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"Ethics in Governance"

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Introduction

There are a number of codes on corporate governance written for different jurisdictions and I thought that, before talking to you today, I should re-read the 2011 Code of Corporate Governance published by the Commission – with which I'm sure you are familiar.

Its first paragraph ends with the encouraging words – in bold – *that "ultimately, corporate governance is about the behaviour of Boards and their directors."* In my view that sentence is drafted a little narrowly although it can be taken to imply further reach. I would go as far as to say that ultimately, good corporate governance is about ensuring that a firm acts in an appropriate way. The directors are responsible for establishing the behaviour of the whole firm, not just their fellow directors and the board collectively. They are, after all, directors and the law does not make concessions for non-executive directors – and they are there to direct the work of the firm.

Turning to the ethical section of our code – Principle 3 – Business Conduct and Ethics, it states, *"all directors should maintain good standards of business conduct, integrity and ethical behaviour and should operate with due care and diligence and at all times act honestly and openly."* Thereafter, it makes no comment on ethics. It is not unusual in this. When reading corporate governance codes I am reminded, a little, of the 'Yes Minister' sketch where Sir Humphrey suggests that Jim Hacker should deal with any public expectations relating to reform of the civil service through the use of the term "Reform" in the title of Hacker's Reform Bill without, thereafter, actually doing anything to ensure the aforementioned reform is addressed in the body of the text.

That most corporate governance codes are so very high level on the subject of ethics is probably because, in our secularist, relativist post-modernist Western culture, having a definite opinion on ethics is a bit like having a definite opinion on what death means; rather uncool and socially more than a little awkward. A good regulator should not, however, care very much about being uncool provided that he or she is effective and, after many years of breaking up some metaphorically rather drunken corporate parties and of uncovering things some people would far rather I had overlooked I am quite used to being thought awkward. Thus, I'm going to focus on ethics today and advance an opinion on both why it is important and what it should mean for firms.

Morality and risk of reliance on law in a free society

Many decisions firms take are not purely technical. They are not based, for example, on a pure technical analysis of the discounted cash flows which result from two similar projects.

Rather, they involve judgements about what is the right thing to do based on sentiment as much as pure empirical logic. One historical response from some quarters of the business community has been that it is alright for them to do anything provided it is within the law and that it enhances shareholder value. That perspective is perhaps defensible if one takes a traditional view of law.

Aquinas, the leading political thinker of the Middle Ages, outlined four kinds of law:-

1. Eternal Law – practically identical with the reason of God;
2. Natural Law – a reflection of divine wisdom in created things;
3. Divine Law – essentially revelation, such as the special code of laws which where given by God to the Jews as his chosen people; and
4. Human Law – that which applies to human kind the greater principles of order that prevail throughout the world – "an ordinance of reason for the common good, made by him who has care of the community.[1]"

As one can see, Aquinas's conception of law was rather more complete than simply law being the latest ordinances passed by the States of Guernsey or the latest rules published by the Commission. If one tested one's decision making against all four strands of law then one would probably be left with a fairly comprehensive set of guidance on the factors to take into account when exercising judgement. Problems may, however, arise when those in business decide that the law is defined not in Thomasian sense but rather in a very narrow "Human Law" sense.

Some may advance the argument that Human Law is all with which they should, as business people, be concerned and that after that it is legitimate to exercise judgement merely with reference to profit maximisation. Whilst there is an undoubted logic to that line of argument, I think freedom-loving business men and women should be careful about advancing such a case because of where it leads in the face of popular disquiet at failings within firms. If law is to be the sole limitation on the actions of businesses then every corporate failure which reveals moral and ethical failings may logically be dealt with by the legislative class through moral and ethical legislation which forces firms to act in very specific ways in very specific circumstances. Those drafting such legislation might, in their desire to force firms to be moral, legislate in ways which severely impeded business which would otherwise have been both legitimate and lucrative. To put this another way, if you advance the argument that there is not more to business ethics than narrow compliance with the laws passed by the legislature, you arguably advance an argument that where ethical shortcomings are exposed, the State has a duty to legislate to inhibit them as that is the only way in which change can come about. To advance that mere compliance with law and the pursuit of profit is an optimal modus operandi for a firm, I'd gently suggest, may well take business down the road to serfdom popularised by Hayek as the State becomes ever more demanding in its laws because it knows it can place no reliance on the morality or ethics of its people when divorced from formal obligations under the law.

