Corporate governance and responsibility

Foundations of market integrity

Bill Witherell, Head, OECD Directorate for Financial, Fiscal and Enterprise Affairs

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Good governance goes beyond common sense. It is a key part of the contract that underpins economic growth in a market economy and public faith in that system. The OECD Principles of Corporate Governance and Guidelines for Multinational Enterprises are two essential instruments for ensuring that this contract is honoured.

The recent spate of US corporate failures and breakdowns in truthful accounting has undermined people's faith in financial reporting, corporate leadership, and the integrity of markets the world over. The fact that the wave of scandals has come hot on the heels of a collapse in the high-tech bubble has a sharp ironic flavour. Both events have their roots in the heady days of stock market exuberance, when anything was possible, from creating multibillion dollar companies with little more than an idea, an investment angel and a lot of faith, to believing that markets would buy any yarn a group of fast-talking executives could spin, even if to cover up serious losses and illegal practices. The corporate scandals and the bursting bubble have different causes though: on the one hand, illicit management decisions and cover-ups, and on the other, over-bloated investment assessments followed by a sharp market correction that spelt the end for thousands of high-tech wannabes. Still, it is difficult to disentangle the negative effects these two parallel developments have had on the confidence of investors.

With the bursting of the high-tech bubble, share values were written down and venture capitalists took a bruising, as did many shareholders. That is the downside of committing resources to investments with a high risk/high reward profile. But in the cases of corporate misbehaviour, the public, employees and pensioners were deliberately misled. They have now lost many billions of dollars, and in some cases their life savings, while some insiders benefited. The truly unfortunate part is that both events might in their own way have been avoided (or at least anticipated) if effective corporate governance and high levels of corporate responsibility had been respected.

The role of good governance and corporate responsibility in helping to assure the well-functioning markets needed for economic growth and development cannot be taken for granted. This idea has been repeated by government and business leaders the world over, and most recently reaffirmed at summits from Doha to Johannesburg. But we are falling short: the systems may be there – the US had, on paper, one of the best – but evidently they have not worked. Fixing them will require both private initiatives and strong government action.

Good corporate governance – the rules and practices that govern the relationship between the managers and shareholders of corporations, as well as stakeholders like employees, pensioners and local communities – ensures transparency, fairness and accountability. It is a prerequisite for the integrity and credibility of market institutions. By building confidence and trust, good governance allows the corporation to have access to external finance and to make reliable commitments to creditors, employees and shareholders. It is this contract that underpins economic growth in a market economy.

When this trust is undermined, lenders and investors lose their appetite for risk, and shareholders offload their equity, resulting in lost value and reduced availability of capital. This goes for every stage of the investment process, affecting issues from property protection and ownership registration, to disclosure and the distribution of authority and responsibility among company organs.

Clearly, the importance of good corporate governance goes far beyond the interests of shareholders in an individual company. Indeed, the central corporate governance principles of transparency and accountability are crucial to the integrity and legal credibility of our market system. We already trust corporations to create jobs, generate tax revenues and provide markets with goods and services. Increasingly we make use of private sector institutions to manage our savings and secure our retirement income.

Private participation in delivering these services has been proven to work, but it is constantly under scrutiny and must remain so. Some private pension funds, for instance, have recently been informing their pensioners of the prospect of reduced payments, due to falling stocks. If market risk and cycles were the only cause behind these announcements, that would be fine. The stakeholder public would probably live with that, and anyway, the market provides other instruments for customers to invest in, like property or long-term bonds. But to the extent that the market's fall can be traced to scandals and breaches of trust, public support wanes and the market becomes unworkable. The state's reputation is also at stake.

This underscores a widespread public – and hence political – interest in reinforcing corporate governance practices. Such concerns become even more important in

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an international context where the full benefits of free capital flows will only be realised if there is a mutual understanding on the basic elements of good corporate governance. These are the core concerns that triggered and nurtured the discussions on corporate governance in OECD countries, leading to the development of the **OECD Principles of Corporate Governance**. These principles, that have received OECD ministerial backing, form the basis of a true global standard in corporate governance.

In the light of recent developments, OECD ministers have called for an assessment of these principles. The basic ideas enshrined in the principles are not being questioned, but there evidently is a need to provide further guidance, particularly with respect to achieving effective implementation in the dynamic markets of the 21st century.

