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Business Ethics in international companies: Insights of the last 20 years. A Swiss experience

Dominique Biedermann, PhD
Chairman of Ethos Foundation, Geneva

Ladies and Gentlemen, Dear Participants,

It is a honour for me to be invited as a keynote speaker of this conference dedicated to Business Ethics.

Business Ethics has always been a very important issue for Ethos Foundation that was launched 21 years ago. However, the perception of this concept has sensibly evolved since then. It is with great pleasure that I will give you an oversight of how this evolution is perceived from the perspective of a large institutional shareholder.

My presentation will be structured in three parts:

- First a short introduction to Ethos and Socially Responsible Investment (so called SRI).
- Secondly, a number of considerations on the Business Ethics concept.
- Finally, an oversight of the evolution and implementation of Business Ethics in Swiss listed companies in the last 20 years.

1. Ethos & SRI

By way of background, I will start with a short introduction on Ethos and SRI. This will allow you to better understand the perspective from which I am making this presentation. Ethos Foundation has two purposes: first to promote SRI and second to contribute to a stable and prosperous socio-economic environment. The foundation currently consists of 220 Swiss pension funds that manage approx. CHF 250 billion on behalf of more than 1.3 million members, which corresponds to approximatively 25% of the Swiss pensions system.

For Ethos, SRI is not limited to simply adding environmental, social and governance (so called ESG) criteria to the traditional financial criteria used in asset management. In fact, a responsible investor must also actively exercise his shareholder rights. This includes voting in shareholder general meetings and also engaging in dialogue with investee companies.

This approach has been developed progressively during the course of the past 20 years. When we launched Ethos in 1997, the main focus was to analyse how ESG parameters were taken into account by companies, in particular the way companies addressed Business Ethics. These assessments led to over or under weighting companies in the portfolios or to simply excluding them in case they did not fulfill a minimum of requirements. We very rapidly observed that the impact on companies was often non- significant.

To be able to influence a company, it was necessary to be present as an active shareowner who exercises his voting rights and who takes the floor during general meetings. This was not always sufficient, because a large part of the topics at stake are not submitted to shareholder vote. For example, in Switzerland, the approval of a code of conduct which constitutes the core of Business

Ethics, is not in the competencies of the shareholders but of the board of directors. To convince the company to improve its practices in this regard, it is therefore necessary to engage in constructive dialogue outside the general meeting.

Today, the active exercise of shareholder rights takes more time and resources than a simple extra-financial analysis of companies. But it is worth doing so because it is only this approach of active ownership that has an impact on companies. I must however note that such an approach is credible and effective if the investor is long-term oriented and has some financial leverage (for pension funds) or moral leverage (for Church investors).

2. Business Ethics

I have now reached the second part of my presentation, Business Ethics per se.

Generally speaking, one must admit that during a long time, Business Ethics were not really a subject of discussion. When I was a student at the University of Geneva in the 1980s, the dominant economic theory was making reference regularly to Milton Friedman who had summarized the purpose of companies in his famous assertion:

„The Business of Business is Business"

Today, who would dare affirm in such an insolent manner that the unique and ultimate purpose of a company is to make a financial profit? Time has definitely changed. Today, in many companies the purpose of the business is closely related to the long-term interests of their different stakeholders: the shareholders of course, but also the employees, the clients, the suppliers and civil society to whom one must add the two stakeholders who have no representatives and are therefore considered as mute: future generations and the natural environment.

The relations between a company and its various stakeholders is guided by:

- First, the codes of best practice in corporate governance in respect of the relations with the shareholders.

- Secondly by the corporate code of conduct in respect of the relations with the other stakeholders.

With regard to the codes of conduct, best practice requires coverage of at least three fields: Business ethics stricto sensu, and social and environmental responsibility.

Let's have a closer look on the Business Ethics part:

Today, the economy often considers business Ethics under a <u>normative</u> angle, meaning that this notion covers a number of norms that are considered mandatory. In reality this is an Anglo-Saxon approach with a strong moral component that includes listing practices that should not occur: no corruption in business, no child or forced labor, no creative accounting etc.

At the opposite, in continental Europe, we are rather tempted by a <u>positive</u> approach with regard to business ethics that consists in considering what must be qualified as good practice. This is an argumentative consideration on how one can act ethically in the context of business. Such an approach leads to defining a set of positive recommendations, such for example that CSR should be extended all along the supply chain of a company, or that the company should pay taxes in the countries where it operates and not in tax havens. A positive approach of CSR allows to go further than simply forbidding, by highlighting the values that should guide the actions of companies.

The topics usually included in the business ethics part of a code of conduct are the following:

<u>Respect of the law</u>: First and foremost a company must clearly stipulate that the respect of the law is fundamental alongside the respect of best practice codes and company standards that often

exceed the requirements of the law. This allows to clearly define the values of the company and to show that any violation of the rules will immediately be sanctioned.

