"**Creating value through governance: channelling corporate culture and ethics in boards**?"

REPORT

On 5 May, ACCA (the Association of Chartered Certified Accountants) and ecoDa (the European Confederation of Directors' Associations) jointly organised a conference called "**Creating value through governance: channelling corporate culture and ethics in boards**?", hosted by MEP Cora van Nieuwenhuizen at the European Parliament, to discuss with a panel of experts possible ways to enhance corporate behaviour, risk management, companies' performance, ethics and culture.

The roundtable was moderated by **Jeroen Hooijer**, head of Company law, DG JUST, European Commission, and comprised of **Peter Montagnon**, Associate Director of the Institute of Business Ethics, **Ewan Willars**, Director of Policy, ACCA, **David Herbinet**, Partner and Head of Corporate and Public Interest Markets, Mazars, **Luc Hendrickx,** Director of Enterprise Policy and External Relations, UEAPME, **Paige Morrow**, Head of Brussels operations, FrankBold, **Stephanie Maier**, Head of Responsible Investment Strategy and research, Aviva Investors.

The debate revealed that

- We have reached the limit of what we can deliver through regulation: we need to restore trust in business and to create values by giving more emphasis on corporate culture.
- Corporate culture is indeed rising up the agenda but we need the right tools to embed it at each level of the company. It has to be an ongoing conversation.
- The culture issue needs to be addressed, for example though a critical evaluation of existing corporate governance rules to check if they are fit for purpose. Corporate culture is about understanding and shaping what drives behaviour of individuals within a company, especially when they are under pressure.
- A starting point would be to have a value system set by boards and top management, leading by example –"tone at the top" – under a balanced "stick and carrot approach". There is a need for incentives, but also for the imposition of real deterrent in case of bad behaviours. It was stressed that consistency between a clear corporate purpose, strategy, set of values and behaviours is desirable.
- Corporate governance, ethics and corporate culture are not only about multinationals and listed companies, smaller non-listed entities or family businesses - which represent about 99 % of all companies - also have a strong interest in it and see their added-value.

Main highlights

Cora van Nieuwenhuizen, MEP

- Corporate Governance remains a topical issue in the media. It is important to discuss the topic broadly, with a vast range of stakeholders, without waiting for the next scandal.
- Ethics, corporate values and corporate governance should be on the top of the agenda of every company, large and small, and not only when companies face a crisis. It is important to remember that culture cannot be changed in a fortnight or even in a few months, it is a long term journey. Corporate culture has to be challenged regularly to make it a lively reality.
- As regards to the "stick and carrot approach" – it is all about finding the right balance. It is important getting the incentives right, unfortunately it is very difficult.
- In corporate culture it is all about the tone at the top. If it is not right at the top, the rest of the company won't work well.
- We need to be wary of large manuals and codes of conduct. In the end it always comes down to behaviour. We need to have proper discussions about how much regulation we need in corporate governance. We have to find the right balance. If we have too much regulation, we are harming businesses, if we don't have enough of it, we create possibilities for wrong behaviour.
- People are more keen to follow examples rather than to obey the rules.

Jeroen Hooijer, Head of the Company Law unit, DG JUST, European Commission

- Corporate culture is an important subject, even at times when it seems not urgent. It normally is better to take action before things become urgent.
- In the end it are not the rules that count but the spirit that counts; you also have to give the right example. When the tone at the top is not right, it is very difficult to contradict and to intervene for the people below in the organization.
- It is important to maintain culture at all stages and at levels – it requires permanent attention.
- Most companies try to do their best but there is a complex grey zone between right and wrong.

Peter Montagnon, Associate Director of the Institute of Business Ethics (see paper)

- We have reached the limit of what can be delivered through regulation. We need regulation, but too much of it is damaging. Regulation embodies three main risks. People who impose it have no natural interest in financial success of companies so it is costly and tends to stifle entrepreneurial flair. If you impose rules on senior management, they become engaged in a compliance exercise and are less likely to think for themselves about how they expected people to behave; finally, regulation discourages the building of trust, because the very need for regulation implies a lack of trust. We need to restore and rebuild trust in business and all these factors mean that regulation, while important, can easily become a drag on the process.
- The critical point is to make sure that boards and senior management understand the vital importance of corporate values and culture and how it will impact their business model. A business model based on sound values is sustainable. A business model based on flawed

values is not. We want to get to the point where a strong culture and values are so deeply embedded in our companies that employees at every level will make good quality decisions. This reduces risk substantially.