Corporate structures change fast, while financial innovation and globalisation all present new challenges to maintaining good corporate governance. The recent high-profile cases of governance failure and corporate misconduct have shown that corporate governance mechanisms sometimes have not kept up with these developments.

The OECD principles already highlight that an annual audit of accounts be conducted by "an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented". The principle is there, but as we have seen recently, it was not always heeded. Governments, security market regulators and the private sector itself are all taking steps to strengthen the implementation of this principle.

Nor have company boards lived up to their responsibilities. For instance, the OECD principles recommend that the board "monitors and manages potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions". There is obviously a gap between risk management practices by corporations and investors and the existing tools for disclosing, accounting for and controlling risk. And monitoring is not easy, since the conflicts of interest that have been identified extend beyond the corporations themselves to financial analysts, rating agencies and financial institutions. In other words, who can we trust? We need to develop governance tools and incentive structures that are more robust in the face of rapid financial innovation, and procedures that leave no doubt as to the stakes involved. Accounting standards need to become principle-based, rather than being based on rules that invite evasion.

But while details and principles may be strengthened on paper, they will serve little purpose without the political commitment to abide by them. The aim is to reinforce the contracts of trust that drive our market democracies; governments as custodians must take a lead in ensuring these contracts are not only understood, but honoured too.

Responsibility

Corporate managers' responsibilities, of course, are not limited to producing truthful financial reporting, carrying out the core functions of conducting business and obeying the various applicable laws. Businesses also have to respond to the expectations of the democratic societies in which they operate – expectations that often are not written down as formal law. The term "corporate responsibility" refers to the actions taken by businesses in response to such expectations in order to enhance the mutually dependent relationship between business and societies. Shareholders, in fact, expect their corporations to meet society's demands, consistent with maximising the value of the firm. Indeed, experience has shown that companies that do so are generally the best performers in the long run.

The challenge of meeting these expectations has become more complex in today's global economy, with firms typically operating in a number of legal, regulatory, cultural and business environments. Globalisation's benefits are well documented, but it has raised legitimate public concerns, several of which have been directed at multinational enterprises as agents of the globalisation process. Multinational enterprises sometimes are perceived as taking the money and running, not doing enough to build up local economies, and so on. They are accused of being party – in many cases, inadvertently – to serious problems such as corruption of public officials, human rights and labour rights abuses and environmental damage. Companies have to address such concerns when they arise. In fact, apart from ethical considerations and the law, their host-country market valuations would suffer if they ignored them.

In recent years, businesses have engaged in voluntary initiatives to improve their performance in various areas of business ethics as well as legal compliance. They have developed codes of conduct and management systems designed to help them comply with these commitments. They have developed them with the help of labour unions, non-governmental organisations and governments.

The recently updated OECD **Guidelines for Multinational Enterprises** complement and support these private initiatives for corporate responsibility. These guidelines are recommendations addressed by governments to multinational enterprises operating in or from adhering countries. Being from the OECD is somehow appropriate, given that nearly all FDI that takes place in the world originates and is financed in the OECD area. In fact, the MNE guidelines are the only multilaterally endorsed instrument for corporate responsibility and reflect extensive consultation with countries outside the OECD, as well as business and civil society. They cover the full range of areas relevant to standards of responsible business conduct and so provide to corporations a most valuable international benchmark of society's expectations (see article, p.10).

Further improving the "fit" between corporations and the societies in which they operate is a key goal of the OECD. That means strengthening the governance structures and practices within corporations, and their relationships with shareholders and other stakeholders. Good corporate governance and corporate responsibility are no longer add-ons to markets; they are integral to them. They are the basis on which public-private partnerships can grow. The OECD is determined to lead the way. ■

End of an affair?

An opinion poll in *BusinessWeek* magazine shows half of the US believing that what is good for business is not necessarily good for their country. Hardly surprising, you might think – except that the poll was carried out over two years ago, before the high-tech bubble burst and well before the recent corporate scandals. And the fact that the opinion poll was in one of the US's main pro-business magazines meant that the results simply had to be taken seriously.

They were also quite unexpected. The *BusinessWeek* poll was wide-ranging, with respondents asked to agree or disagree with several given statements. The one that made the headlines was simple: in general, what is good for business is good for most Americans. Some 47% of respondents agreed with that statement, but 49% disagreed. This was much more negative than the previous poll conducted in 1996, when just 28% felt their interests and those of business were not necessarily the same. Another finding to ruffle corporate plumes in the 2000 survey was that 72% of respondents agreed that business had gained too much power over too many aspects of American life.

