Publication Launch
Ethics, Risk and Governance: a board briefing paper
Peter Montagnon, Associate Director, Institute of Business Ethics with Sir Winfried Bischoff, Chairman, Financial Reporting Council

Panel discussion chaired by Sir Richard Olver FREng
Additional panellists: Simon Walker, Director General, Institute of Directors, and Philippa Foster Back CBE, Director, Institute of Business Ethics
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Simon Walker
The evening was hosted by the IoD on behalf of the IBE. Simon began proceedings by pointing out that this discussion was at the core of the IoD. The paper was commended as “more plainly worded common sense” than hundreds of other business ethics books which can be found on many bookshelves.

An overview of the current business climate was given in which it was observed that companies cannot operate in isolation from the culture in which they run their franchise and that the growth of groups like the Five Star movement in Italy, which urges ‘de-growth’ for business, continue to highlight the fact that without ethics, business loses its identity.

To many, business causes suspicion and alarm. Business therefore needs to act to improve ethical behaviour; otherwise governments and regulators will do it for them.

Sir Richard Olver
Before handing over to Peter, Sir Richard’s commented that reputation is a gold standard for organisations. It is hugely difficult to obtain, yet very easy to lose. It is imperative that boards are engaged in setting the standards and the values by which they want their organisation to be governed.

Peter Montagnon
Peter offered a number of personal reflections from the process of authoring the paper, including:

- How he was personally drawn to business ethics in the wake of the banking crisis where it was quite clear that there was an ethical element which had merited very little discussion and had been overlooked. The point was also made that this was likely to be because ethics is difficult to get to a handle on, and the lack of solutions on offer meant it was commonly overlooked.

- The crisis did however raise a number of philosophical questions such as “what is the purpose of the corporation in the 21st century?” It has become obvious that the answer of shareholder maximisation in the short term is insufficient, yet whilst there is general agreement around what it is not, there is limited consensus on what the answer actually is.

- A recent study which showed that over 50% of Tory voters, who have traditionally been overwhelmingly pro-big business, now have an issue with big business.

These reflections led to two questions which the paper attempts to answer. The first and the ‘easy’ question is “what is the role of the board in setting values?” The second, more difficult question, where this debate has the tendency to come unstuck is “what is the role of the board in determining and understanding what drives behaviour?”
In answer to these questions, Peter made three observations:

1) Profit is important. The debate around ethics is often lost as the need for profit is overlooked. Profit is a reward for bearing risk. However, it must be fairly derived and not achieved through exploitation. This however may be subtle, as it is very unlikely that a board will make explicit decisions to achieve profits through such means.

2) Ethics is not anti-business. Senior people often get defensive at the mention of ethics. The discussion should not be framed in terms of individual morals, as most senior executives are generally good people. It is instead about how a collective works together, what expectations are placed on staff as to what they should achieve, and how they should achieve it.

Quoting from the Salz review – “However, culture exists regardless. If left to its own devices, it shapes itself, with the inherent risk that behaviours will not be those desired. Employees will work out for themselves what is valued by the leaders to whom they report” – an example of employee decision making when under pressure was given.

3) This is not a simple compliance exercise. In the US, the approach has been influenced by Federal Sentencing Guidelines which has resulted in a legalistic attempt to control behaviour. However, values and cultures are a necessary part of the equation – these are about the way a business operates. This is defined by the business model, which, to be sound, needs to be based on values. It is easy to lose sight of the values and behaviour which should be the foundation of the franchise.

This is also not only about customers, but requires a wide observance of and engagement with all stakeholders, and can only be achieved by the board who need to be proactive in, and responsible for, the setting of values and an appropriate business model. There is also an important role for the CEO and management of the organisation, to whom the responsibility of embedding these values should be delegated. This highlights the importance of the character of the CEO.

In order to move beyond compliance there needs to be a commitment by the board to getting out and about, or as the paper puts it, directors should “get out and kick the tyres.” This will require both setting the right incentives, not just at senior management levels, and keeping track of products that may start as benign which may become toxic (such as PPI).

Sir Winfrid Bischoff

Sir Win began by commenting on the mission statement of the IBE “...to encourage high standards of business behaviour based on ethical values”, stating that this has never been more necessary or more true. Espousing such values is not just about public perceptions but should be about the long term benefit of companies. This is important across all sectors of the economy.

Quoting the Lambert review – “The overriding responsibility for improving the behaviour of banks must lie with the leadership of the institutions themselves, operating within the framework set out by the regulators. It is for them to define the values and purpose of the banks which they lead, to appoint and promote people who are aligned with its values, to decide which types of business they are happy to accept and which to turn away, and to do everything in their power to make sure that the tone set at the top reaches all the way down through these often very large organisations” – the principles were applicable to all sectors, and this statement should be generically applied, replacing the word ‘banks’ with ‘companies’.
Additional observations on how to promote high standards of business behaviour based on ethical values included:

- Regulators have a role in dealing with behaviours that are unacceptable.
- Only the company, and the behaviour of the collective individuals, will make a difference.
- This requires vigilance and a lot of thought, whereby the board needs to lead by example, and be seen to be doing it.
- Chairmen and chief executives need to be clear and consistent about behaviours which are not acceptable.
- Communicating from the board outwards is easy, basic metrics on how they are embedded is easy. However, employees often hide things from the board to give a perception of perfection.
- Boards need to send an unambiguous message about what will not be tolerated.
- The board must lead, but they cannot achieve this on their own – there is a role for regulators; there is not enough emphasis on governance below the board level; and internal auditors play a crucial role in providing assurance to the board, ensuring the relevant information is passed upwards. On this point, a recent publication by the Institute of Internal Auditors – Auditing Culture – was commended, and the foreword from Philippa Foster Back was quoted: *Internal audit is a unique function within an organisation with its independence and access to give assurance to those in the boardroom. This can provide confidence that there is a strong commitment to good conduct and that it is actually being translated into everyday behaviours, but also, more importantly, where it is not. To have this information allows the board an opportunity to mitigate the risk of integrity failure.*

A final few comments were made on the issue of directors’ remuneration. The observation was made that the increased voting rights of shareholders appear to be being used. High levels of dissent have been seen, with even some votes being lost. The hope was that boards would now heed these warnings from their shareholders. It was also observed that the Code of Corporate Governance has often been misquoted to justify “excessive” levels of pay. This needed to be re-read, and re-applied properly, and there needed to be a change to remuneration philosophy.

These remarks were followed by questions from the floor where all members of the panel were invited to respond.