Global Corporate Governance Forum

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Sustainability and Corporate Social Responsibility:

How to Integrate Social Responsibility Objectives with Business Incentives for Value Creation and Profit Maximization

Madrid

Keynote Address at IE Business School, by Phil Armstrong

The 5th Social Responsibility Forum: Leading to the Next Big Thing

Key Points

Opening Remarks

Thank you for the invitation to address this November Forum. I congratulate the IE Business School for pushing the frontiers on sustainability by convening this dialogue. By facilitating these exchanges—the 5th no less—IE demonstrates a track record of leadership in helping to place social responsibility as a central agenda in boardroom decisions. "En hora buena!"

Environmental protection and human rights movements have been the pioneers over many decades that persevered in the face of strong opposition. Their progress is the foundation of our current sustainability agenda. And, they continue to challenge our understanding about the proper role of free markets and the private sector.

As my background is in the private sector, I would like to share with you a **practical business perspective** of how it is possible to seamlessly integrate social responsibility objectives with the more traditional business incentives for value creation and profit maximization.

Today I want to address the important issue of how the global financial crisis has created a greater sensitivity and appreciation among companies towards the effects that lax corporate governance and ethical values have on their own business, and more broadly on society and its welfare. This is a tremendous opportunity that we cannot afford to waste.

It is within our reach to advance the future of sustainability and to align the human values that sustain this agenda with free market forces.

I should point out that these are **personal observations** drawn from my own experiences as well as my work with the Global Corporate Governance Forum.

That aside, what I hope to do in this short time is to direct your thoughts to how the new generation of business leaders holds the key to realizing a new order of sustainable business practices.

The "Next Big Thing" rests with all of you: students and business schools. But before I explain myself, let me speak about the work of the Global Corporate Governance Forum, as it helps to reinforce and validate my personal conclusions.

➢ The Forum's Role

The Forum was established by the World Bank and the OECD during the East Asian Crisis in the late 90s. Its primary role then was to facilitate the articulation of the newly promulgated *OECD Corporate Governance Principles* in non-member OECD countries, meaning "developing countries."

10 years hence, we are looking at another major crisis – with one significant and compelling difference. This one was started in the very countries responsible for insisting on those standards which, as you can imagine, makes for some interesting dilemmas right now.

If there is one key lesson from the Forum's work over the last decade is that there is no single perfect model for corporate governance, but that the principles and values anchoring good corporate governance practices are central to building <u>better companies</u> and <u>better societies</u>.

The Forum is located within the private sector arm of the World Bank Group, the International Finance Corporation, which is our anchor donor. The Forum is also funded by several European governments. Regrettably we have not yet been able to convince Spain of the merits of our work!

The Forum has been engaged in more than 70 countries worldwide. For example, we assist our client countries in the development of codes and standards, work closely with institutions seeking to enhance their board leadership training capacity, provide training of financial journalists, and help with the implementation of dispute resolution mechanisms for business. We depend a great deal on the advice and guidance of our private sector advisors, who represent more than 75 business leaders, investors, professionals and corporate governance experts worldwide.

In our work, particularly in code development and training of board directors and journalists, we stress corporate responsibility and use case studies to illustrate the importance and value of adopting sustainable approaches.

Sustainability is deeply embedded in the Forum's mission and activities and it is something with which I closely identify given my background in the mining industry, and as someone very conscious of the environment and who holds a deep love of Africa's wildlife heritage.

➢ Sustainability Comes of Age

In the decade since the Forum came into existence, the business landscape has changed dramatically, particularly consumer priorities and the corporate governance framework that guides the way that companies conduct business nationally and globally.

Among the most striking and promising transformations that we are observing is that sustainability has evolved into a sizable market with untapped potential for large-scale growth. In the span of the past decade, it has **grown into a big business**.

This phenomenon is **supply and demand driven**, and it is no accident. It is rooted in the structures of changing market incentives and opportunities. It is a change that is evolving from opportunistic initiatives to jump on the green bandwagon and progressively shifting to a new understanding of the ethics and values that drive sustainable businesses and free markets.