It was not all bad news for corporate America. Indeed, 68% of respondents agreed that American business should be given most of the credit for the prosperity that prevailed during most of the 1990s. However, one question might make worse reading if the poll was conducted today: when asked how much confidence they had in those running big business, only 19% had a lot of confidence, though as many as 58% had at least some.

Opinion polls have their limits, though the *BusinessWeek* survey at least suggests that, probably because of a backlash against globalisation as demonstrated at Seattle in 1999, the public image of corporate America was looking tarnished well before the scandals that erupted at Andersen, Enron and elsewhere. These scandals appear to have transformed that disillusion into a crisis of confidence.

Is it the end of the affair between America's public and its business world? Probably not, though a more demanding public will mean the relationship may never be quite the same again. There is a coincidental footnote to add to this story: the issue of *BusinessWeek* in which this rather astonishing opinion poll appeared was dated 11 September, 2000.

- "Business Week/Harris Poll: How Business Rates: By the Numbers" in *BusinessWeek*, 11 September, 2000. See the full poll at: http://www.businessweek.com/2000/00_37/b3698004.htm

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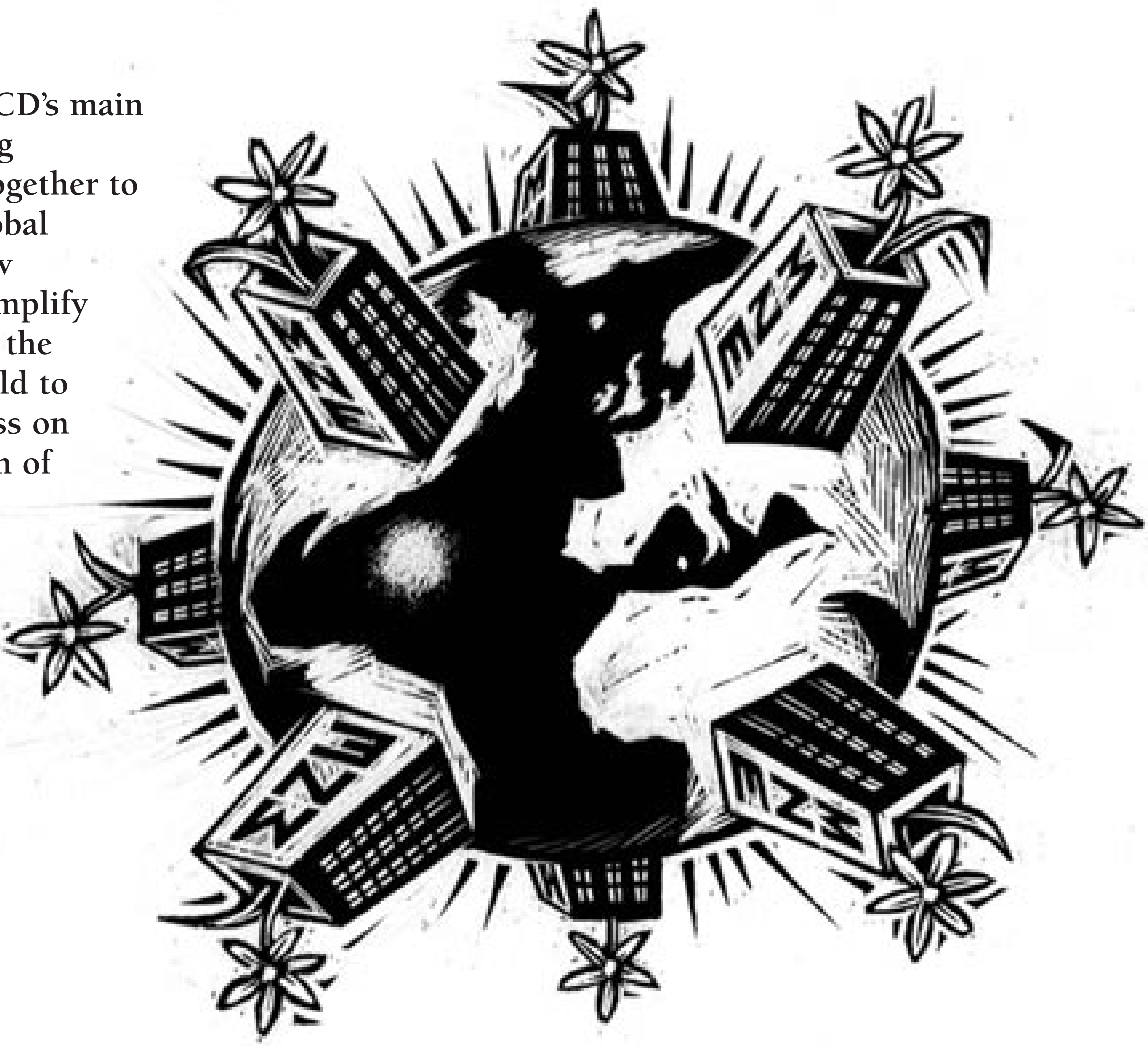
The supply chain: a key link for better governance

