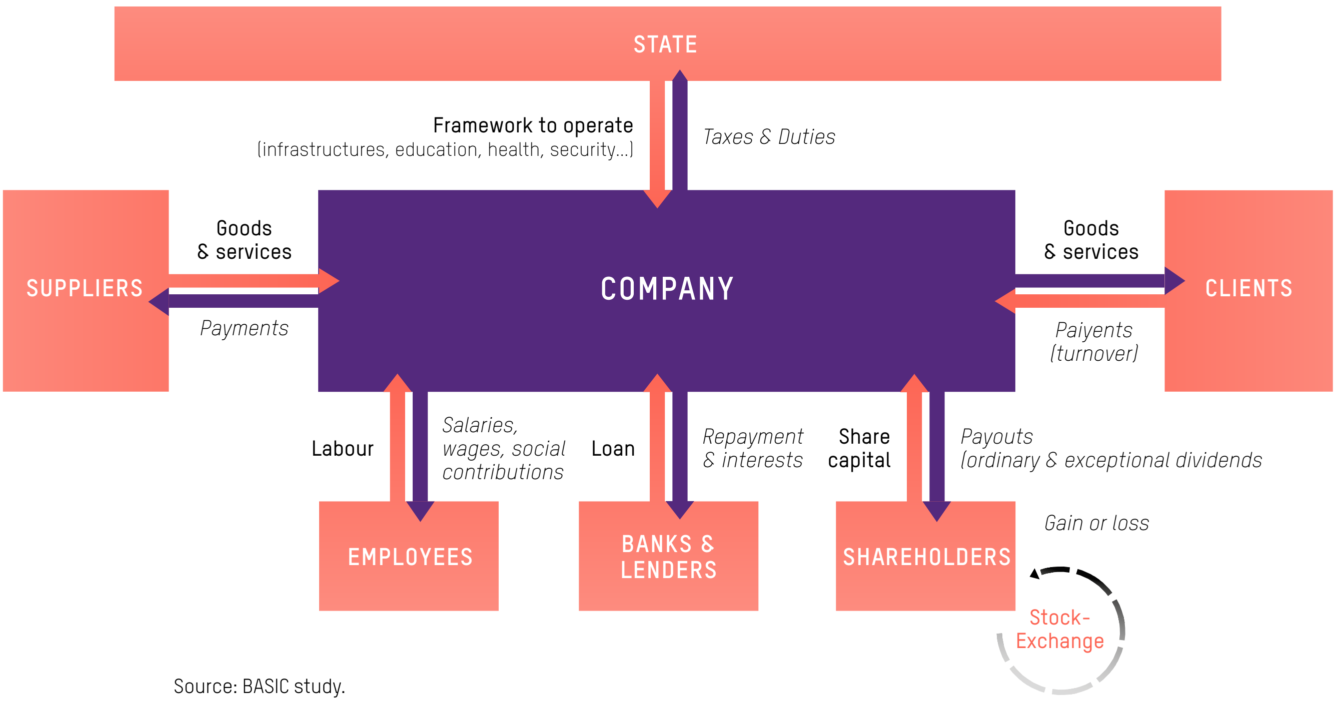
Our research focused on the former DAX 30 companies,[28] which by definition were the largest German corporations with respect to market capitalisation or trading volume at the time. The composition of the DAX Index is reviewed and adjusted on a regular basis. For the purpose of this study, we included the 30 companies that were listed on the DAX Index for at least 5 years between 2009 and 2020.[29]

Owing to corporate reporting obligations, large sets of data were available for the companies included in the study. With their primarily global focus, these companies were also a very good representation of Germany's export-oriented economic model. Another factor that justifies the focus on these companies is their strong economic and social influence.

We will only be offering a brief description of the methodology used for the BASIC study. More information can be found in the study itself.[30] The underlying data have been published by BASIC, where legally permissible.[31]

The sales and profits of all private companies are dependent on the contributions of a series of stakeholders who are vital to its successful operation as a business. The following diagram illustrates these relationships.

FIGURE 2: ECONOMIC STAKEHOLDERS: THEIR CONTRIBUTIONS AND WHAT THEY RECEIVE IN RETURN



Source: BASIC study.

BASIC calculated the share of turnover received by the various stakeholders, e.g. in the form of wages, tax payments or dividends, in return for their respective contributions. For this analysis, BASIC used data from the year-end results published in the companies' annual reports for the years 2009 to 2020, along with supplementary data from the *ORBIS Global Database*.

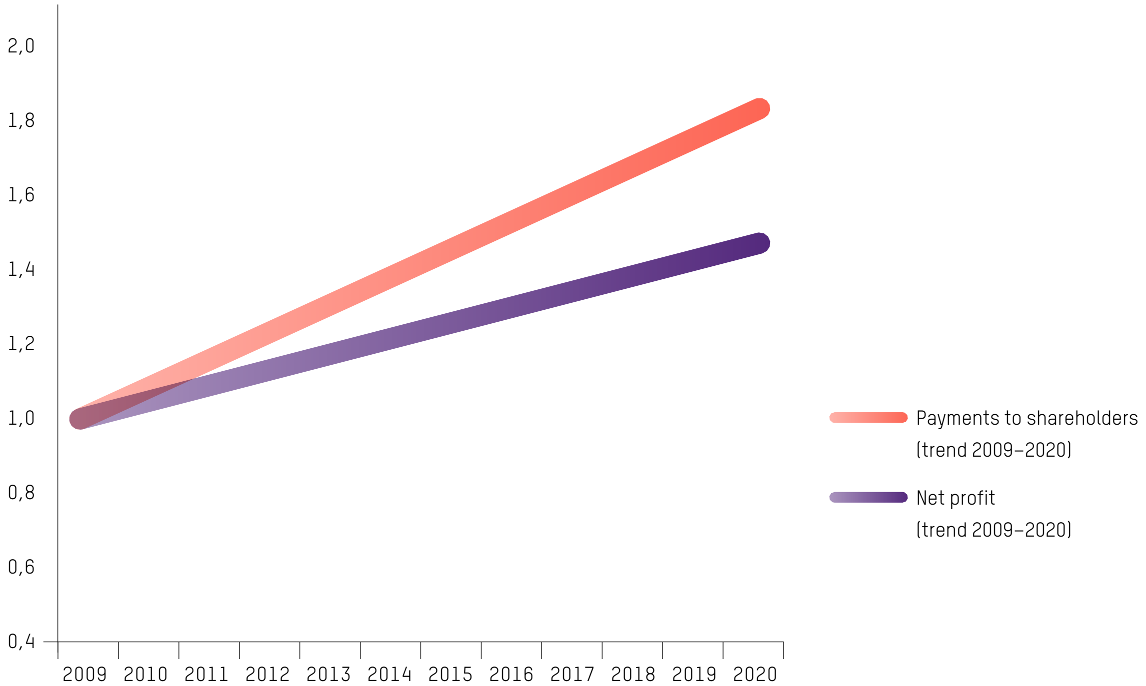
However, in the evaluation of this information, it is important to take into consideration the structural characteristics associated with this selection, e.g. with respect to the sectoral mix, the regional orientation and the companies' level of globalisation, as well as the special reporting rules set by the International Financial Reporting Standards.[32]

FINDINGS

The analysed DAX companies are in an increasingly better financial position

From a financial perspective, the investigated companies have on average been developing successfully since 2009, based on data from the BASIC study.

FIGURE 3: ANNUAL PROFITS AND SHAREHOLDER PAYMENTS SINCE 2009



Source: BASIC study.