On the demand side - US consumers in 2008 doubled their spending on sustainable products and services to an estimated $500 billion[1]. And with middle-income consumers expected to triple in size worldwide by 2030[2]—with China alone accounting for 220 million (a fourfold increase from 2004 levels)—the challenges and opportunities for the sustainability agenda are framed by a projected market of 3.5 billion consumers with income brackets of $6,000-$30,000 in purchasing power parity.

A recent European Commission survey finds that three-quarters of Europeans are ready to pay more for environmentally friendly products. Similarly, a March 2010 CSR survey by Penn Schoen Berland/Burson-Marsteller of the US market powerfully reveals that **consumers are paying greater attention to social responsibility issues**.

These and similar survey findings reveal significant implications for the scale of transformation that we can expect in the coming years.

Low-income consumers are no less significant. Today, this bracket of consumers—earning less than $3.35 a day—account for two-thirds of the world population and have a combined spending power of approximately $5 trillion. In Africa, for example, low-income consumers make up 71 percent of the region's purchasing power and 95 percent of the population[3].

The poor, by sheer numbers, will be a force in shaping the future of sustainability and the priorities adopted by companies committed to sustainable development.

On the supply side - **sustainability initiatives generate important financial value** and are good for business. Plain and simple! Examples are many and varied:

- **Wal-Mart** is saving upwards of US$25 million in fuel costs by introducing efficiency standards in its truck fleet
- **GE** has saved US$100 million by introducing energy management measures; BP saved US$650 million over three years by reducing GHG emissions

[1] NYT, June 11, 2010, "Products that are Earth-and-Profit Friendly."

[2] World Business Council for Sustainable Development, "Sustainable Consumption Facts and Trends, " 2008.

[3] IFC, "The Next Four Billion," 2007.

- **SAP's** sustainability strategy produced 90 million euros of direct savings to the company in the first year of the program
- **Apple's** iTunes has sold over 8.5 billion songs, the equivalent of 85 million CDs that would have been made, shipped, and someday discarded in landfills
- Nine of the recent World Cup teams sponsored by **Nike** wore jersey's made entirely from 13 million plastic bottles saved from going to landfills, sharing its intellectual property openly to accelerate sustainability practices.

Of course, and time doesn't allow me to spend much time on this, but with **high profile commitment to sustainability and ethical values comes a significant price –** as BP only knows too well, as does Wal-Mart and Nike in earlier episodes.

Companies that ignore the business implications of these new consumer priorities which place a high value on socially responsible products and practices will face long-term competitive risks. According to a study by The Corporate Library and Calvert Investments in the U.S., boards have a long way to go to integrate sustainability into their work.

A study of committee names in the Russell 3000 shows that only 8% have a name that suggests oversight of environmental and social matters, with larger companies being much more likely to do so: 18% of the Russell 1000 companies have such a committee, compared to only 4% of Russell 2000 firms.

As this study concludes: "even where oversight exists, moreover, it often appears insufficient to integrate fully environmental and social factors into a company's strategic planning and operations. All too often, boards still appear to view these issues in soft philanthropic or marketing terms, rather than as hard, fundamental business risks or competitive advantages. In some cases, however, committee charters are being developed that suggest a new and more nuanced approach to social and environmental sustainability."

The bigger **challenge for companies, therefore, will be to build an internal culture of social responsibility**, a far off prospect as current things stand.

Allow me to come back later to this challenge, as it relates to how all of you hold the future in your hands.

In short, **sustainability is a new business paradigm**. It is here to stay as a vibrant new market. It can only increase in force and scale, serving as a new building block for long-term business value.

On this point, it is interesting to observe that at the onset of the global financial crisis, it was feared that sustainability would be sacrificed as companies scrambled to secure their businesses. But, it seems, on reflection, that sustainability might have through this much stronger as it becomes clear how poor governance practices in companies have had a profound impact on society - whether any of this was further fueled by the tragedy of the Gulf of Mexico oil spill is not entirely clear - possibly however!