One of the OECD's main roles is to bring stakeholders together to discuss key global challenges. Few gatherings exemplify this more than the roundtables held to discuss progress on implementation of the OECD Guidelines for Multinational Enterprises. The most recent one was held over the summer.*



Globalisation has given rise to a kind of economic "culture shock" and international business is one of the principal sufferers. Tens of thousands of companies are trying to conduct business in a global mosaic of legal, regulatory, business and social environments. Operating in all of these environments and responding to their diverse expectations of corporate behaviour is a formidable challenge, in particular as public (and market) pressure becomes more intense. Many companies have taken positive steps by introducing corporate codes, embracing multilateral principles and so on, yet, according to participants at a recent roundtable on the OECD Guidelines for Multinational Enterprises there is much more to do.

Take a recent study of the results of audits of 300 supplier establishments operating in poorer countries that was financed and published by a group of leading French retailers. In the view of Neil Kearney of International Textile, Garment and Leather Workers' Federation "the details make grim reading" – children under 13 hard at work, non-compliance with minimum wage laws, working weeks of "86 hours or more", "inadequate" occupational health and safety conditions, "endemic" abuse of workers' rights, including suppliers using physical force to prevent workers from exercising their right to organise. Other documents highlighted obstacles to organising labour unions and the presence of children in the supply chains of major agrifood companies. These are probably exceptional cases and most good corporations would not tolerate them, but where they exist, all would agree they must be taken seriously.

The OECD roundtable's theme was supply chain management. It showed the advantages and difficulties of multistakeholder cooperation. For while all participants, whether government, business, labour or civil society groups, clearly cared about the problem, they had different views on how best to tackle it. Business generally argues that the key lies in better supply chain management to alleviate poverty and improve respect of human rights, others see tighter regulation and surveillance as the only way to achieve progress. Deborah White of Proctor and Gamble said the business community was committed to finding answers, and while André Driessen from the Confederation of Netherlands Industries and Employers underscored the business sector's willingness to co-operate with unions, NGOs and governments to search for solutions, Stephen Canner of the US Council for International Business noted that governments have to act too as "there are limits to what companies can and cannot do". Others countered that while governments clearly had an important job to do, lack of government responsibility "is not an excuse for lack of corporate responsibility".

Can domestic law help? Yes, but it is not enough. Some countries like China, as Serena Lillywhite from Brotherhood of Saint Laurence, an NGO that inherited a small business, noted, set certain labour standards and rules that matched those of many OECD countries, but their enforcement was lacking. International declarations on labour and human rights, and standards and principles such as those from the OECD help to fill that vacuum, as do corporate codes of conduct and other private standards issued by labour unions and NGOs.

Business representatives stressed their view that corporate responsibility in the supply chain could not extend to "taking on" other companies' problems – in particular, their legal or regulatory responsibilities. Companies exist as discrete units for reasons of economic efficiency and legal accountability, they said. In any case, it is not economically or logistically feasible for all enterprises to monitor and audit all their suppliers.

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This position sparked a reaction. Carol Pier of Human Rights Watch argued that when companies fail to use their influence over their suppliers' regarding respect of labour rights, these companies are complicit in those human rights violations. Ineke Zeldenrust of the Clean Clothes Campaign was pragmatic in stressing responsible supply chain management and the need to "break it down … and look at how it (supply chain management) can be operationalised."

Monitoring the guidelines

Roundtables like this one on MNE supply chains are held annually at the OECD in conjunction with meetings of the National Contact Points (NCPs). These have been set up in 37 countries to monitor the implementation and efficacy of the MNE Guidelines and to promote awareness of them. Promoting the Guidelines is important, since standards and principles, however eloquent or tough to negotiate they may be, are quite powerless unless as many people as possible know about them. The MNE Guidelines are now quite well known by business, unions and civil society in some countries and are featured on many websites. But as reports from the NCPs show, they are hardly known at all in other countries.