As shown by the diagram, the DAX companies included in the study were able to increase their profits by an average of 48 per cent. These increases would have been even higher were it not for the severe economic downturn of 2020. One notable aspect of these findings is that the total annual payouts to shareholders made by the companies rose at an even faster rate, increasing by 85 per cent in the period covered by the report. In absolute terms, the total amount paid to shareholders doubled from €20.3 billion in 2009 to €41.97 billion in 2020.

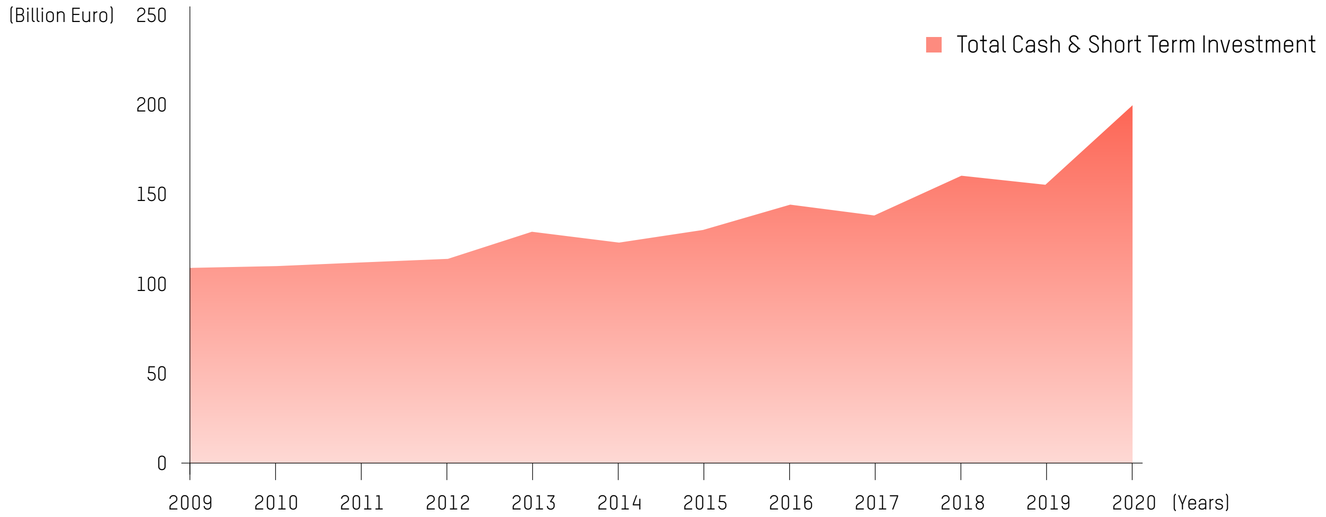
Companies can use their financial flexibility in various ways. For example, profits can be used for making payments to shareholders in the form of ordinary or extraordinary dividends, or share buybacks,[33] which serves the interests of the shareholders. Another option is to allocate profits to reserves, in which case they remain in the company and can be used for financing investments or strengthening the company's financial reserves as cash in the bank,[34] which has a positive effect on both the company value and the shareholders' wealth. In practice, most companies choose to use these two options in combination.

However, another option would be to reinvest their profits for social and environmental good. For example, companies could pay higher wages, with immediate positive effects for their employees. They could also take into consideration the interests of other parties affected by their business activities, e.g. by paying higher prices to suppliers or systematically preventing negative human-rights or environmental impacts. In practice, however, this form of profit distribution is practically unheard of, owing to the fact that higher wages or higher prices for suppliers rarely have a positive effect on share prices.[35]

Priority to shareholders

A closer analysis reveals two interesting facts: First, in the time period considered for the study, the total amount paid out to shareholders was easily covered by the companies' profits, and second, German companies tend to keep a significant percentage of their profits in the company. The latter can be seen, for example, in the build-up of liquid assets (e.g. cash in the bank), which increased from approx. €122 billion in 2014 to €198.4 billion by the end of 2020.

FIGURE 4: CASH AND CASH EQUIVALENTS



Source: BASIC study.

But this begs the question: What if the past twelve years had been less successful for the German companies? Would they have nevertheless paid so much in dividends to shareholders? If we look at the years with fairly low profits, such as 2009 and 2020, we find that the companies still paid a relatively large percentage in dividends: And in spite of the periodic fluctuations in profit, the amount paid to shareholders is rising steadily. Apparently, companies strive to smooth out any volatility in payments to shareholders so that their shareholders receive dividends in both boom times and downturns.

> Multiple times energy companies RWE and E.ON paid dividends although a net loss had been made, inspite of the fact that both companies have a significant need for investment in the ecological transformation.

In certain years, some companies paid out more to their shareholders than they earned as profit (net income) – and there were even cases in which companies continued to pay dividends although a net loss had been made. The latter was observed for multiple years with the energy companies RWE and E.ON, in spite of the fact that both companies have a significant need for investment in the ecological transformation. The very high payments that Deutsche Telekom made to its shareholders relative to its annual net profits in eight of the twelve years are also notable – perhaps a wiser choice would have been to invest more strongly in its digital infrastructure.

Shareholder payouts that exceed a company's profits in a given financial year should be viewed critically: In order to make these payments, the company is forced to tap into its reserves. These decisions may occasionally be justified, e.g. if a company is unable to find any lucrative investment opportunities. However, in the aforementioned examples, it is impossible to believe that no investment opportunities could be found in the companies' established business areas.[36]

FIGURE 5: SHAREHOLDER PAYMENT RATIO (TOTAL AMOUNT PAID TO SHAREHOLDERS DIVIDED BY TOTAL NET PROFIT) OF THE INVESTIGATED COMPANIES BETWEEN 2009 AND 2020

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Deutsche Telekom	9.59	2.01	5.41	-0.57	2.38	0.77	0.78	1.04	0.89	1.53	0.74	0.68
Munich Re	0.59	0.99	2.04	0.42	0.45	0.85	0.75	0.89	6.09	1.01	0.85	1.43
ThyssenKrupp	-0.07	0.25	-0.18	0.00	0.00	0.30	0.28	0.29	-0.14	11.63	0.00	0.00
Linde	0.51	0.37	0.36	0.40	0.43	0.54	0.56	0.60	0.91	0.00	1.99	2.81
Siemens	0.61	0.60	0.43	0.95	0.92	0.70	0.76	0.62	0.65	0.78	0.89	1.07
Adidas	0.30	0.29	0.31	0.54	0.40	1.24	0.98	0.62	0.57	0.99	0.42	2.03
Deutsche Börse	0.79	0.93	0.64	0.91	0.81	0.51	0.63	0.34	0.55	1.04	0.53	0.51
Deutsche Post	1.13	0.31	0.75	0.53	0.47	0.54	0.71	0.80	0.57	0.71	0.61	0.58
Bayer	0.85	0.95	0.55	0.64	0.54	0.54	0.50	0.49	0.32	1.54	0.67	-0.19
Allianz	0.46	0.41	0.73	0.40	0.40	0.50	0.51	0.51	0.52	0.51	0.51	0.59
Deutsche Bank	0.09	0.30	0.26	2.94	1.15	0.62	0.00	-0.28	-0.30	0.85	0.00	0.00
SAP	0.34	0.52	0.45	0.38	0.36	0.40	0.45	0.41	0.54	0.44	0.57	0.71
RWE	0.52	0.56	0.68	0.94	-0.22	0.36	-0.03	-0.00	0.49	1.28	0.06	0.59
K+S	0.54	0.45	0.47	0.41	0.13	0.46	0.45	0.35	0.38	1.14	0.09	0.00
Fresenius Medical Care	0.30	0.27	0.25	0.26	0.74	0.28	0.26	0.25	0.30	0.20	0.79	0.65
Daimler	0.00	0.45	0.42	0.39	0.36	0.38	0.42	0.41	0.38	0.49	0.42	0.41
BMW	0.97	0.26	0.31	0.32	0.32	0.33	0.33	0.34	0.31	0.32	0.33	0.33
Henkel	0.37	0.28	0.28	0.27	0.33	0.35	0.33	0.34	0.31	0.36	0.39	0.57
Infineon Technologies	0.00	0.17	0.14	0.35	0.61	0.38	0.36	0.33	0.36	0.28	0.39	0.79
Merck	0.66	0.13	0.16	0.19	0.37	0.42	0.47	0.34	0.26	0.18	0.45	0.33
Beiersdorf	0.43	0.50	0.64	0.36	0.30	0.30	0.24	0.22	0.24	0.22	0.22	0.28
BASF	1.14	0.44	0.37	0.49	0.51	0.50	0.67	0.68	0.47	0.62	0.36	-2.86
E.ON	0.34	0.49	-0.87	0.95	0.53	-0.31	-0.14	-0.05	0.17	0.29	0.77	1.20
Vonovia	0.00	0.00	0.00	0.00	0.33	0.53	0.47	0.23	0.27	0.33	0.74	0.30
HeidelbergCement	0.53	0.14	0.19	0.29	0.15	0.29	0.31	0.45	0.41	0.36	0.11	-0.20
Fresenius	0.25	0.22	0.22	0.21	0.22	0.22	0.22	0.22	0.23	0.22	0.25	0.29
Volkswagen	0.67	0.15	0.09	0.08	0.21	0.21	-0.04	0.20	0.17	0.20	0.22	0.29
Continental	0.00	0.00	0.24	0.24	0.26	0.27	0.27	0.30	0.30	0.33	-0.49	0.00
Commerzbank	0.00	0.00	0.00	0.00	0.00	0.00	0.24	0.00	0.00	0.29	0.00	0.00
Deutsche Lufthansa	0.00	0.24	-8.77	0.00	0.67	0.07	0.14	0.13	0.16	0.18	0.00	-0.00

