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ibe Institute of Business Ethics   ecoDa

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Brussels

Does European Corporate Governance Need More Ethics?

EVENT SUMMARY

Does EU Corporate Governance Need More Ethics?

IBE/ecoDa event, Brussels
July 2nd, 2013

IBE/ecoDa addressed the question of "Does EU Corporate Governance needs more ethics" at their event on July 2nd, 2013 in Brussels following the publication of an IBE paper entitled "review of the ethical aspects of corporate governance regulation and guidelines in the EU" (available at www.ibe.org.uk)

Julia Casson, Director of Board Insight Limited and author of the report, made a short presentation of the key findings:

At EU level:

- Little explicit reference to ethical behaviours in EU corporate governance provisions,
- Does not imply lack of ethical consideration, but an absence of explicit use of ethics terminology
- EU has not imposed a standard governance framework – but encouraged harmonisation - except for some "hard law" provisions (annual corporate governance statements; shareholders' rights provisions, financial services provision)
- Harmonisation impeded by factors including:
  - Different views on what is ethical,
  - Differing political, cultural, social factors
  - Some member states more used to 'soft law' guidance – lends itself more to including 'ethical' language
  - EU enlargement
  - Issues spread across more than one EU DG
  - Different board and shareholder structures

At member state level:

- Governance Codes of member states contain similar provisions regarding some ethical aspects of corporate governance, but also lack ethics language
- Monitoring and enforcement varies widely
- Some member states have introduced hard law for certain matters
- Guidance in a few countries has is begun to include behavioural aspects
- Growing debate on ethical behaviours is a context

According to **Anthony Smith-Meyer**, Editor in chief of the new Journal of Business Compliance and ILA Certified director Corporate Governance is a framework enabling an organisation to meet its stated objectives. Corporate Governance helps to extract information from the company and its environment and to bring them to a platform in order to identify dilemmas and challenges, and to further inform decision making. This is where discretionary

and ethical judgement comes in through the leadership. Corporate Governance Codes includes diversity policy, board evaluation, nomination procedures and a risk management approach (including reputation risks). It is only at the point at which leaders are required to exercise their discretionary judgement in the choice between legal alternatives that ethics is instrumental in the chain of events. What really matters for companies is leadership ("tone of the top"). Leadership might be the "missing link" between governance and ethics. Companies should wonder what kind of leadership they need?
Research shows that individuals moving from the private life to a hierarchical structure have a greater tendency to obey and are less willing to challenge or inclined to demonstrate empathy towards those who endure the consequences of their actions. Ethical leadership is the ability to see the many elements/perspectives of the organisation and of its environment, to understand the impact of companies' decisions on stakeholders, to confront values (with a degree of empathy) and to take the responsibility for the actions that are taken (accountability). Leadership must create a thinking culture and a culture of accountability. An alternative question could be "does EU ethics need better governance"!

Roger Barker, Director of Corporate Governance and Professional Standards at the Institute of Directors, stressed that ethical codes and values' statements constitute reference points and a useful prerequisite but are not enough. Ethics should not appear only at the top and should be embedded in companies' processes. Ethics should be associated to a whole range of initiatives and should be subject to a true commitment. A full comprehensive communication of the ethical code is needed especially in the appraisal and the disciplinary procedures for employees. Roger Barker insisted on the need to have ethical policy consistent with the company strategy and to disclose it to stakeholders. Ethics codes can not be used in isolation; all policies including remuneration policy must be consistent with the company's ethics. Ethics has to be integrated with the rest of the governance framework. The creation of an ethics committee, the appointment of an ombudsman and appropriate incentives can play an important role to make the ethical policy effective in the company.

Jeroen Hooijer Head of Unit responsible for Corporate Governance and Social responsibility at European Commission, underlines how values evolve over time and therefore legislating in the field of ethics can be delicate and soft law might be preferred. If regulatory authorities try to influence behaviours, they should carefully avoid producing box ticking exercises at the same time. The absence of explicit reference to ethic does not imply that the regulator is not already favouring ethical behaviours. With the CRD IV Directive, the regulator is intervening in the remuneration package by imposing binding rules for bankers' bonuses. The EU regulator is intervening also in the field of CSR with the initiative on non-financial reporting. But in the end, this is up to companies and boards to take strong ethical choices while complying also with the law. Corporate Governance is as such a dynamic process. Society expects more and more from companies and their directors and social media is fuelling a push for more transparency, accountability and responsibility not only towards shareholders but towards all stakeholders. Furthermore, what it means to behave ethically is at the end very much judgmental issue that requires choices to be made. We should in this respect not forget that in case of conflict of norms, managing by instinct is not always the right thing to do.

Following the presentations by the speakers, **Philippa Foster Back,** IBE Director, moderated the debate with the audience.

The participants and the speakers were in agreement that well run companies with a strong corporate culture perform better and are able to recover better from problems and crisis.

It is important to persuade people of the merit of good governance. In fact, training is a direct way to influence behaviours and can help directors to have better responses. Rules, frameworks and proceedings are useful but what really matters is the ability to discuss and to lead. Acting according to the law does not mean acting ethically. Making the correct choice goes beyond making a black or white choice. If best practices can help to conduct fruitful discussion, boards have really to find time to discuss dilemmas. In addition, every director joining a company should get an induction programme to better understand the values of the company and its corporate culture so that companies could behave in a more appropriate manner.

The debate focused also on stakeholder pressure and the role played by social media. It is obvious that organisations behave differently when they know that they are watched. Having the spot light on companies forces them to act in a more ethical way.

Some participants challenged the fact that having an ethics committee could reinforce the ethical policy of a company. To their mind, such ethics committee could lead to a box ticking exercise and it could complicate the decision-making process. In response, the panel made it clear that ethics can not be delegated and that ethics needs to be integrated in everything that the board does. It is therefore important for an ethics committee to report (as any other committee) to the board and to make sure that the full board is aware of the ethical issues.

The issue of taxes was also raised. It is becoming a new topic in corporate governance and company law that can affect the company's reputation.

It was stressed that finding a way to measure ethical performance is difficult but not impossible. It can be done qualitatively rather than quantitatively. Surveys can be conducted in companies to get a broad based picture and to make sure that employees are aware of what is expected and respect the corporate culture and the processes. But it remains extremely difficult to prove the return on investment. It is important to monitor the awareness, to check if the communication has been effective and to take adequate sanctions in case of poor behaviour. Boards should also look at their decision making processes and check to what extent they have proven to be ethical.

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