At this point it would be nice and easy to say that the appropriate answer is simply to move back up the chain from compliance with Aquinas Type 4 "Human Law" to Aquinas Type 3

[1] *Summae Theologia* 1a, 2ae, q. 90, 4 (as summarised by Sabine and Thorson in their *History of Political Theory Fourth edition* (1973)

"Divine Law" and simply, for example, take the ten commandments from the Jewish Torah, add in "do as you would be done by" and "love one another" – in the αγαπε rather than the ερος sense I hasten to add - and job done. You would therein have a guide to corporate ethics which is pretty straightforward and easily taken into account when making boardroom judgements on what a company should do.

The problem is, of course, that reliance on skyhooks is greatly frowned upon in Western Europe. The veracity of revelation is challenged by a current secular orthodoxy which prides itself on a form of scientific rationality which precludes any reliance of that which cannot be proven in a science lab[2]. Thus almost all modern boards would reject any notion of instructing employees to take into account instructions with explicitly religious overtones. Even if they actually thought it was a good idea (and one doesn't have to be a theist to think that there is some quite useful instruction on how to live life in some historic religious texts), they would probably get told that according primacy to one or another set of religious teachings in the workplace risked infringing the European Convention on Human Rights.

Interestingly, a large number of educational institutions don't seem to experience a great problem with according primacy to a certain set of religiously inspired codes for life. It is curious how so many of us who are still quite insistent that our children receive an education firmly grounded in ancient teachings on right and wrong, are apparently content that upon leaving school those same children will have to translate into spending most of their waking hours in organisations where there is no overarching moral narrative, no ethical raison d'etre.

Turning from modernist, quasi-philosophical objections to statements of morality in business to more pragmatic objections, there are also strong arguments against too much focus on morality in business. These go along the lines that such piety is only affordable by those on a public service payroll, that the business of business is not to be moral but to make profit and that in any case, the greatest moral service which a businessmen can do his fellow man is to meet his payroll and thus allow his staff to pay their way in the world. The difficulty with this sort of thinking is that while we can probably all feel sympathy with it, it doesn't deal adequately with the issue of the multi-billion pound costs to the shareholders of Libor rigging, payment protection insurance mis-selling and FX market manipulation, to name but a few recent examples. Nor does it adequately deal with the not insignificant issue of the vast costs to taxpayers of bailing out all the firms which failed because they had become places where greed triumphed over any sort of purported professional code or notion of right or wrong. I am certainly not advancing the case that businesses which seek to behave in a moral manner do not put themselves at a disadvantage in some situations compared to those which don't have any moral compass but I question whether shareholders can afford the costs of owning financial services firms which are increasingly being fined incredible amounts of money for their unethical and wrong behaviours and, much more importantly whether, as a civilisation, we can afford the costs of having the commanding heights of our economies dominated by entities which lack a decent moral code.

The third objection to making morality part of business is impracticality. Even if you believe in sky hooks of some description, the sorts of choices one has to make in business about what

[2] Even though it is questionable whether large parts of modern theories of quantum mechanics are open to anything akin to laboratory analysis - see p. 71 of "Big Data" by Victor Mayer-Schonberger and Kenneth Cukier (2013) for a discussion of Chris Anderson's argument that quantum physics has become a purely theoretical field where experimentation to prove theories is near impossible.

to sell to a customer, how to sell to a customer or whether to get rid of an employee who is letting down his team but who will be personally damaged by dismissal, are full of grey rather than being black or white. There are likely to be good and bad aspects to different decisions – selling a customer a slightly less useful but more profitable product may enable you to raise the money to invest in a better bit of analytical software to do a better job for other customers in the future or may provide enough money to make an interest payment when a business would otherwise have to break a contract to repay debt to its financiers. There are many genuinely difficult moral conundrums both inside and outside business which don't have tick box answers, irrespective of any moral code you may or may not subscribe to on a personal level.