Source: BASIC study.
Shareholder payments represent the sum of all dividends (ordinary and extraordinary) and share buybacks.

Figure 5 shows the relationship between the payments to shareholders and profits. The purple shading indicates that the shareholder payouts of the respective year exceeded the profit. The red shading is used for years in which payments were made to shareholders in spite of net losses.[37]

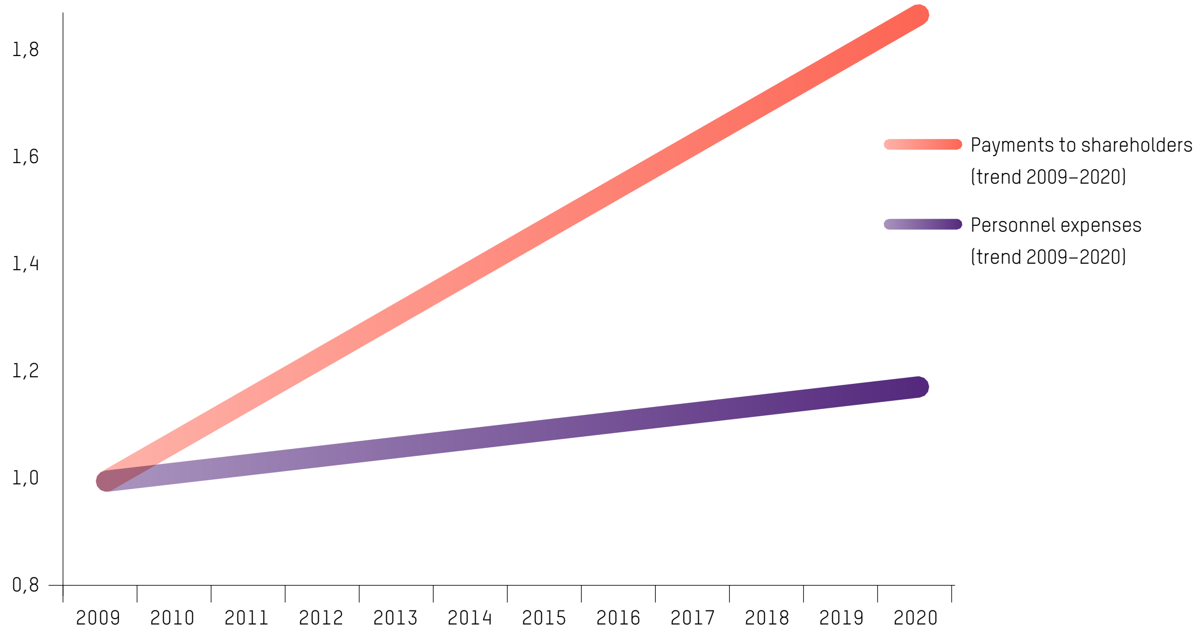
Developments are exacerbating inequality

The impact on wealth-distribution is an important aspect to consider when discussing companies' dividend behaviour. In periods of crisis, when companies appeal to their employees to accept wage restraints and former DAX 30 companies make use of state funding schemes, such as furlough schemes,[38] no restrictions apply for shareholders. Figure 6 below illustrates the magnitude of the inequality.

In the period considered for the study, the companies' payments to shareholders almost doubled, while their personnel expenses increased only slightly. The diagram shows that shareholders have profited more from the companies' net income than employees. the wealth distribution.[40] This is why payments to shareholders tend to exacerbate income and wealth inequality.

Another factor to consider in the context of wealth-distribution policy is the level of executive remuneration. Not only is this remuneration several times higher than that of the average employee; it also increased by a greater amount (34%) than the average employee salary (25%) between 2009 and 2020.[41]

FIGURE 6: PAYMENTS TO SHAREHOLDERS VS. PERSONNEL EXPENSES OF THE COMPANIES BETWEEN 2009 AND 2020



Source: BASIC study

Moreover, shareholders make up only a small percentage of the population: A mere 17.5 per cent of German citizens own shares directly or through mutual funds, and more than half of these shareholders have a net monthly household income of more than €3,000.[39] In addition, the latter group owns a significantly higher percentage of the assets invested in shares: In Germany, 95 per cent of the capital of private companies is owned by households in the top 10 per cent of

> A mere 17.5 per cent of German citizens own shares directly or through mutual funds, and more than half of these shareholders have a net monthly household income of more than €3,000.

The widening pay gap among workers is also an important aspect of this issue. A 2019 IWF study showed that, between 2002 and 2014, the income gap widened significantly to the detriment of low skilled workers.[42] Unfortunately, the information required for a thorough analysis of pay gaps within the companies in this study is not available. In this context, we would welcome more detailed reporting on personnel expenses, including information on the payment of certain groups of employees, as well as the distribution of average wages by quartile.

The CEOs of the investigated companies earn an average of €3.4 million per year, which is 48 times the average annual remuneration of their employees. Topping the charts with an annual salary of approx. US$18.5 million is Linde CEO Steve Angel, earning 245 times the average salary of Linde employees.