Yet, if the MNE Guidelines succeed in winning the confidence of business, trade unions and NGOs, they could become one of the most important global initiatives for global corporate responsibility there is, bolstering such instruments as the UN Global Compact. The OECD, as home to most of the world's multinationals, can and must win that confidence.

The NCPs have already begun to bring material on specific cases for investigation, of which there are now over 20. These involve consideration by adhering governments of issues that go to the core of the debate on globalisation, whether it be behaviour of French companies (there were two) in Burma, a Canadian company's "resettlement" problems in the Zambian copper belt, occupational health and safety and accident indemnities for Indonesian and Philippine sailors working for OECD based maritime transport companies, a Korean-run production site in Guatemala or even a UK retailer's behaviour elsewhere in the OECD.

No one has a monopoly on the answers, but it is only by knowing and understanding the problems face on, and working together to deal with them that corporate responsibility will improve. After all, whether the goal be sustainable development, poverty reduction, equitable rights or just plain decent ethics, better business behaviour is in everyone's interest. ■

The OECD Guidelines for Multinational Enterprises can be consulted at www.oecd.org/daf/investment. Detailed accounts of the proceedings of this roundtable are available on request at daf.contact@oecd.org or at observer@oecd.org.

** Views expressed by participants at the roundtable are not necessarily shared by the OECD or its member governments.*

Knowledge in a world of risk

Forging a global corporate citizen

Young Chul Kang, Managing Director, World Knowledge Forum Secretariat

Can we promote ethical and responsible business practices and make financially successful companies in the process? Yes.

After the accounting debacles of Enron and WorldCom, the credibility of large companies hit rock bottom. In a bid to restore confidence, the US authorities now require chief executives and chief financial officers of large listed companies to swear to the truth of their financial statements. The chief executive officer (CEO) and chief financial officer may be charged with civil and criminal offenses if any of their financial statements are found to be false.

If only the problem were confined to the US, but it is not. The same kind of problem has arisen in Korea, where recent accounting fraud in venture companies listed on the Korea Securities Dealers Automated Quotations index (Kosdaq), the Korean equivalent of the US Nasdaq, caused the index to plunge to a mere 53 on 19 September 2002 from a high of 279 on 15 December 1999. The CEOs of 810 companies listed on the Kosdaq have made voluntary pledges to ensure accurate accounting. Although these pledges are not legally binding, the list of participating companies will be publicly announced and a company's image risks being severely damaged if it fails to uphold its promise.

Such events bring home the fact that as globalisation proceeds at a fast pace, companies in different countries are being scrutinised in relation to the same set of principles and guidelines. To survive, it no longer matters whether a company is an international or a domestic player. It still has to comply with what are internationally accepted as the "right" principles of corporate ethics and governance.

Companies are being made to act as responsible citizens of this global society, and they could be severely sanctioned, not just by the market but by legislators, should they be seen to fall short of their duty of making a good and honest profit for shareholders and keeping clear, accurate and open accounts to prove it.

How can we promote ethical and responsible business practices and thus help make financially successful companies in the process? And how should the concepts of corporate ethics and social responsibility in the 21st century knowledge society differ from those of the industrial era of the 20th century?

In order to implement corporate citizenship globally, it is essential to

A jubilee of human knowledge

The theme of the third World Knowledge Forum (WKF) is "Knowledge in a World of Risk: A Compass towards New Prosperity".
"We like to define the World Knowledge Forum as a 'jubilee of human knowledge'," says the WKF website (www.WKForum.org). "Evolution," it says, "refers to steady, predictable change. Revolution – like a rugby ball in which we cannot predict the direction of the next bounce – is all about disruption, discontinuity, instability, and unpredictable change. Could this be deemed as a threat? Or opportunity?"
The World Knowledge Forum takes place in Seoul, Korea on 15-18 October. This year's speakers include OECD secretary-general, Donald Johnston; World Bank Human Development Network managing director, Mamphela Ramphele; and 2001 Nobel economics laureate, Joseph Stiglitz.
Governance issues figure highly on this year's agenda, in particular at the OECD's plenary session on "Sustainable Globalisation: Politics, Money and Trends". Bill Witherell, director of the OECD Directorate for Financial Fiscal and Enterprise Affairs, and William Davie of Schlumberger, are among the speakers.

