Occasional Paper 8

A Review of the Ethical Aspects of Corporate Governance Regulation and Guidance in the EU

BY JULIA CASSON

Published by the Institute of Business Ethics
in association with ecoDa

Institute of Business Ethics

ecoDa

Author

Julia Casson is Director of Board Insight Limited which advises a wide range of organisations on corporate governance issues. In particular, the company carries out board evaluations, governance reviews and director development programmes.

Julia Casson was EU Policy adviser to the Institute of Chartered Secretaries and Administrators from 2005 - 2011 and currently chairs ICSA's EU committee. She is a Fellow of ICSA. Prior to establishing Board Insight, Julia had a career as a Company Secretary with a number of international listed companies, latterly at Pearson plc. She is a frequent writer and speaker on governance matters.

www.boardinsight.co.uk

Acknowledgements

The author would like to thank the IBE and the members of the Ethics Working Group at ecoDa for their assistance and support with this report. In particular she has greatly appreciated the guidance and attention to detail of Dr Nicole Dando, Head of Projects at IBE.

The IBE is grateful for comments on earlier drafts from the following: Peter Montagnon, Financial Reporting Council; George Dallas, F&C Investments; Paul Moxey, ACCA; Peter Kennerley, Aggreko; Vanessa Knapp OBE, retired partner at Freshfields Bruckhaus Deringer LLP; Dr Dimitrios N. Koufopoulos, Hellenic Observatory of Corporate Governance; Patrick Zurstrassen, ecoDa; Amélie Bodson, GUBERNA; Tapani Varjas, Hallitusammattilaiset; Roger Barker, Institute of Directors, UK.

The IBE would like to thank EADS for their financial support of this project.

The conclusions and views expressed in this report are those of the Institute of Business Ethics and not necessarily shared by the reviewers or sponsor.

A Review of the Ethical Aspects of Corporate Governance Regulation and Guidance in the EU

Price £10   ISBN 978 1 908534 07 01

First published June 2013
by the Institute of Business Ethics – in association with the European Confederation of Directors' Associations
24 Greencoat Place
London SW1P 1BE

Registered Charity No. 1084014

Contents

IBE Foreword

In today's environment, stakeholders have high expectations that companies should be run in accordance with good corporate governance practices.

The IBE, in commissioning this report, wished to understand whether there is guidance for companies in governance policies, at national and EU level, on ethical business practice. We wished also to explore whether there are cultural differences or different approaches at a policy level across Europe.

What this report did reveal is that to date, explicit reference to ethical principles has generally been absent from corporate governance guidance and regulation both at the EU level and within member states, except Belgium and the UK. The report did find similarities in corporate governance requirements around practice and certain issues, but a comparison of explicit ethics drivers was not actually possible.

As a practical matter, many companies recognise that to encourage positive behaviours and repeat business with their customers, they need to undertake their business in the right way. Companies therefore draw up their values, embed them with their employees and monitor that they do business according to them, knowing they will be held to account if they do not. The values espoused include for example integrity, honesty and openness.

However, not all companies do this and business, according to many public opinion polls, is not highly trusted. The publication of this report is therefore intended as a prompt for discussion. Why is there a lack of explicit ethical imperative at the corporate governance policy level? Should this omission be addressed? And what else might business do?

Philippa Foster Back OBE
IBE Director

Sponsor's Foreword

EADS is a very successful example of a truly European company with products of repute known around the world. As such, we are proud that these are products of integrity made by people of integrity.

Therefore we are equally proud to sponsor IBE's project on the Ethical Aspects of Corporate Governance Regulation and Guidance in the European Union.

Part of our success is down to our determination to make Ethics & Compliance central to our conduct and our business activities. Indeed, Ethics & Compliance is identified as one of the eight EADS group priorities for 2013. We believe that integrity is a competitive advantage in maintaining sustainable success, and we support the OECD's recommendations to restrict public procurement to responsible contractors.

EADS has embedded a strong ethics culture throughout the company - from top management to all our employees around the world. Furthermore, EADS' Board of Directors proactively monitors the effectiveness of the company's Ethics and Compliance program.

On a personal note, I welcome this IBE project and believe we should strive to make European standards a worldwide reference for ethical corporate governance.

Pedro Montoya
EADS Group Chief Compliance Officer

EADS

EADS is a global leader in aerospace, defence and related services. In 2012, the Group – comprising Airbus, Astrium, Cassidian and Eurocopter – generated revenues of € 56.5 billion and employed a workforce of over 140,000.

Introduction

Questions of ethics, or the 'right way to run a business', are inherent in all aspects of corporate governance and in every board decision and action. Ethical choices are relevant within the core business strategies that boards pursue and the way that they direct the business as a whole to achieve them.

Since the introduction of an EU Directive in 2006 (2006/46/EU), all listed companies in EU member states have been required to publish a corporate governance statement (although many companies were already doing so voluntarily). This paper explores whether, in legislation, frameworks and codes of corporate governance across the EU and within its member states, there are any explicit statements or requirements to govern business in line with ethical principles or commitments. Is the implicit inter-relationship between corporate governance and ethics clearly articulated? Has the consideration of ethical principles explicitly influenced the development of corporate governance? And to what extent are there different notions of what is fair and responsible governance in different countries – in terms of both governance frameworks and governance processes?