However, data is available on the relationship between CEO salary and the average employee salary. According to a current study by the German organisation Deutsche Schutzvereinigung für Wertpapierbesitz e.V. (DSW) and the Technical University of Munich (TUM), the CEOs of the investigated companies earn an average of €3.4 million per year, which is 48 times the average annual remuneration of their employees. Topping the charts with an annual salary of approx. US$18.5 million is Linde CEO Steve Angel, earning 245 times the average salary of Linde employees.[43]

In this context, a historical or global perspective can be helpful. For example, in 1965 the average CEO compensation package in the US was 20 times higher than that of their average worker.[44] In France's public sector the annual CEO compensation relative to the average worker's annual salary is capped at 20-to-1. Progressive companies have also started to set their own limits: E.g. the Brazilian company SEMCO SA, with over 3,000 employees, observes a maximum ratio of 10:1.[45]

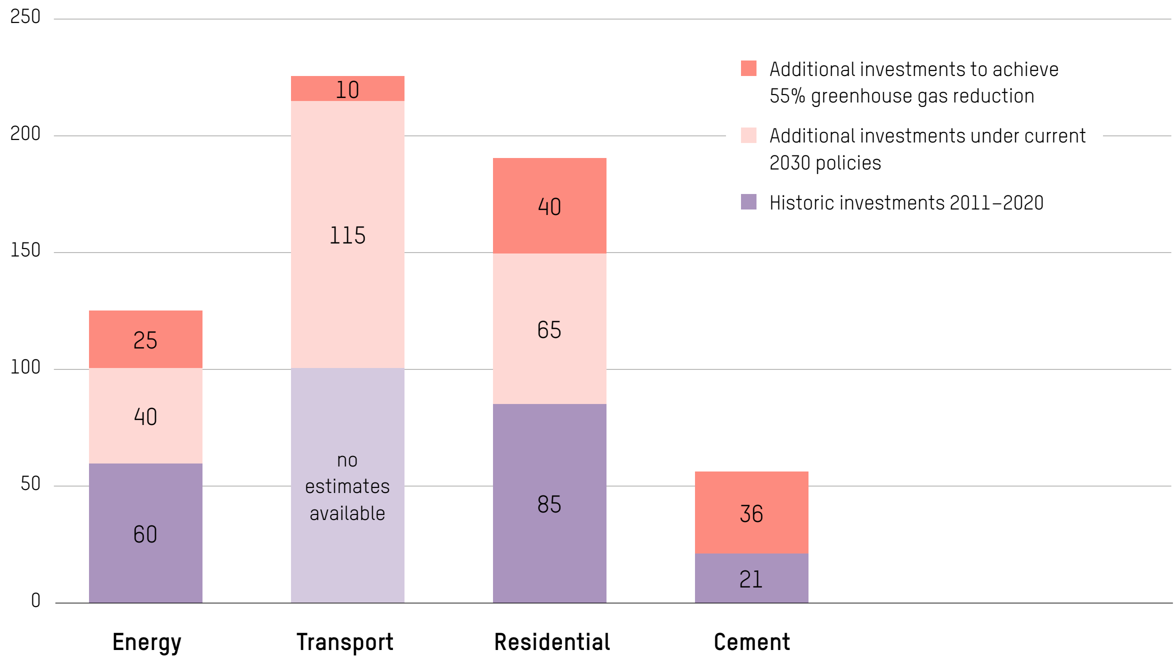
These findings clearly show that the investigated trends for shareholder payouts, reserves and remuneration are exacerbating both wealth and income inequality.

Inadequate investment in climate-friendly business models

As mentioned in the introduction, companies and their associations are currently demanding extensive subsidies as compensation for adopting business activities that would contribute to the achievement of the internationally agreed 1.5°C target. BASIC investigated to what extent private companies would be able to fund such investments from their own profits and reserves.

Its analysis is based on European Commission studies on the required investments of a selection of key sectors. In 2020 the Commission estimated the volume of additional investments that each European sector would have to make in order to achieve the EU's target of reducing greenhouse gas emissions to at least 55% below 1990 levels by 2030 and reaching carbon neutrality throughout Europe by 2050. The European Commission then compared these estimates with the investment levels at the time.[46] According to the findings, which are illustrated in Figure 7, all of the European economic sectors included in the Commission's analysis will have to make contributions to the transition, but the challenge will not be the same for all sectors. These estimates are extremely conservative, considering that, from a global perspective, the EU's underlying goals would not be sufficient for achieving the 1.5°C target.[47]

FIGURE 7: CURRENT SECTORAL INVESTMENTS AND PLANNED INVESTMENTS FOR THE ACHIEVEMENT OF THE CLIMATE TARGETS IN BILLIONS OF EUROS/YEAR



Source: BASIC study, based on European Commission 2020[48] and French Agency for Ecological Transition 2011.[49]

In addition, by consolidating data from the National Energy and Climate Plans (NECP) of the various EU Member States, the European Commission also examined how the total investment required should be split between public and private investments. Taken together, these plans assume that, for the transition to a low-carbon economy, investments from public and private sources will be required at a ratio of 50:50.

On the basis of these findings, BASIC examined the consequences of the European plans for the DAX 30 companies that are active in the following four key sectors:[50]

- Transport (BMW, Daimler, Volkswagen, Deutsche Lufthansa)
- Energy (RWE and E.ON)
- Cement (HeidelbergCement)
- Real Estate (Vonovia)

Their approach will be explained below on the basis of the transport sector. BASIC made a rough estimate of the total investments required for the four aforementioned companies of the transport sector by calculating the percentage of the EU investments estimated by the European Commission for which they would be accountable. For this purpose, they calculated the share of the sector's greenhouse gas emissions for which each company is responsible based on their respective market share.[51]

The calculated result represents the percentage of the transport sector's total investments that should be financed by BMW, Daimler, Volkswagen and Lufthansa. If, like the EU, we assume that 50 per cent of these investments should be financed by private companies, then the four companies would be responsible for an additional €13.8 billion in investments.[52]

If this required investment volume is compared with key financial data for the transport sector, extrapolated from the four companies in the analysis, the results are as follows:

- Between 2009 and 2020, the combined average annual pre-tax profits for the four companies was €28.61 billion, of which an average of €7.2 billion were spent on income taxes, €5.9 billion were paid out to shareholders and €4.5 billion were used for increasing the companies' cash reserves. The remaining amount was reinvested by the companies in their operations.
- In 2020 their cash and cash equivalents totalled €102.36 billion.

> With the extra annual investment estimated by the European Commission, the companies' pre-tax profits, income tax and shareholder payments would still be at the level of 2009 to 2010.

The estimated additional annual investment volume of €13.8 billion would cut these companies' average pre-tax profits for the years 2009 to 2020 approximately in half, reducing their ability to make payments to shareholders, fund other investments and increase their cash reserves. However, they would also have to pay less in taxes, which would mitigate the effect: With the extra annual investment estimated by the European Commission, the companies' pre-tax profits, income tax and shareholder payments would still be at the level of 2009 to 2010.

By reinvesting their €102.36 billion of cash reserves in the required climate-friendly restructuring measures over a period of ten years, these four companies alone could achieve an annual investment capacity of approx. €10 billion, which would already cover nearly three quarters of the required investment volume estimated by the EU.