It is no exaggeration to venture that sustainability will change and transform the future role of the private sector, and how we—as a society—will redefine the meaning and purpose of free and efficient markets.

Today, no serious business leader will claim that sustainability and social responsibility are utopian concerns. On the contrary, they are grappling with the challenge, and in the process are trailblazing the path for sustainable business practices.

The process of change rests in the hands of entrepreneurs and it begins with the dialogue that I referred to in my introductory remarks. **The essential component of this dialogue, in my opinion, is how we define our ethics and values <u>in practice</u>**. This is a very basic, but for some it seems, revolutionary notion in terms of current business standards and conduct. At the same time, I am not for one moment suggesting that there is a universal or common answer, because it is nuanced towards culture, traditions, religion, and many other sensitive aspects that inform various societies' views of right and wrong.

➢ A Decade of Rapid Transformation and Evolution: What Have We Learned So Far?

Before we discuss how this dialogue should take place and how we translate and integrate the notion of ethics into standard business practices, let me first comment on the progress that we have made over the past decade or so—particularly with respect to corporate governance—and how this informs the conditions for social responsibility to take root as a mainstream consideration of business decisions.

The last decade has been a defining period for the accountability and transparency framework that guides company activities. Much of that framework underpins the issues that revolve, ultimately in my opinion, around sustainability issues.

The global financial crisis marks a watershed moment for the corporate governance principles and standards that are in currently in practice—and that are now the subject of intense reform debates globally.

There are a number of lessons and observations being gradually drawn about what factors caused, and who shares the main responsibility for, the global financial crisis.

Probably most disturbing is that the causes of this crisis are not novel: we've seen it in 1990's (East Asian crisis) and repeated far too often in the 2000's (Dotcom Bubble, and numerous corporate scandals mostly in the U.S. – first Enron and now the banking sector).

Our corporate governance framework has largely evolved as a response to these past episodes. An important distinction with the current crisis is that it was not born out of corporate malfeasance and fraud as with a number of the earlier episodes that gave rise to the first ever corporate governance code—the Cadbury Code in the UK in the early 90's, and later to the draconian requirements imposed by the U.S. Sarbanes-Oxley Act in the early part of our new century.

However, notwithstanding the proliferation of CG Codes worldwide, especially over the past 10 years – with the exception of the King Report, **sustainability remains an issue that sits apart from the more contemporary aspects of recommended practices and principles of good corporate governance**. I would venture to suggest that even the bit that is covered by the OECD in its *Corporate Governance Principles* is largely inadequate for the challenges that regulators and companies face in this modern era.

This must surely change! **The consequences of lax corporate governance standards are too readily evident!** Even by averting the worst potential consequences of the global financial crisis, the world weathered a great recession that had its most negative impact on jobs and the most vulnerable members of society.

World Bank figures tell us that some 53 million more people have been trapped by poverty than would have happened without the economic downturn. Similarly, the Asian Development Bank estimates a loss of US$50 trillion in the capital valuation of financial assets globally, equivalent to one year of world GDP. And when it comes to jobs, the ILO reports that the financial crisis has led to a 73% increase in unemployment in developed countries.

Spain, Portugal, Ireland and Greece have suffered and continue to tackle very difficult structural economic reforms exacerbated by contagion effects from the global financial crisis.

Also in many regions we observe secondary effects that give rise to a broad range of societal problems, political instability, and policy uncertainties, such as more assertive nationalism postures, less tolerant immigration policies, and zero-sum negotiation positions among governments, civil society and the private sector.

Therefore, the global financial crisis has ushered in a new period of corporate governance reform, and hence potentially a further step in forging a new global consensus. The recently announced initiative to mainstream the sustainability reporting standards espoused by the Global Reporting Initiative into the mainstream accounting standards led by the International Accounting Standards Board is an interesting development and worth watching.

I do want to make the point that **I am not entirely persuaded that the commonly accepted standards of good corporate governance practices have failed** but rather their application was distorted for several reasons.

These range from an unhealthy obsession of companies to simply comply without taking seriously the underlying substantive basis of recommended practices, to weak or incompetent enforcement by regulators, and the absence of sound, thoughtful engagement by institutional investors.