Business ethics and corporate governance

Corporate governance lies at the very heart of the way businesses are run. Often defined as 'the way businesses are directed and controlled', it concerns the work of the board as the body which bears ultimate responsibility for the business. Governance relates to how the board is constituted and how it performs its role. It encompasses issues of board composition and structure, the board's remit and how it is carried out and the framework of the board's accountability to its stakeholders. It also concerns how the board delegates authority to manage the business throughout the organisation. It does this by cascading down specified limits of authority to committees, the CEO and the executive team, who in their turn delegate tasks to management and employees more generally. This authority allows management to carry out, in accordance with specified budgets and timings, the purpose, vision and strategy which the board has agreed.

The extent to which business decisions reflect ethical values and principles is a key to long term success. **The business case for business ethics** has been well proven by the costs and impacts of the repeated high profile cases of corporate greed and misconduct, often by senior individuals crossing ethical boundaries as well as ignoring or circumventing the rules set out in law. Trust is essential in establishing an organisation's licence to operate. Maintaining successful business relationships and operations requires businesses to manage their risks, including their integrity risks, and guard their reputations. Trustworthiness is a valuable asset and guarding that asset is a core remit for those running a company; it is a core remit of good corporate governance.

The imperative for ethical behaviours and practices to be part of governance has arguably never been more important. **So how is ethics played out in the boardroom?**

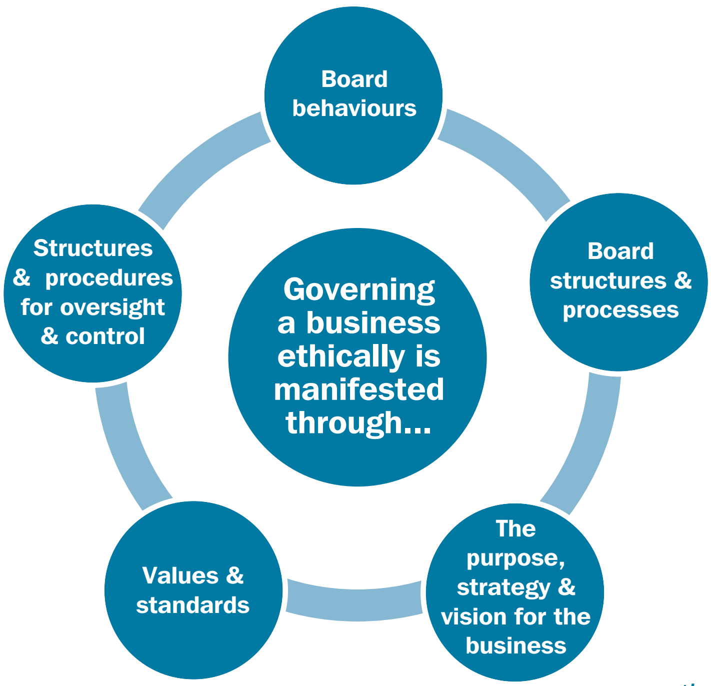
In this context, business ethics, defined as the application of ethical values to business behaviour, is essentially about the discretionary decisions a board takes to deliver on its duties as set down in law, specified by best practice, and demanded by shareholders and other stakeholders. Ethical choices are relevant within the core business strategies that they pursue and the way they direct the business as a whole to achieve them. Boards take decisions which have far-reaching consequences and directly affect the lives of their employees and other stakeholders. Conversely, a lack of decisive action may also have significant consequences.

Business ethics also refers to the way the board conducts itself and the way board members choose to behave in carrying out their role. High levels of competency and skill are required of the board, with directors exercising proper care in their duties, upholding high standards of integrity and acting fairly. The culture of an organisation will be strongly influenced by the nature as well as the quality of the leadership shown by the board. A lack of strong and clear leadership from the board will generally result in inconsistencies in ways of behaving and working, with practices deriving from employees' personal preferences and habits continued from previous employment rather than being ethically driven. A board is responsible for determining, articulating and communicating the values and standards of the business, and for ensuring that the policies, procedures and controls in place act to embed, rather than hinder, ethical values throughout the business.

Figure 1 illustrates the means by which a business is governed ethically. The board sets the 'tone from the top' of the organisation principally through five means and all these elements need to be in place in order for a board's commitment to ethics to be put fully into practice:

- **Behaviours** – example and leadership
- **Board structures and processes** – appropriate committees, terms of reference and documentation, board/committee interface
- **Purpose, strategy and vision** – what the business will achieve and how
- **Values and standards** – the way in which business will be done
- **Procedures and controls for oversight** – appropriate policies, monitoring and reporting.