Whilst the grey nature of many business decisions is irrefutable, I'm not convinced that the greyness always provides an adequate excuse for not applying moral standards to them to assist in the making of appropriate decisions. After all, the profitability implications of a great number of business decisions are necessarily grey for a considerable time after a decision is taken. That has never precluded potential profitability being taken into account in business decision making.

To summarise, I've advanced the case that a narrow reliance on following Human Law at a corporate level, absent any meaningful ethical code of conduct, is proven to have failed in the financial crisis. To persist with the belief that all a business must do is to obey the law, narrowly defined, in a free society is merely to advance a case for an ever greater extension of law and regulation to microscopic levels such that we become both an unfree and a grossly inefficient society in which profits and prosperity are difficult to obtain. I've further advanced a case that neither the greyness of many business decisions nor the balance which must sometimes be struck between developing the most perfect deal for the customer and meeting the payroll should preclude the consideration of ethical issues by a corporate body. What I have not dealt adequately with is the problem, in secularised Western Europe, of relying on sky hooks or on anything which even smells of a skyhook. In other words, from what can one derive one's ethical code.

Many philosophers have advanced a case that there are no absolutes of right and wrong and that good and bad is merely a relative concept. Anthropologists have been known to argue that right and wrong differ between different cultures and they certainly have a point that the social norms highlighted in, for example, *The Forest People*[3], are somewhat different from those in modern Guernsey. When told that right and wrong must be relative because different peoples have different behavioural norms, I find myself drawn back to John Cremony's analysis in his famous work *Life Among the Apaches* where he observes, *"The native American is no idiot. He knows right from wrong, and is quite as cognizant of the fact when he commits a wrong as the most instructed American of European origin. If the reader should feel a particle of doubt on this point, all he has to do is to commit a wrong upon an Apache, and he will very soon become convinced that the native American is quite as much aware of the fact as he can be.*[4]" I would concur with John Cremony's judgement that, irrespective of historical background and religious affiliation or otherwise, most individuals

[3] *The Forest People (Triad/Paladin)* 1984 by Colin Turnbull in which he describes the life of the BaMbuti of the Ituri Forest in North East Congo in a work widely considered a classic of social anthropology.

[4] John Cremony - Life Among the Apaches (1868) San Francisco. I have taken the liberty of adapting the quote, whilst - I trust - preserving the essence of it, given some of the descriptors used within the original quote might offend post modern sensibilities.

have a sense of what is right and wrong in terms of their reciprocal relations with others and that is something which has perhaps been underexploited in the financial services sector in recent years. I'd further contend that most people can tell when they have done something bad and when they have done something good. These are facets of humanity on which firms can build – assuming for one moment that their recruitment criteria are not designed to screen in favour of the relatively small number of individuals who lack the most basic sense of right and wrong. In advancing this perspective, I appreciate that I'm probably making the most contentious point in this talk in that I am advancing a case that we, as humans, do have within us, some almost innate notions of right and wrong, societal norms based on reciprocity and some sense of fairness. Those of you who would like to engage with some of the empirical evidence on this score may perhaps find Nobel Laureate Daniel Kahneman's book *"Thinking Fast and Slow"* interesting. In it and in his paper "*Fairness and the Assumptions of Economics"*[5] he comments on cognitive experiments associated with game theory where humans will take logically irrational decisions, in terms of reward, because to be logical would contradict some basic sense of fairness and equity.

Having discussed, albeit briefly, the issue of notions of right and wrong in human society, I am now in a position to return to the tricky issue of how a board, setting an explicitly moral code by which they expect their staff to conduct themselves, could work alongside the general disquiet in secularised Western European culture about citing skyhooks as grounds for anything. I can see two principle options, although there are obviously various other permutations which are plausible.

The first option is valid if one is willing to run with the case I put forward above, that whilst there are cultural variations, the vast majority of humans have a sense of right and wrong in terms of reciprocal relations with each other. If you accept this then it becomes possible, without being discriminatory, to assemble a meaningful ethical code for a firm which explicitly addresses the issue of right and wrong in a manner which is not unacceptable or offensive to any employees whom a firm should wish to retain. The content of such an ethical code could be drawn from teachings which may or may not have religious inspiration. It is quite possible to be a theist or an anti-theist and yet believe that both Socrates and Paul of Tarsus have some worthwhile things to say.