What worries me is that the ongoing reform process, in my personal opinion, is driven more by political expediency and I am **not sure that some of the structural issues that led to this crisis have really been addressed or are even likely to be addressed.**

By taking a broader view of what should be the way forward beyond this crisis, the world is discerning that solutions towards sustainable economic recovery largely depend on restoring trust, confidence, and legitimacy in business transactions.

At the end of the day, the degree to which our reform and change processes alter the existing structure of market incentives will determine the seriousness of our intent: are we simply trying to move out of this crisis or are we willing to reconfigure a more accountable and transparent accountable framework? Do we want to rock the boat or just settle for the status quo?

Altering the status quo means reconfiguring values and realigning behaviors with the structure and incentives of free markets. It is about how people behave, how they react, and how they respond both to the spirit and to the letter of laws and principles that we set for ourselves in the way that we want to conduct business.

In the recently issued Walker Report in the UK, this point was noted, and there seemed to be a strong view that a lot of the **difficulties encountered in the financial sector were more behavioral rather than failure to comply** with existing corporate governance standards and rules.

However, I must confess that that getting this equation right—of aligning incentives, behavior and regulations—is a complex dilemma and does not present simple, quick and clear solutions.

It is not easy to create regulations that address and respond to the way that people naturally behave. The status quo is to define norms that prohibit or prescribe certain type of actions and subsequently continue to plug gaps and loopholes that appear around prohibitions or with abuses.

While a number of countries increasingly apply a Regulatory Impact Analysis to evaluate the costs and benefits of new legislation, I wonder if we shouldn't be thinking about an equivalent behavioral analysis?

We know that the financial sector attracts the brightest minds of our generation—most of you sitting here—who are capable of creative and lightning-speed innovation, especially when they are lucratively remunerated to think of new ways to generate bigger and bigger profits.

It is altogether a different proposition to try to regulate such "natural" innovative behavior and incentivize it towards productive purposes that serve the best interests of society. Getting this balance right may not be feasible at all, so we continue to revert back to the status quo of regulatory reform.

On the other hand—and perhaps the more feasible route—is to acknowledge deep rooted inconsistencies with current incentives for sustainable economic growth and financial stability, and, from such starting point, align our regulations with broader long-term objectives. Let me illustrate with a relevant example.

If we consider the core strategic component of CEO leadership and performance, we face a situation where analysts are measured largely on how well they call quarterly performance - thereby being incentivized to pressure companies to produce the results that will render good calls every quarter.

At the same time, CEOs are implored to think long term, to set company strategy long term, to report long term, but we measure them short term. The incentives for short-term performance are inconsistent with our broader concern for long-term thinking!

A recent study by Mercer of some 1 000 equity mangers, found that two-thirds were churning their portfolio in excess of their targets at an average rate of some 70 or so percent. That, ladies and gentlemen, is not long term investing for sustainable returns, that is simply trading – and we see the consequences in our markets and the way boards make decisions in response to these pressures!!!

Long-term sustainability is definitely not in the picture of reform proposals, simply because existing incentives are not framed for that purpose. To the contrary, incentives are very short term and very opportunistic.

There is an entire proposition here which I would like to explore, but not here today, and that relates to the role of pension funds and their trustees. At the moment, too much emphasis is placed on the "top down" approach to regulations and rules – we need an equivalent "push-pull" approach led by responsible, informed and properly qualified pension fund trustees (much akin to independent non-executive directors). But, that is another discussion for another day. I am still trying to guide us to what could be "The Next Big Thing"!

At the end of the day, we must ask who will have the courage of leadership to demonstrate that we must somehow contain the way people behave?

The reconciliation and a better realignment of incentives and governance frameworks must include a discussion of values and ethics. And, how such a discussion can build long-term value creation for companies. The 2009 King III Report in South Africa sets a new benchmark with the introduction of an entire chapter on ethics and sustainability dimensions.

In my personal opinion, the discussion around business ethics is not taking place at sufficient levels. At least not in a systematic fashion, nor in a context that is seen as an integral part of business strategy.