Figure 1 **Ethical aspects of corporate governance**



continues

Figure 1 *continued*

Board behaviours	The board members carry out their duties in a way that reflects ethical values such as integrity, respect, fairness and honesty.
Board structures & processes	Which facilitate ethical behaviours, avoid unethical ones (such as unmanaged conflicts of interest) and ensure proper accountability - e.g. appropriate board composition, committees, decision-making procedures.
The purpose, strategy & vision for the business	The board sets the purpose for the business and what the business stands for; its strategic decisions reflect the business's core values.
Values & standards	The board articulates and ensures the implementation of the standards of behaviour it expects for business practice, the way business will be done and its role in society (including ethics programmes and CSR initiatives).
Structures & procedures for oversight & control	Mechanisms of delegation and control are conducive to ethical business practice.

Looking for ethics in governance

The boards of companies are being expected to take the lead in the cultural shift that has resulted from the current economic crisis. If corporate governance measures are being driven by financial sense and business efficiency alone, their role in facilitating this shift may be questioned.
This paper has 3 aims:

1. To review the ethical aspects of corporate governance policy debates and frameworks at the EU and member state level
2. To identify any commonalities and differences regarding principles of good/ethical governance
3. To consider the extent to which ethical behaviours are becoming part of the corporate governance agenda in response to the crisis of trust in business.

To achieve these aims, evidence of explicit reference to any ethical underpinnings of governance in policy, guidance and regulatory documents was sought in the following three forms. It is important to note, of course, that the absence of any explicit reference to ethics in these three ways does not imply that ethical considerations were necessarily ignored during the drafting of guidance, nor that there is no presumption towards an ethical approach to business in the member states of the EU.

1. **Is there reference to the ethical aspects of governance described in Figure 1 above?**
   It would be expected that the way the board members ought to behave in carrying out their role would be central to ideas of good governance as set out in guidance and policy. Also salient would be a requirement for oversight of the values and culture of the organisation, as well as of the appropriate structures, processes and controls to ensure decision-making and behaviours that are in

line with ethical principles. Finally, ethics can be seen in terms of a requirement for appropriate governance structures and mechanisms at board level so as to facilitate ethical behaviours by the board.[1]

2. **Have any ethical principles explicitly underpinned the way boards are required to operate and organise themselves?**
   What is judged as ethical, and what an ethical choice would look like, is subjective and varies among individuals, and among and within cultures and organisations. However, there are typical ethical value words that are used by businesses to articulate their commitment to ethical standards, behaviours and practices. These include, for example, fairness, honesty, respect, integrity, openness and responsibility. Also, reference to leadership attitudes and traits relating to setting an ethical tone might be expected in corporate governance guidance; including fair-minded, courageous, respectful, open.

3. **Is there a requirement that boards address particular issues with a strong ethical dimension – either within the board or throughout the company as a whole?**
   What is deemed to be an ethical issue, as opposed to a purely business issue, can also be a matter of opinion. There will be multiple drivers for addressing issues such as diversity and bribery and corruption. In governance guidance and regulation, to what extent is there a requirement to tackle issues generally considered to have an ethical dimension, and to what extent is that requirement driven explicitly by ethical principles? In particular, this report focuses on five governance areas: diversity, remuneration, stakeholder accountability, conflicts of interest and transparency.

In addition to desktop research, a small email survey was carried out among organisations representing corporate directors in several EU member states (member associations of ecoDa).

A core assumption for this report is that boards will seek to obey the law, in their own behaviours as well as in what they expect of the company. There is widespread recognition that ethical practices and behaviours in business cannot be attained simply by 'tick box' requirements. Doing business ethically transcends what can be captured in laws and rules. As explained above, ethics concerns the way people and organisations choose to behave.

Who this report is for

This report will be relevant to anyone interested in the evolving debate around culture and behaviour in business, and how this is played out within corporate governance guidance in the European context. All those concerned with the development of governance, whether working within companies or as advisers, should find material within the report which is thought provoking.

This paper should be of interest to boards and executives as it outlines the current status of ethics in corporate governance in the EU and may inspire them to look again at their ways of working and how they gain public legitimacy – particularly in terms of the five governance areas explored later in this report.

Finally, the report will be of use to those responsible for ensuring that a corporate Code of Ethics (or similar) sufficiently reflects ethical practices and challenges at board level.

[1] Foster Back P (2005) *Setting the Tone: ethical business leadership*, IBE

The structure of this report

Chapter 1 explores the extent to which ethical values and ways of working have, to date, informed governance practice at the pan-European level.

Chapter 2 starts by reviewing the drivers for ideas about what is ethical governance. It considers the extent to which there are generally accepted principles across Europe of the 'right' way to run businesses, including right behaviours for board members, and looks for any differences across member states.

To further develop this theme, Chapter 3 looks at approaches to a number of governance issues which have a strong ethical dimension at board level. The five issues – diversity, remuneration, stakeholder accountability, conflicts of interest and transparency – involve discretion by the board and are key aspects of ethical behaviour within the boardroom, as well as being issues which boards need to address for their organisations. They have been chosen primarily as issues which boards are being required to consider by EU governance rules and guidance. A number of other key ethical issues for companies, notably bribery and corruption and fiscal policy, have not been considered here since they are not a central part of the debate at the EU corporate governance policy level.