Another issue is corruption: Not only active and passive corruption is not tolerated but this also includes « any form of corruption whatsoever», such for example “facility payments” as described by the NGO Transparency International.

Another sensitive issue is the respect of competition rules. It is very important not to just laud the principles of a free economy, but also strictly sanction any collusion on price or other cartel agreement.

The topic of conflict of interests is also very important in business, as it is virtually impossible to avoid conflicts of interests in any aspect of life. However, it is necessary to decide what conflicts of interests are incompatible with a specific function or activity and must definitely be banned and those that can be managed. In principle, a permanent conflict of interest cannot be accepted.

Now Data protection: This is a topic that has recently come to the center of attention as it is a very sensitive issue. Currently, amendments in legislation occur in many countries with regard to this issue. An example is the entry into force in a few days on the 25 of May of the European directive called the General Data Protection Regulation (GDPR).

Finally, in the chapter of Business Ethics, fiscal responsibility of companies should also be defined and outlined. This matter is still not very much dealt with, but it has gained significant importance following the erosion of the tax payments of companies that transfer their profits to low tax jurisdictions. Tax optimization is not illegal per se.

However, this does not mean that it is responsible behavior for a corporation to create artificial business or tax structures in order to pay little or no taxes. This is called “aggressive tax optimization”.

With regard to fiscal responsibility the Business Ethics rules should include at least the following two principles:

- Taxes must be paid in countries where the companies operate
- The companies should disclose their tax payments country-by-country.

The European Union is ready to publish a new directive in this field despite strong opposition from businesses.

3. Implementation and evolution of business Ethics in Swiss listed companies

I have now reached the third and last part of my presentation that addresses the evolution and the implementation of Business ethics principles by Swiss listed companies in the course of the past 20 years.

When Ethos Foundation started its engagement program with Swiss listed companies 15 years ago, only one third of the 100 largest companies had a code of conduct. Among those, certain even refused to disclose it to their shareholders. According to these companies, the code concerned just the employees who were the only ones to know its content and should keep it a secret.

Fortunately, things have evolved since then. Today, 90% of the 100 largest Swiss listed companies have a code of conduct which is posted on their website. Discreet dialogue conducted by Ethos consistently over the years has definitely contributed to this evolution. This does not mean that the code’s coverage is perfect. As of today, only 25% of the companies that have a code of conduct cover extensively all the matters pertaining to business ethics, and social and environmental responsibility.

The same applies to the code's implementation. To be credible, the principles included in a code of conduct and in particular the issues related to business ethics should be of the responsibility of the highest-level officers of the company, preferably the Chairman of the board of directors and the CEO who generally present and sign the code together.

Employees are the main recipients of the code. However, some other stakeholders are directly concerned by various business ethics principles, in particular the suppliers. This is why companies often establish a code of conduct that is specific for suppliers who are asked to approve and sign the code in order to be able to work with the company. This allows to guaranty the respect of certain fundamental rules of business all along the supply chain.

The effective implementation of Business Ethics principles requires the translation of the code in the various languages spoken in the jurisdictions where the company's employees are located. The code must be systematically distributed to the employees that should receive specific training.

In the context of the implementation of the business ethics principles, one of the most sensitive points is the need to dispose of a whistleblowing system, to allow an employee of the company or a business partner of the company to be able to inform that a violation of the principles is happening without having to do so via the usual communication channels.

To be efficient, such a system should allow guarantying the anonymity and the protection of the whistleblower. This of course means that any denunciation that would subsequently prove to be deliberately false should be strictly sanctioned.

In brief, I can confirm that the attitude of the management of companies with regard to business ethics has evolved in the right direction in the course of the years. In the context of Ethos' engagement, we have seen a clear change in mentality. 15 years ago, many boards had never received any question on this topic from their shareholders and the subject was considered as taboo. The information available was scarce and transparency very limited.

Today, the situation is very different, as a majority of listed companies have realized that Business Ethics deficiencies constitute a important financial and reputational risk.

Certain issues are still not fully integrated in the code of conduct as for example fiscal responsibility. Despite the tax evasion scandals revealed by the "Panama Papers" and the aggressive tax optimization of certain companies, this topic is still one that is not easy to discuss with the board and management of Swiss listed companies.

This is a typical case illustrating the limits of self-regulation. External pressure is necessary to bring about change. I am of the opinion that such pressure can come from the following three sources: the regulator, civil society and the shareholders of the companies. Regarding Switzerland, I do not think that the legislator will be an early mover in this field. I am however much more optimistic regarding the influence of civil society and the company's shareholders. Since a few years, one can see that institutional shareholders have gained importance and become more and more active. The success of Ethos Foundation in the field of engagement is typical of this evolution.

In conclusion, I would say that the principles that guide Business Ethics are now part of the corporate culture of many listed companies and constitute one of the tenets of a company's license to operate.

Thank you for your attention!