Accountability and transparency frameworks always come down to values, to dimensions of leadership, and to how we design our governance frameworks to enhance, reward and embed values across the entire vertical and horizontal structure of a business organization. It is a tall order, but times call for the courage to step forward and lead this needed transformation.

The next big thing—if we want to rock the boat in a manner of speaking—is to take up the mantle of **building strong value systems founded on clear ethical guidelines and practices**.

As the new generation of business leaders, together with the institutions that are responsible for establishing the content and focus of your training curriculum, you hold the key to making the future vision of sustainability a reality.

Your actions, your leadership, your commitment will determine our capacity to align business values and ethics with the priorities for a sustainable future of our planet and our civilization as we know it. This is no exaggeration!

The road ahead is already paved by necessity and ready to be forged by courageous thinkers and business leaders. It is the option of a Jeff Immelt of GE taking business leaders to task for not taking sufficient responsibility over the recent financial crisis or former Citi head, Chuck Prince, and his rather unfortunate analogy of musical chairs and the financial markets.

➢ The Long-Term Vision of Business Sustainability

The Global Scenarios Group at the Tellus Institute – a U.S. think-tank has developed four future world scenarios to differentiate the scale of transformation that we must achieve and commit to if we seek to build a global civilization based on sustainability. The scenarios are based on quantitative projections to the year 2100 across multiple economic, social, environmental, and natural resource variables.

Their premise starts from a moral imperative to pass on an equal or less diminished world to future generations.

The first two scenarios—**Market Forces** and **Policy Reform**—are based on a continuing evolution of the values and power structures that form our existing governance systems. Pretty much "business as usual".

The other two scenarios—**Fortress World** and **Great Transition**—envision a completely new institutional order, one that is based on an authoritarian order by global elites on the one hand and on the other hand a transformation of human values with corresponding governance frameworks.

These four scenarios are meant to stimulate critical reflection on needed actions that can no longer be postponed. With population estimates at 10 billion people by the year 2100—based on existing consumer values that will see an eightfold expansion of the world economy by the end of the century—our ecological system and natural resources cannot sustain civilization without a values-led change in social responsibility by consumers and the world of business.

The most promising scenario, the Great Transition, envisions a new phase of human history. One that begins with an adjustment of human values towards "a triad of ascendant values: human solidarity, ecological resilience, and quality of life."

The **vision of sustainability**, therefore, is predicated on defining a new set of values that prize qualitative dimensions of human well-being, environmental protection, and the strength of communities. It is a shift away from regarding progress and development as a function of GDP or through conventional quantitative measures of income.

The prospect of civilization collapse, ultimately, is trumped not by the political will to reform (which has a very poor track record to boot, especially from the current crisis) and/or technological innovation, but by **constructing new human values**.

The call for a transformation of human values should not be confused by jumping on the bandwagon of sustainability. Our understanding, our behavior, our incentives, our institutions, and our practice of private enterprise under free markets must be rooted and evolve from a foundation of ethics and values, not simply from a pure profit or tactical calculation.

Another initiative that challenges the status quo is the proposal by the *Great Transition Initiative* to form a **World Corporate Charter Organization**.

By recognizing that globalization has reached a point where national jurisdictions no longer control the full impact that companies bear on global issues—trade, environment, finance—the call for a Global Corporate Charter is an effort to re-establish real accountability over corporate behavior.

The shift of business regulation from national to supranational governance systems is bold and may appear utopian by its implication to push aside nation-state sovereignty. But we have workable precedents to make giants leaps in governance transformations that serve the broader welfare of increasingly interconnected societies.

The European Union is a prime example that national sovereignty is not incongruent with more enlightened visions that seek a sustainable world.

And, if we factor in that over 75 000 companies operate globally—where the average annual revenue of each entity hovers around US$300 billion, and where half of the largest world economies are constituted by these companies and not countries—then supranational solutions for corporate accountability takes on a more feasible possibility.

Indeed, the proposal for a Global Corporate Charter is clear on complementing rather than supplanting national enforcement regimes. The avenues for compromise and consensus remain very wide. It is a matter of enlightened resolve by public-private interests.