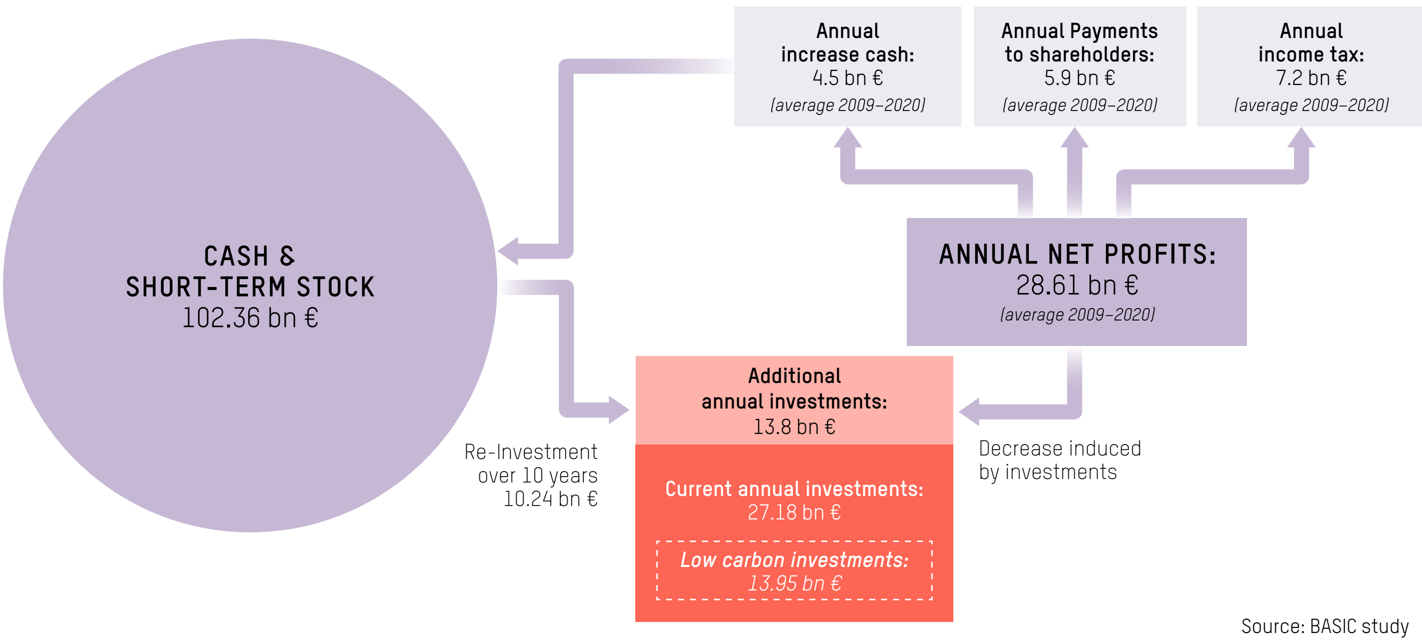
In light of figures like these, it is questionable whether companies in the automotive industry actually need the level of public financing they are currently receiving.

BASIC applied this same logic to the three other key sectors mentioned above and the corresponding DAX companies investigated in the study. Further information about these calculations can be found in our Technical Report;[53] the key findings will only be covered briefly here.

In the residential sector, the analysed company Vonovia could easily cover the required €100 million in additional annual expenditure from its annual profits of approximately two billion euros.

The energy companies RWE and E.ON, even with their cash reserves, will face major challenges in the financing of the required investments. These findings are unsurprising in light of the high carbon intensity of their operations. The energy-intensive cement company would also have to spend the majority of its profits and cash reserves to finance the investments required for achieving the climate targets. This shows that, in these sectors, a radical adaptation of

FIGURE 8: ADDITIONAL INVESTMENTS REQUIRED BY AND POSSIBLE FINANCING SOURCES FOR THE TRANSPORT SECTOR



Source: BASIC study

the business models is necessary for addressing the challenges of climate change. In this context, price increases for end products are also conceivable, e.g. in the cement industry, which is responsible for eight per cent of the world's carbon emissions.[54]

The BASIC analysis shows that the investigated companies in all four sectors are not investing nearly enough in the climate-compatible restructuring of their business models. The amount they have spent on investment is far below the required investment volumes estimated by the European Commission – which is all the more unsettling if we consider the fact that the Commission's estimates are not ambitious enough for staying below the 1.5°C target. At the same time, the necessary investments estimated by the Commission would be financially affordable in a key sector like transport. It is a conscious decision on the part of management to instead use the company's financial flexibility in the interests of the company shareholders.

Insufficient funds invested in the fulfilment of human rights due diligence obligations

Numerous studies show that, in the period covered by our research, human and labour rights were repeatedly violated in global supply chains and production networks. Reported abuses include violence against environmental activists, forced resettlement or other violations in the context of large infrastructure projects like the construction of dams or wind parks, for which German companies like Siemens, Daimler, Allianz and Munich Re supplied goods or services,[55] violations of the right to water or health in the mining of metals for the German automotive industry,[56] violations of rights in mining operations for energy companies[57] and ThyssenKrupp[58] and labour rights violations in the manufacturing of clothing for German textile companies like Adidas.[59]

Adidas would be able to finance the payment of living wages for all workers in its suppliers' operations and nevertheless remain profitable, although its profits would drop to 50 per cent below the average level for 2009 to 2020. In this case, Adidas would still be able to make payments to shareholders at the level of 2013, when its shareholder payouts were already among the highest in the textile industry.

In 2021 the so-called Supply Chain Act was passed in Germany, requiring companies to ensure that their business activities do not increase the risk of human or labour rights violations. In order to fully comply with their human rights due diligence obligations, companies have to restructure their business models accordingly, which includes planning the required investments. As early as 2014 a survey of the DAX 30 companies revealed deficiencies in compliance with human rights due diligence obligations.[60] The United Nations agreed these due diligence obligations for all companies as early as 2011 in their Guiding Principles on Business and Human Rights, and the German government clearly communicated its associated expectations for German companies in 2016. These obligations explicitly call for a systematic approach and reporting on the respective measures. Some of the investigated companies publish information on corporate social responsibility programmes or measures they have adopted in this context. However, in their annual reports, none of the investigated companies have outlined comprehensive transition paths that specify concrete targets and investment requirements with key facts and figures.[61] We can therefore deduce that their response has been limited to sporadic reports of individual measures and projects instead of an integration of the obligations into their business models.

Owing to a lack of transparency in the supply chains and production networks, it has not been possible to fully assess the volume of investments that will be required for the respective companies. Adidas was the only DAX company in this study that, under enormous public pressure, ultimately agreed to disclose sufficient information on its supply chains. These figures enabled BASIC to calculate, as an example case, the expenditures that would be required in order to raise wages in Adidas's supply chains to the level of a living wage.

According to BASIC's estimates, Adidas would have incurred approximately €597 million in additional expenses in order to ensure the payment of living wages throughout its supply chains during the period covered by the report, while the average annual pre-tax profits during the same period totalled €1.2 billion: These figures clearly show that Adidas would be able to finance the payment of living wages for all workers in its suppliers' operations and nevertheless remain profitable, although its profits would drop to 50 per cent below the average level for 2009 to 2020. In this case, Adidas would still be able to make payments to shareholders at the level of 2013, when its shareholder payouts were already among the highest in the textile industry.

Currently, there is no way to fully evaluate the wage and human rights situation for the suppliers of all companies in the study. An analysis of this kind would require a much higher level of transparency in company reporting: A good starting point, for example, would be a detailed list of the most important suppliers and their regional distribution. It would be necessary to require all companies to provide the respective information, considering that, today, every multinational corporation has global supply chains, and the prevailing standards in the respective regions are an important aspect of their social responsibility.

At the same time, it is clear that suppliers would have to be paid higher prices in order to ensure better conditions for workers involved in the production of intermediate goods and the extraction of raw materials. These prices should cover the costs of a socially and ecologically just production, which is impossible without them. In general, the lack of transparency around this issue makes it very difficult to access information; nevertheless, the analysis of the revenues earned by the investigated companies shows that the percentage of these revenues that goes to suppliers and service providers has declined significantly. In the period covered by this report, it dropped from 65 per cent (2009) to 60 per cent (2020).[62]

In light of the existing studies on human rights violations in the supply chains of German companies, along with the lack of climate-change mitigation investments described above and our findings for the investigated companies, it can be concluded that considerable investment is required for tackling the respective social and environmental issues and that many companies have failed to make these investments in spite of their comfortable financial situations.