The second option should work even if you think that definitions of right and wrong in reciprocal relations between humans are culturally specific and possibly that the notions of right and wrong are relative rather than absolute. In this instance, a board - without making any sweeping cross-cultural assumptions, should be capable - if it is a functional board - of coming up with an ethical code for its business based on its members understanding of right and wrong. Such a code can then be promoted throughout an organisation as part of an organisation's code of conduct which should influence the factors it considers when taking decisions in a positive fashion. In such circumstances it would clearly be a matter for the board whether the code drew inspiration from one or more religious or humanist texts. Provided it is not done in an explicitly confessional manner, I cannot see any particularly good reason to reject the inclusion of the ethical teachings of those associated with some of the world's great religions. Acquinas, after all, whilst trading for much of the past seven centuries under the religious name of St Thomas, included a great deal of helpful advice for

[5] *Journal of Business* 1986, vol 59 no. 4 pt 2

the medieval pastoralist on how to deal with the practical issues of life as well as some quite high flying philosophy and theology.

The tension between morality and business is not new. If we look back at Richard Burton's account of his illegal pilgrimage to Mecca in the 19th Century, he chronicles a devout Muslim on his Hajj who cannot bring himself to take an oath not to lie, on the basis that to take such an oath would mean that he could not continue his trading business on his return home[6]. I think we would not be remiss in asking ourselves whether one of our own co-workers would feel similarly constrained today. If we think that they would be similarly constrained, I'd argue that there may be a problem with corporate governance, ethics and quite possibly the business model in the organisation concerned. Warren Buffet, of course, set up his insurance company when he found the business model of his father's stock broking firm did not allow him to align his interests with those of his clients; something he recounts in his approved biography[7]as not feeling quite right.

In talking to you today I have quite consciously not sought to differentiate between ethical and moral behaviour because I do not believe that the academic distinctions which are sometimes drawn between the two have that much practical relevance. What I have sought to do today is to make the case for a meaningful discussion of morality at the boardroom table and for ethical codes within firms which can inform decision making at all levels of the organisation. I believe that firms which merely take a compliance approach - that is to say that they assert that their activities are only constrained by the law, and perhaps even the law as interpreted by an imaginative advocate or compliance consultant - do themselves and their sectors a disservice. If you are only constrained by human law and if you create a culture - as so many large financial institutions did prior to the crisis - where any discussion of ethics and morality is practically impossible by anyone not ready to resign, then you must be ready to live with the consequences when firms fail because of their failure to ensure their staff behave in a moral manner. Those consequences have included, in recent years, vastly increased regulatory burdens as law makers have responded to the lack of morality in parts of the financial services sector with thousands of pages of prescriptive regulations which would have been largely unnecessary had the boards of some financial services firms had enough courage or foresight to have and enforce meaningful ethical standards.

In summary, if you like freedom and if you dislike supranational regulations telling you exactly what to do and how to do it, you need to make sure that financial services firms address the ethical void which too many of them have lived with for too long. Much freedom has been lost as a result of the increased regulation which followed the financial crisis. If we wish to preserve that freedom which remains we need to encourage an environment in which the consideration of the morality of actions, alongside the consideration of potential short term profitability of those actions has a secure seat at the tables where decisions are taken on what actions to pursue. I think the excuses for not doing so are limited and the downsides of not doing so very considerable. If the global financial services industry fails to give proper consideration to whether something is "right" or "wrong" in its decision making then it will have only itself to blame as international law makers impose their version of such considerations upon it in a fashion which the industry will find both distasteful and impedimentary for commerce.

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[6] Richard Burton – *A Secret Pilgrimage to Medina and Mecca* (1857)
[7] p. 171 *The Snowball* by Alice Schroeder (2008) Bloomsbury

Right and wrong, truth and falsehood still deserve to be meaningful constructs in our secularised Western culture. If we think we can safely ignore them in any significant part of our societal construct, it is questionable whether we still deserve to be considered a civilisation in the classical sense of the term.

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