Sustainability based on an amalgamation of human values from multiple stakeholders is a long-term vision, but it means addressing the structural weaknesses that we are not grappling with to restore financial stability, sustainable growth, ecosystem survival, and poverty alleviation.

It is about being visionary, it is about being bold in concept!!

Although unrelated, in another context, Professor Diaz-Gimenez of the IESE Business School – your competitor in Barcelona – makes the compelling point that "…we have essentially integrated global capital markets but we do not have global regulation".

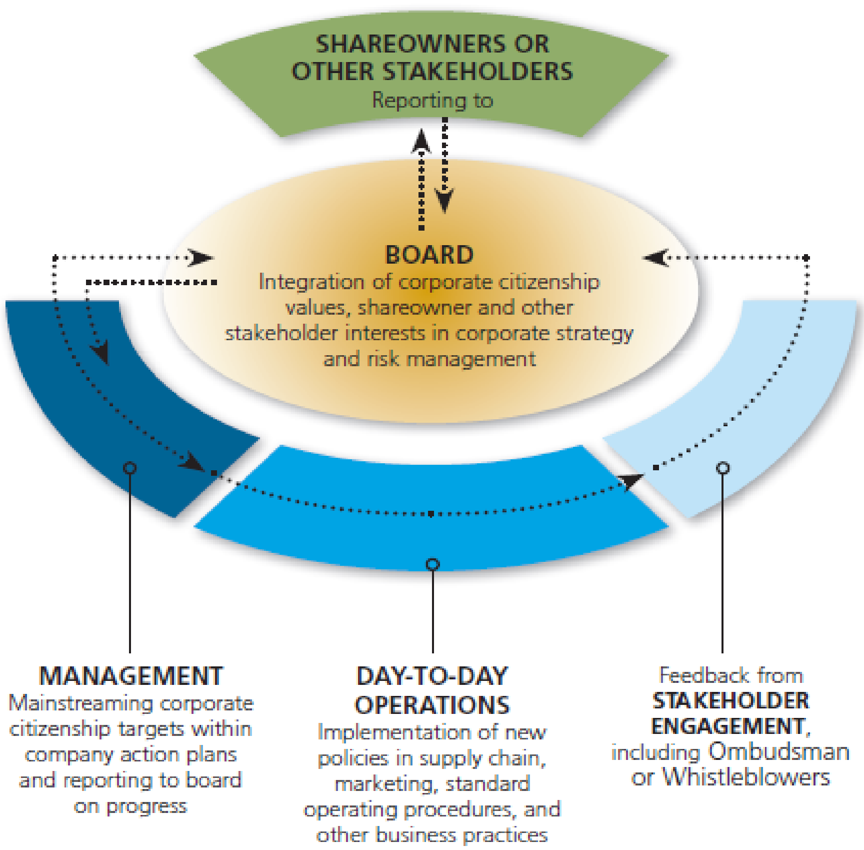
The **way forward requires a new mindset**, a new orientation in leadership, and a new practice of business ethics and values.

➢ The Next Big Thing: Ethics as a Core Strategic Component of Doing Business

The global scenarios of the Tellus Institute and the proposal for a Global Corporate Charter are natural extensions of concrete actions and results that we have already achieved towards building a new culture of business ethics. There are already a number of organizations and champions across all regions and countries leading this transformation.

Two of the more prominent global initiatives, the UN Global Compact and the Global Reporting Initiative, demonstrate that the long-term vision of sustainability and the transformation of human values and ethics is a practical reality, that it is taking root globally, and that it is a multi-stakeholder dialogue seeking consensus.

We can build on the work of these and many other pioneers.



The **UN Global Compact** celebrated its 10th anniversary this past July, and represents the most far reaching alignment to date of values and expectations between society and companies about achieving common goals around sustainability and good corporate citizenship.

Over 6,000 companies from 130 countries are signatories to the UN Global Compact, who in partnership with civil society, labor, and governments have build consensus around 10 sustainability principles.