- Business ethics is not about deciding that you have a social agenda, it is about encouraging people and enabling them make good decisions when they're under pressure. One of the biggest problems in companies is when people are given targets they cannot meet.
- We have to rebalance our approach to rely less on prescriptive regulation and, perhaps, more on efforts to facilitate and support the creation of a sound culture. At the same time it would be right to introduce more "*stick"* into this. People need to be held accountable for their actions. Those that have broken the rules need to be punished. Fining their organisations is not a deterrent.
- Shareholders don't own companies, but they bear risks and therefore should have control rights, but we cannot rely on them to do the work of regulators. Shareholders often have unreal expectations that lead to bad behaviour in companies, but some like sovereign wealth funds have a long term approach that should be encouraged.
- You cannot have a business model without reflecting values of the people who have established it. If you want a good and sustainable business model, you need good values to start with. That's where the leadership comes in. You want good behaviours to spread around the company. It is difficult to design regulation around it; it comes down to the boards and the tone at the top. Boards need to know how the right signals have been transmitted and have to watch the incentives.

Ewan Willars, Director of Policy, ACCA

- Recently we had an overwhelming focus on rules and it is a part of the problem. Culture, corporate values, what drives behaviour is the missing part of the picture. The culture of the organisation affects risks and how they are taken and managed, it affects the decision making process. It is often forgotten that it has an impact on performance and functional behaviour.
- It should indeed be squarely in the sight of board members. It should also be in the minds of all finance professionals, ranging from finance leadership, those undertaking audits, to new students considering a finance profession. The challenge is to understand and assess culture, to be able to do this consistently, and in a meaningful but accessible way, and to deliver actions and practical insights. What we have to do now is giving boards - and others - the concrete tools and language that they need to do so, and empower them to improve corporate culture.
- However, these issues are difficult to engage with. ACCA study *Culture and Channelling Corporate Behaviour* aims to assist boards and senior managers in preparing to assess their corporate culture and in understanding how it can influence either functional or dysfunctional behaviour. It recommends that boards use a set of trade-offs, such as about conformity and challenge, innovation and control or trust and accountability, as a framework to map out the culture their organisations have.
- Tone at the top is essential, but now we have businesses that are spread across different continents and are becoming very complex. So it is about tone at the top, at the middle and at the bottom. You have to track how your decisions are being made and to be aware of the incentives. By breaking up culture you can understand it more effectively and to give organisations the tools to engage more effectively.
- The big issue in ethics and education is maintaining it throughout the career.

David Herbinet, Partner and Head of Corporate and Public Interest Markets, Mazars

- If we look at the facts, we are not in a good place – there is significant rise in inequality and one of the lowest rate of growth in history across the world. We have to look at the role of business and boards and to see how it can be changed. Europe has a significant role to play in reinventing the businesses' place in society.
- It would be wrong to assume that culture and ethics in boards are weak. Most boards do what they think is best at a given time.
- There is a need for a shift in paradigms: the value of business to society is strongly linked to the business purpose. It has to be aligned with social usefulness. Values and behaviours need to be completely aligned with the business purpose. In order to make it work, investors and boards need to be interested in long term success of the business.
- Mazars has developed a Board Charter. It is a tool for boards for sustainable success.
- What businesses need these days are not ideas - they have ideas - but the courage to deliver and to generate value through these ideas. Critical to any aspect of value, culture or ethics are trustworthiness and responsibility. Boards need better information on how their business really operates (eg in relation to culture or Human Rights) and consider how they should disclose that information to their shareholders and other stakeholders.
- The key point is that every organisation is a living organism and is on a journey. It is important to have the right tools alongside this journey to know where they are and where they want to get to.
- We also need to question if companies have ethics and integrity on their lists at the stage of recruitment. It has to be a continuous development and assessment process throughout the career.

Luc Hendrickx, Director of Enterprise Policy and External Relations, UEAPME

- It is crucial to stress the importance of corporate governance for SMEs. Ethics is something that small and medium size enterprises care for. Findings show that an individual entrepreneur is driven by personal values and ethics.
- We should not legislate further more. The subsidiarity principle should apply at European level. The topic should be left to subsidiarity because it is about the business culture and regional and local dimensions should be taken into account. They are different in all member states and that should be respected. It is about awareness raising, about existing practices and voluntary codes.
- All the recommendations around corporate governance are usually directed to listed companies. However SME owner-managers are looking for more pragmatic, practical and understandable solutions for the daily governance of their companies. There is a clear difference between listed and non-listed companies. We need also specific recommendations for family businesses because they are confronted with specific family governance problems (e.g. transfer of share, of the business,…).
- The aim of corporate governance for SMEs should be to provide help and support the companies in an efficient way. It should offer a practical manual in order to create a profitable and sustainable company.