The significance of remuneration structure and composition of management bodies

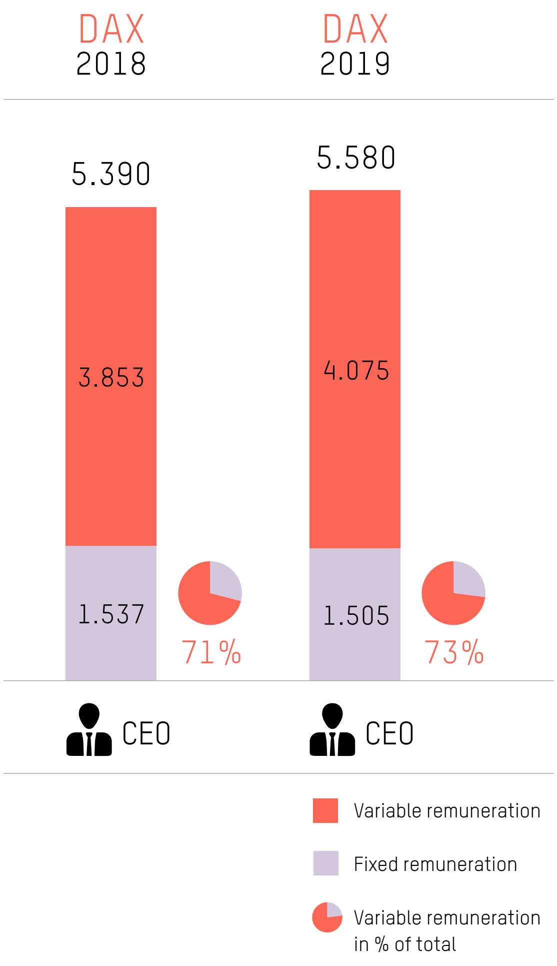
In the period covered by this report, the thirty largest DAX companies decided not to invest in the changes required for addressing social and environmental issues and to instead build up their reserves and make payments to shareholders. This means that they unilaterally served shareholders' interests – at the expense of all other stakeholders.

Studies on corporate decision-making suggest that one important reason for this trend is the increasing financialisation of the corporate sector. For example, researchers from the University of Greenwich carried out a longer-term cross-border analysis of labour compensation as a ratio to the value added generated by listed companies in Europe.[63] Their analysis revealed a clear correlation between the decline in wage share, the financialisation of the management and the increasing influence of shareholders on corporate governance. This correlation is particularly strong for Germany, where the ratio of labour compensation to value added fell by 18 per cent between 1995 and 2016.

Although this study does not focus exclusively on the former DAX 30 companies, it nevertheless confirms the increasing importance of shareholders since the late 1990s.

Executive remuneration is also recognised as a key lever in the financialisation of companies. Therefore, BASIC used the results of a study from the consulting firm Ernst & Young (EY) to take a closer look at the remuneration packages received by the CEOs of the investigated companies.

FIGURE 9: REMUNERATION PACKAGES OF THE CEOs OF GERMAN CORPORATIONS AND THEIR FIXED AND VARIABLE REMUNERATION COMPONENTS



Source: Based on EY (2020), cited from BASIC study

The consolidated figures from Ernst & Young show that the remuneration received by the CEOs of the former DAX 30 companies consists primarily of variable, performance-related components, such as bonus payments. For the investigated corporations, this component accounted for 73 per cent of the total remuneration, as shown in Figure 9. Variable remuneration components provide strong behavioural incentives for executives, which is why their concrete structure, e.g. the specified criteria, can have a major influence on business practices.

"In absence of EU action [with respect to interest representation], the prevailing social norm of shareholder primacy will not be challenged and will continue affecting corporate governance, leading directors to primarily focus decision-making on short term shareholder value maximisation. The long-term interest of stakeholders other than shareholders is likely to remain on the side-line in board decisions."

Study published by the European Commission

The findings of BASIC's research and other studies suggest that the trend of financialisation and the associated structure of the remuneration packages received by management play a significant role in a company's decisions as to whether its activities should be focused on the public good or on particularistic interests.

Since as early as 2009, supervisory boards in Germany have been required by law to align remuneration structures with a management style focussed on the sustainable development of the company. In 2020 additional legislation was passed, clarifying that this requirement does not refer exclusively to the long-term – e.g. financially sustainable – development.[64] An analysis of the investigated companies' status reports for the 2017 financial year revealed that only 44 per cent of the companies used non-financial key performance indicators for calculating the variable components of their remuneration packages and that not even these indicators took social and environmental factors fully into account.[65]

Another decisive factor in corporate decision-making seems to be the composition of boards themselves. The most recent study on directors' duties and sustainable corporate governance prepared for the European Commission identified the lack of consideration for the interests of other stakeholders as a key driver of unsustainable corporate policy.[66] Its conclusion: "In absence of EU action [with respect to interest representation], the prevailing social norm of shareholder primacy will not be challenged and will continue affecting corporate governance, leading directors to primarily focus decision-making on short term shareholder value maximisation. The long-term interest of stakeholders other than shareholders is likely to remain on the side-line in board decisions. [...] At social level, due to the persistence of this driver, the voices of many of the companies' stakeholders, including the most vulnerable social groups (such as workers in third countries along global supply chain), will continue being unheard in company decision-making."

The fact that companies, by prioritising reserves and shareholder payouts over necessary social and environmental expenditure, are focusing primarily on the interests of the shareholders is hardly surprising considering that shareholders make up the majority of the members of boards of directors of the investigated DAX 30 companies. The company Vonovia even managed to circumvent Germany's codetermination laws by forming a European Company (Societas Europaea, SE), enabling it to choose a one-tier system of corporate governance with no employee representation whatsoever.[67] Vonovia's strategy is consistent with the nationwide trend towards the weakening of employee codetermination in Germany. These developments are all the more alarming when we consider that strong employee participation is correlated with sustainable business practices, as is further described in the section on the representation of various interest groups. The interests of other stakeholders – like consumers, suppliers or people affected by human and environmental rights violations in the supply chains – have absolutely no representation on corporate management boards. As a result, the concerns of these groups are not taken into consideration in decision-making processes focused on whether relevant social or environmental expenditures should be made.

CONCLUSIONS

Fundamental political considerations

The developments outlined above are not the results of isolated decisions, but rather the products of a misguided understanding of the sense and purpose of corporations as short-term profit maximisers driven by shareholder value and the associated power structures. It is high time that the political framework be re-evaluated with the aim of establishing a new corporate philosophy focused on the public good.

> The European Parliament concludes that initiatives based on voluntary instruments and soft law have for the most part proven ineffective in changing corporate behaviour towards sustainability.

The transition to a new corporate philosophy cannot be achieved through the voluntary initiatives and self-regulatory commitments of the companies themselves. This fact is clearly illustrated by the findings of a 2020 monitoring survey commissioned by the German federal government to assess companies' implementation of the UN Guiding Principles on Business and Human Rights. It revealed that less than 17 per cent of the surveyed companies were fulfilling their obligations.[68] The European Parliament shared similar findings in its report on sustainable corporate governance, concluding that initiatives based on voluntary instruments and soft law have for the most part proven ineffective in changing corporate behaviour towards sustainability. In this context, the Parliament explicitly called for regulatory measures to ensure "that companies take due consideration of societal and environmental concerns, such as the rights of their employees and respect for planetary boundaries, in order to address the most pressing risks posed to these by their activities."[69]

The analysis of the DAX corporations' business conduct outlined in this report revealed that, in recent years, the amount spent by companies on shareholder payouts and executive remuneration has risen faster than their annual net profits. Investments in the measures that are necessary for preventing negative external effects and improving the social and ecological balance have not been made to the extent required in spite of the fact that sufficient financial resources were available. If a socio-ecological transformation of our economy is to succeed, then companies must start prioritising these investments and expenditures over shareholder payouts.