These principles are built around some of the most contentious issues of human rights, environmental protection, anti-corruption, and labor rights. So again, we know that compromise is possible and that divergent interests can find common ground through dialogue and shared visions.

The UN Global Compact, therefore, demonstrates that leadership and political will can make a huge difference in finding solutions that can be global and local, private and public, visionary and operational, and, most importantly, accountable in results and performance.

Like the UN Global Compact, **the Global Reporting Initiative** - GRI for short - has also advanced the sustainability agenda to global scale within a very short time. In the year 2000, when GRI issued its first sustainability reporting guidelines, only 50 organizations issued sustainability reports following the GRI guidelines.

Within a decade, GRI has become the *sine qua non* international standard for sustainability reporting, alongside the International Finance Corporation's **Equator Principles** and its own **Performance Standards** (which among other things touch on issues of human rights and community engagement).

In some respects, with courage and leadership, we are in touching distance of what is possible!!
It is clear that we have reached a point where we must begin to define the basic values that we want to see articulated by companies in their corporate behavior.

We have to recognize that **ethics and values differ across countries** and that they are judged from various lenses, which presents a series of challenges and problems for companies that want to make them operational. Ethics will be different in China, in Russia, in Costa Rica, in Nigeria, or Jordan. [**light moment**: in the U.S. your business partner may be offended if your entertainment keeps him awake beyond midnight, whereas here in Spain—the offense occurs if the party does not pick up after midnight!]

However, **social responsibility is the common thread**. It is about companies achieving symmetry with the welfare of society and environmental protection. What should be the focus and what priorities should companies respond to from all the interests groups vying for their own cause?

➢ Rolling Up our Sleeves: Sustainability and Ethics in Practice

Seeking and working with a forward-looking vision is an important distinction, both for society and for realizing the inherent potential of the sustainability agenda.

Where to begin? How do we translate and integrate ethics and values into business operations? With so many competing demands and so many considerations to balance from multiple interests groups and stakeholders, the reality is that a company can only address so much before it becomes economically unrealistic.

So is it really possible to build a culture of business ethics and what are the practical steps going forward?

There is a lot that every company can do - no matter the size, resource base, ownership structure, and even its level of commitment to business ethics.

From a practical standpoint, building an ethical organization and committing to sustainability practices entails a basic set of decisions and considerations.

The most common first approach—already codified in the latest revisions of national corporate governance codes and one that is becoming standard industry practice—is to start with a corporate code of ethics or statement of business principles.

The process to develop an ethical code embodies all the necessary components to cement in reality the long-term vision of sustainability: continuous dialogue, multi-stakeholder consultations, re-engineering of accountability and transparency frameworks, training and adaptation to changing contexts, and, foremost, "tone from the top."

A corporate ethical framework or code outlines the values and beliefs by which a company will conduct its business decisions and operations. It sets long-term goals and provides a framework by which to evaluate how effectively a company is meeting its stated commitment to ethical performance.

The value of a code of ethics is that it is more than simply a statement of a company's moral beliefs—it is a clear and unequivocal articulation of a company's commitment to continually align the values of the company to evolving market circumstances and consumer preferences. It is the expression of a true and long-term commitment to all the dimensions of social responsibility.

One of the key considerations in implementing a code of ethics is to decide among the two basic types that exist: an <u>aspirational</u> or a <u>directional</u> code.

Aspirational codes are values-based and provide ample flexibility to engage all company staff in developing the company's ethical culture. Because they set general principles that can be clarified over time with practice and with their application to various ethical dilemmas, aspirational codes can be as short as one or two pages and thereby rapidly deployed company wide.

Directional codes tend to be more prescriptive of what is permissible or forbidden behavior within a business organization. Because of their rules-based nature, directional codes can be perceived to be top-down and controlling processes that leave very little discretion to employees about using individual judgment to interpret a company's stated ethical values and principles.

Most companies, however, adopt hybrid versions of these two types of codes of ethics.

Among other key considerations that must be taken in developing a code of ethics is the **formulation process**, of whether it will be an organization-wide process of consultation and consensus building to articulate the content and the tone that will be reflected by the code of ethics.