- Corporate governance is important for all companies, it can certainly bring added value, and can increase the image and reputation of an SME towards its stakeholders. It is useful for a long term value creation and can also be an advantage in the recruitment process.
- Non-listed SMEs are very diverse. There is no *one size fits all* solution. We should take into account the characteristics of individual firms when giving recommendations. We must consider the sector, size, and different stages of development of the company.
- What happened because of the financial crisis should not be extended throughout the whole business community. Personal values are extremely important in small enterprises and are usually not dismissed during the time of a crisis.

Paige Morrow, Head of Brussels operations, Frank Bold

- Through a project on the Purpose of the Corporation, FrankBold has worked closely with experts across Europe and North America to analyse legal frameworks and business practice. One of the issues that came out is a common but erroneous assumption that shareholders own publicly listed companies.
- Short-termism has been identified as one of the causes of the crisis. If we are focusing on maximising the shareholder value on short term, there is a reluctance to invest in innovation.
- The draft Shareholders' Rights Directive seeks to strengthen long-term engagement of institutional investors and promote stronger accountability for delegated decision-making. The challenge is that shareholding patterns differ significantly across Europe and it is unclear whether we may realistically expect institutors with diverse portfolios to be as engaged as controlling shareholders (or activists, who frequently pressure target companies to boost shareholder value through a focus on short-term efficiency, restructuring, etc.).
- The objective should not be more regulation (or conversely, deregulation) but rather a critical evaluation whether existing corporate governance rules are fit for purpose in that they create the right incentives to drive innovation and job creation.

Stephanie Maier, Head of Responsible Investment Strategy and Research, Aviva Investors

- We are very supportive of the Shareholders' Rights Directive. Investors have a huge role to play in holding boards to account. However, we need greater transparency in how investors act, greater demand for responsible investment, greater financial literacy. More active engagement and more responsible ownership would essentially go a long way in addressing some of the challenges we are discussing today.
- Very often, most issues with companies, comes down to issues of leadership, behaviour and values. If we have the right framework at the top, then in general companies tend make the right decisions. That means the right decisions in the long term interest of a broad range of shareholders and stakeholders.
- Investors clearly prefer a company with good culture and ethics. Poor culture and ethics can cost companies and their shareholders dearly. For example through loss of employees, fines or removal of their license to operate.
- Good culture can also create value and this is particularly interesting. Some estimates state that 80% of a company's value is determined by intangible assets. Strong assets and high levels of organizational performance go hand in hand. Brand, IP, trust, loyalty, customer satisfaction, goodwill, risk management, are all better with the right culture and behaviours.

- While it is difficult to measure, however, it doesn't mean we shouldn't be looking at measuring it or that, where disclosure is good, proxies don't already exist.
- A recent study from Macquarie into the performance of ASX200 listed companies demonstrated that leaders in 'employee engagement' outperformed laggards over the previous 8 years. Productivity is linked to employee satisfaction and motivation and costs can be saved through avoiding industrial disputes, lower turnover and lower absenteeism. These are all indicators that can be used to gauge the 'health' of a company's culture.
- As regards to the role of the board, setting the tone at the top is extremely important. When it comes to ethics, there is a need for leadership. It is about having good frameworks, not exhaustive rules. Those frameworks and mechanisms have to promote and reward good behaviour that is in line with companies' values. We need to create the right message at the level of leadership to enable that. The structure of incentives is also very important here.
- Diversity on boards should be strongly encouraged. One of the indicators of a healthy organisation is where unacceptable behaviours are able to be challenged. It is more likely to get that if there is a diverse outlook to start with. It is important to help people understanding when they need to escalate an issue, when they should ask for help, that it is ok to challenge something in a constructive way. The training enforces the culture; the culture enforces the desire to train and to look for answers and resolutions. We want to see the right level of conversations and questioning internally.
- As investors, we can support strong culture through engagement and sharing best practice across companies. It is something we would all benefit from.