Considering these facts, the provision of the additional subsidies that business leaders are demanding to help them invest in the socio-ecological transformation does not seem especially prudent. Instead, the focus should be placed on how and in whose interests a company is managed. An appropriate regulation of shareholder payouts could create the necessary financial flexibility and reduce the pressure on companies to make excessive payments to shareholders. Accordingly, this section will consider the regulation of sustainable corporate governance in three areas: (1) directors' duties and corporate purpose, (2) shareholder payouts and investments, and (3) the composition of management bodies.

The associated proposals apply to all large companies, regardless of their legal form. However, owing to the focus of this report, all proposals are worded with a special emphasis on joint stock corporations.

1 Concrete proposal 1: Introduce effective regulations requiring companies to serve the public good

The first and most important step is redefining corporate purpose: The interests that boards are obligated to serve should clearly incorporate a fundamental respect for planetary boundaries and human rights.

From a historical perspective, the idea that companies are obligated to serve the public good has always been an integral part of national legislation in Germany. In the 1794 Prussian General State Laws, the introduction of special advantages for companies, particularly the limited liability of their members, was clearly linked to an obligation to serve the public interest (*fortdauernder gemeinnütziger Zweck*).[70] Compliance with this obligation was to be ensured by means of state supervision, and later through the supervisory board of the respective company as an "extended arm of the state".[71] In 1965 the legislature decided against making direct reference to the public good, reasoning that it was a self-evident fact.[72] A corresponding legislative proposal by the SPD parliamentary group in 2017 failed.[73]

These examples show that companies' obligation to serve the public good has a clear basis in German law.[74] The relevant provisions of German company law need to be revised accordingly, emphasising the obligation to serve the "interests of the company" (*Unternehmensinteresse*) and defining these interests in detail. Furthermore, any definition of these company interests must include the observance of planetary boundaries and the respect for relevant human and fundamental rights, unless these interests have already been enshrined in other legal obligations and their observance is being strictly enforced.

To ensure their effectiveness, reforms of this kind must go hand in hand with concrete requirements and powerful enforcement mechanisms:[75]

To ensure that the legal obligation to serve the public good will effectively guide the actions of directors, it needs to be translated into specific due diligence obligations. These should include both human rights due diligence obligations, like the ones incorporated in Germany's Supply Chain Act, and environmental due diligence obligations, e.g. in the form of concrete requirements for companies to make their business models compatible with the 1.5°C target.

It is important that each of these concrete regulations also include the possibility of establishing a civil liability regime as an effective tool for supplementing official sanction mechanisms. The inclusion of concrete due diligence obligations in the corresponding laws, if appropriately worded, could make liability in tort law on the basis of Section 823 of the German Civil Code (BGB) possible and enable affected parties to take legal action to claim compensation for human rights violations or environmental damage.[76] Official sanction mechanisms in cases of non-compliance with requirements could include fines as well as exclusion from tendering for public contracts[77] or economic aid. Companies could then reclaim associated costs through the internal liability of board members.

The fulfilment of the obligations outlined above will become standard company practice more quickly if they are incorporated directly into the remuneration structure and associated incentives for directors.[78] The criteria currently used for variable remuneration, however, along with the underlying methods of performance measurement, create misdirected management incentives that are associated with numerous negative impacts. This is why the concept of variable remuneration and the linking of remuneration to short-term criteria, such as share price, should be thoroughly re-examined.

Provided companies continue to use variable remuneration at all, provision should be adopted to ensure that it is focused on economically, socially and environmentally sustainable corporate governance. For example, companies could be required to ensure that at least 50 percent of the total remuneration package consists of fixed remuneration together with variable remuneration that is based on the fulfilment of social and environmental criteria. Another possibility would be to consider long-term economic, social and environmental indicators in equal percentages for the variable remuneration.

2 Concrete proposal 2: Ensure that all required social and ecological investments are made, and limit shareholder payments

If enforced by means of effective liability regimes and official sanctions, the aforementioned regulations on corporate purpose and directors' duties should have a direct impact on companies' investment behaviour and profit use.[79] Concrete due diligence obligations give companies targets while leaving them freedom to decide how these targets can best be achieved. **Accordingly, clear and unambiguous legislation must require companies to develop and publish concrete strategies for the implementation of their obligations, specifying the volume of investments that are**

needed in the context of these strategies. Once these investments are made, correspondingly less money will be available for dividends, which companies have been paying at the expense of necessary investments.

The findings of the BASIC study showed that corporations are focusing more than ever on the amount and stability of their payments to shareholders. In this context, lawmakers must ensure that the balance between the wishes of shareholders and the interests of the company is preserved.[80] **This could be accomplished by means of a ban on shareholder payouts that would exceed the net annual profits of a financial year and therefore reduce the company's capital base.**

Furthermore, companies that have accepted extensive economic aid from the state or implemented furlough schemes for their employees should be prohibited from making payments to shareholders.

3 Concrete proposal 3: Require that the views and voices of a diverse range of stakeholders be represented at board level

To ensure that companies will be able to effectively implement their clear obligations to serve the public good taking into consideration social and environmental targets, their boards of directors will require the relevant expertise. Furthermore, in individual cases consultations should be carried out as necessary with important social stakeholders. **This includes the legal obligation to develop effective mechanisms that make it possible to effectively voice matters of public interest and the collective needs of important stakeholder groups,** e.g. the workers, suppliers, local communities and producers in the often long and complex supply chains. The inclusion of these groups should ensure that their interests and rights will be taken into consideration in decision-making processes associated with the determination of a company's best interests in concrete situations. In this context, the study on directors' duties and sustainable corporate governance prepared for the European Commission shows that binding rules have the greatest impact. It proposes rules that would require companies "to establish mechanisms for engaging with and involving internal and external stakeholders in identifying, preventing and mitigating sustainability risks and impacts as part of their business strategy."[81]

Changes in this area are feasible on two levels. Firstly, liability and a strong obligation to serve the public good should have a direct effect on the composition of the companies' governance structures. A stronger institutional integration of environmental and human-rights perspectives in these structures would be conceivable; for example, the members of the supervisory and management boards could be responsible for individual concerns, or boards could form committees. In this context, employee codetermination is an important pillar for ensuring that decision-making processes aimed at determining the company's best interests are fair and equitable. Although employee representation on supervisory boards should not be viewed as a magic bullet,[82] the European countries with the strongest employee participation rights show better employment rates, higher expenditures for research and development, lower rates of poverty and inequality and a greater use of low-carbon energy.[83] Recent studies in Germany have shown that companies with stronger employee representation on supervisory boards pay an average of four per cent more in taxes, are less likely to take advantage of tax-avoidance opportunities and have established more substantial socio-ecological approaches.[84] **Employee representation should be systematically strengthened in order to actively counteract its erosion: above all, by using legislation to prohibit the use of specific legal forms to bypass employee participation rights and by introducing sanctions for companies who illegally ignore these rights.**

Secondly, institutionally embedded instruments are needed. These should include effective complaint mechanisms with routes of recourse for parties affected by environmental, human-rights or labour-rights violations, as well as advisory committees focused on specific issues. The latter should be provided with all relevant data, e.g. information required for the integration of environmental perspectives, and be allowed to report on issues in a transparent manner in order to create a critical public opinion. This is especially important if the affected individuals or groups are not represented by the elected supervisory board members.