If the code does not reflect shared values among all company-wide groups to be affected by the code's standards—directors, executives, managers, supervisors, employees—codes may actually exacerbate tensions rather than forge a common identity around a company's ethical framework. It has to also embrace the cultural and other differences that comprise the employee population – a particular challenge for multi-cultural, global organizations.

Once a corporate ethical code is adopted, the real operational difficulties and challenges of implementation begin. For example, what structures, mechanisms, and authorities will be established to implement, monitor and enforce the code of ethics? How will ethical performance be reported, validated, and communicated internally and externally to stakeholders, customers, and the general public? And what procedural mechanisms will ensure that a company's ethical culture is synchronized with everyday business policies and decisions, such as human resources, internal controls, risk management, communications, compliance, and internal audit?

Answers to these questions are not easy and require committed resources and leadership to ensure that adopted ethical values and principles permeate all business activity and are applied on a consistent basis.

I cannot leave this discussion about the positive aspects of building an ethical framework without pointing to some obvious but important caveats: if it is conceived as the only instrument to advance social responsibility, it will be of limited impact and of minimal reach.

One must also guard against the complacency that codes of ethics can breed: they do not absolve us from making use of individual judgment about what is right or wrong. The bigger danger, however, is to guard against the perception by either stakeholders or employees that a company's behavior is incongruent with the stated principles or values promulgated by a code of ethics; that it is no more than P.R. and marketing. Or, even worse, that actions by senior executives and leaders imply that they are exempt from the organization's ethical standards.

All such dangers can breed apathy and discredit genuine efforts to build a well structured and observed ethical framework in a company!

Also it goes without saying that **a code of ethics is never a substitute for a poor business plan**, nor will it guarantee protection against major ethical lapses of corporate misconduct and fraud. Ever present vigilance and leadership are essential!!

A culture of ethics is realized when it becomes a living part of everyday operations by all staff at all levels of any given company. An ethical organization is realized when the full universe of sustainability values and social responsibility principles become an integral part of a company's DNA - defining the very nature of a company's existence and how it conducts business internally and externally.

➢ Concluding Remarks

In concluding, I've tried to focus on some, but certainly not all, dimensions that warrant deliberation and continuous dialogue to build a common vision and shared values around sustainability and corporate social responsibility.

In the span of ten years—a time period that does not even register as a plot point in the grand scheme of human civilization—we have made significant achievements in forging common ground around issues that were at the margins of corporate strategies and decision making.

If we have come so far, the mainstreaming of ethics and sustainability values into the world of doing business is no longer a utopian dream, but a real possibility and a shared responsibility we should all carry with us.

Focusing on regulatory reforms that do not tackle human incentives, values, and behaviors—such as fixing the governance of boards and companies yet again—will not rescue us from the next crisis or the broader uncertainties that threaten society and its existence as we know it.

Indeed, a key lesson from the global financial crisis reveals that corporate governance principles remain valid and legitimate for sustainable economies and businesses, but that problems must be addressed at the level of the application, oversight and enforcement of such principles and values.

In plain language, it means that <u>better companies</u> and <u>better societies</u> stem from the ethics and values that drive sustainability and social responsibility.

I fear that with the political pressure to quickly "fix" the problems that we may be missing the opportunity to remedy some serious flaws in the way our markets are currently structured. We must remedy some of the more fundamental systemic issues that I have been alluding to.

In the end, the solution is a function of transformed ethics and human values in how we understand and balance the interests of business, consumers, communities, future generations, and the ecosystems that sustain our civilization.

To quote Sir Adrian Cadbury, "In its broadest sense, corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, of corporations, and of society."

Thus, as **the new generation of entrepreneurs, the future lies in your hands**. Business schools in my personal opinion have an important obligation to frame our future within this context!

Looking round me and considering some of the discussions I've had over the past day or so, I am assured that this new mindset can take hold with our new generation of business leaders - which is cause for optimism and

Thank you for your attention and I will be happy to answer any questions or to provide any points of clarity during the course of this evening's discussions.

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