All of these measures are aimed at changing the essence of the currently prevailing corporate philosophy: The exclusive drive towards profit maximisation as the main business objective must be replaced by the public-good orientation of property ownership enshrined in the German Basic Law so that the focus is not primarily on the financial benefits of shareholders or investors, but also on the socially and ecologically just satisfaction of all stakeholders' needs. Without this transformation of the economic actors, it will not be possible to achieve a socially and ecologically just economy at national or international level. At the same time, these measures are interrelated and can only effect a fundamental change in the prevailing corporate philosophy if they are implemented in combination.

COMPLEMENTARY LEGAL REGULATIONS

The aforementioned political proposals concerning corporate governance are to be understood as complementary to other important legislative changes. These changes should include an adequate increase in the carbon price, reporting requirements for non-financial information, specifications for the recording of social and environmental aspects in accounts, and regulatory guidelines, e.g. for the payment of a minimum living wage, not only in Europe but throughout all global supply chains. In certain areas, simple bans are the most effect means of ensuring that companies will accelerate their ecologically necessary innovation work, as was demonstrated by the successful example of the CFC ban.[85] A regulation of corporate governance itself helps make these guidelines more effective so that they are not understood as obstacles, but rather as a way of facilitating the company's own – sustainably understood – best interests.

All too often, state subsidies, like Germany's Innovation Premium for its automotive industry, have been chosen as a means for encouraging companies to invest in social and ecological targets. Powerful companies prefer to use their financial reserves for paying dividends instead of funding environmentally necessary restructuring measures, and their lobbying groups focus on these interests.[86] However, this approach unnecessarily externalises the costs onto society instead of having them paid for where they occur and where in many cases they have been used to make profit.

If we take a step back and look at the necessary restructuring of the economy as a whole towards social and ecological targets, we realise that the further development of regulations on the corporate governance of large corporations is only one part of the solution. In addition, inclusive and sustainable undertakings with a completely different form of governance – e.g. cooperatives or organisations in community-supported agriculture – must be supported in order to pull them out of the niches. These companies and projects could benefit directly from subsidies, as well as indirectly from the guidelines proposed here for large, profit-oriented corporations: Until these economic giants are forced to stop externalising the costs of their negative social and environmental impacts onto society, the smaller organisations that take alternative approaches and consciously strive to reduce these impacts will not be able to compete. The market power of these multinationals should also be limited by effective antitrust and competition laws focused on the public good.

RECOMMENDATIONS FOR POLITICAL ACTION

An appropriate legal framework is needed in order to ensure that companies will align their business models towards practices that respect planetary boundaries and human rights and will make decisions on wages, investments and shareholder payouts in the interests of not only shareholders, but all parties affected.

Company law is a powerful tool in this context. We recommend amending the existing company law towards the promotion of sustainable corporate governance – both in German law and through constructive and proactive collaboration on the relevant legislation at European level.[87]

In this context, the following points are particularly decisive:

1. Introduce effective regulations requiring companies to serve the public good

- The management and supervisory boards should be obligated to serve the interests of the company, and these interests should clearly incorporate a respect for planetary boundaries and human rights.
- This requirement should be fleshed out in the form of specific due diligence obligations – e.g. the requirement to ensure that the company's business model is compatible with the 1.5°C target.
- Official sanction mechanisms and civil liability should exist for enforcement purposes so that companies are also liable for damages towards people who have suffered in concrete ways because of the company's actions.
- Variable remuneration structures should not be permitted to focus on short-term financial indicators. Instead, such remuneration components – if they are used at all – should be based on a combination of long-term ecological, economic and social criteria.

2. Ensure that all required social and ecological investments are made, and limit shareholder payments

- Companies should be required to develop and publish concrete strategies for the implementation of their obligations and to specify the respective investment needs in the context of these strategies. The investments should take precedence over the retention of profit in reserves and the use of profit to make payments to shareholders in the form of dividends or share buybacks.
- Shareholder payments that are higher than the net annual profits of a financial year should be prohibited.
- Companies that have accepted economic aid from the state, including short-time working support, should not be allowed to make payments to shareholders.

3. Require that the views and voices of a diverse range of stakeholders are represented at board level

- Companies should be required to ensure that the public and collective interests of important stakeholders are effectively represented in corporate governance and in decision-making processes aimed at determining the company's interests. These stakeholders include workers, suppliers, local communities and producers in the supply chains.
- The representation of employees should be systematically strengthened. In particular employee participation rights should apply regardless of the choice of legal form, and the failure to respect these rights should be punishable with sanctions.

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GLOSSARY

Net income and profit

Net income, or *net loss*, is the difference between the revenues (primarily sales) and expenses (e.g. for personnel, materials and taxes) of a given company. Net income is commonly referred to as *net profit* or *net earnings* and is an important measure of a company's financial performance. At the end of a financial year, the net income can either be placed into the company's reserves and remain in the company or be paid out to the shareholders as owners of the company. In business and economics, the term *distributable profits* is used to describe the amount available for payments to shareholders.

Dividends

A *dividend* is the most common form of profit distribution. It is a payment to the shareholders from the company's distributable profits as a remuneration for the capital they have contributed. The distributable profits are calculated from the net income, taking into account any liquidation of reserves from previous years. In our research, we came across several cases in which the total amount that a company paid in dividends exceeded its net income for the respective financial year.

Share buybacks

Share buybacks are another form of capital distribution: In this case, the company buys back its own shares on the stock market instead of paying dividends. This results in an increase in the stock price. In addition, the number of shares outstanding is reduced, meaning that subsequently all shareholders will receive a larger share of the profit. This is how shareholders profit from share buybacks. This instrument is particularly popular in the US but is also used occasionally in Germany.

Reserves

Reserves are a part of a company's net worth. They are mainly derived from the part of the net income that remains in the company. In general, these reserves are eventually reinvested, but they can also remain in the company as cash. Owing to the fact that they are accumulated from the company profits, they are ultimately the property of the shareholders.

Investment

A company makes an *investment* with the aim of earning back the invested sum plus interest. In this process, the money invested is exchanged for a capital good. Traditional investments in this context include the replacement of machinery and equipment, or company expansion. The amount spent on the construction or purchase of a manufacturing plant with lower carbon emissions would be considered an investment if, thanks to the new plant, the company would no longer have to pay for its carbon emissions. It would also be considered an investment if it prevented the closure of a factory due to legal guidelines.

In a broader sense, an *investment* is something bought for future financial benefit for the investor, e.g. expenses for research or for building a product brand.

Cash and cash equivalents

Cash and cash equivalents are the assets which are immediately available to the company. They include deposits held at call with banks and short-term investments. Companies need to hold a certain minimum amount of liquid assets to remain solvent in tough times, while any assets in excess of this minimum can be spent.

Equity capital

Equity capital is the portion of a company's assets that is made available by the shareholders as owners, either directly through payments or indirectly through profits that remain in the company (reserves). It is used, together with the debt (borrowed capital) for financing the company's activities.

Variable remuneration

Variable, or *performance-related*, *remuneration*, is the part of a remuneration package that varies based on a specified reference value. The broad spectrum of possible reference values includes profit, share price, customer satisfaction and reductions in carbon emissions. The aim of variable remuneration is to motivate recipients to focus their efforts on the improvement of the reference values; i.e. it is an instrument of behavioural control. This is why the concrete design of the remuneration system is very important. In general, a company can use variable remuneration schemes for any employee. However, owing to its steering effect, variable remuneration is often used for executives, for whom it can constitute a large percentage of the total remuneration.

Shareholder value

This term refers to a strategy aimed at maximising the market value of a company along with the value of its shareholder assets. In this context, the interests of other stakeholders are subordinate to those of the shareholders. When this type of business strategy is implemented, a strong focus on cost reductions, corporate governance practices that favour short-termism and a sharp increase in payments to shareholders are often observed.

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