- Visit www.WKForum.org

stick to one global standard, especially in the field of management practices. By this, I mean that one should not fool oneself by practising double standards. In Korea, an international globally renowned brokerage firm was recently sanctioned by the authorities for leaking an internal report on Samsung Electronics to its customers prior to publication. This "accident" could have been avoided if the company had adhered to the core operating principles that it abides by in other markets. These brokers may try to defend themselves by arguing that this is a common practice among some Korean analysts, but it is this sort of act that may hinder the development of a global standard of corporate citizenship. It also gives ammunition to the anti-globalisation activists.

Some corporate leaders of multinational companies based in developing countries may argue that they would be unable to compete with domestic firms if they had to follow the strict code of ethics set by their headquarters. Clauses strictly prohibiting kick-backs, bribery or undue profits from abusing insider information make it difficult for their business to survive, they say. However, one can cite several model practices from all over the world that demonstrate the execution of global management standards. Johnson & Johnson is a pharmaceutical company that now runs immensely successful operations in Korea while following to the letter the severe code of ethics imposed by its US headquarters. Johnson & Johnson's management have steered clear of untoward practices and still manage to run a successful business.

To implement corporate citizenship globally, it is essential to stick to one global standard, especially in the field of management practices.

Codes of ethics or corporate citizenship must be observed wherever a firm does business anywhere in the world. Corporate governance is a key element of this equation, and may help us to more quickly reach the goal of global corporate citizenship, where we can be sure that all companies operate to the same standards wherever they are doing business. ■

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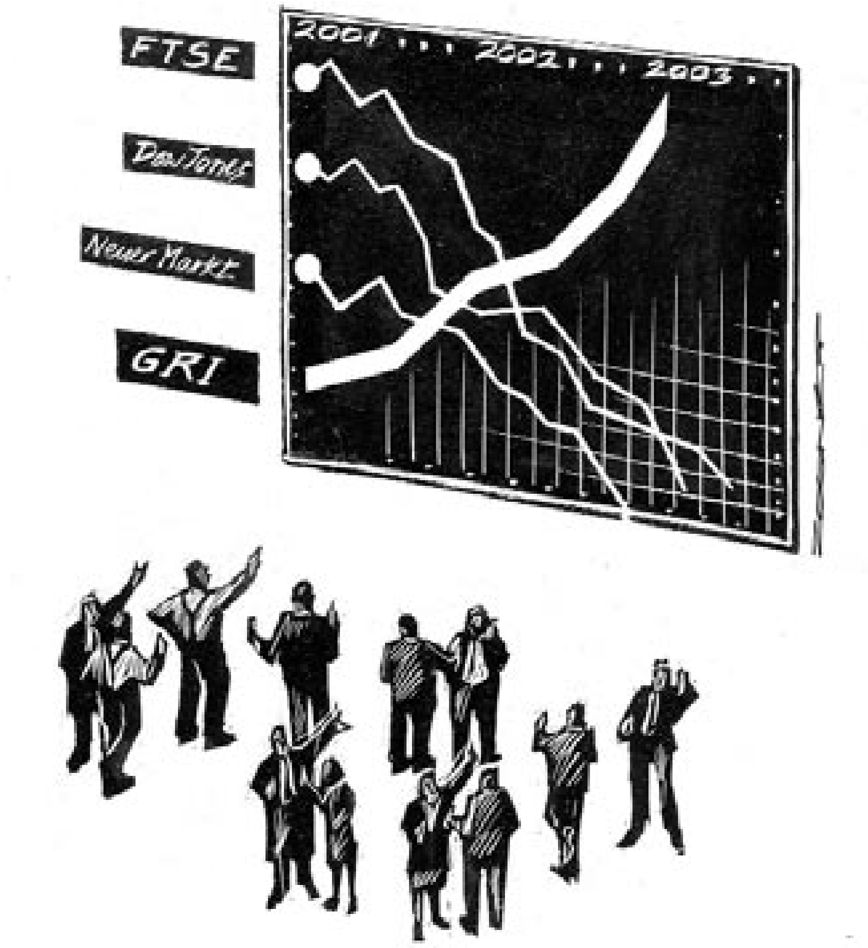
Global corporate citizen

Redefining corporate disclosure

Allen L. White, Acting Chief Executive, Global Reporting Initiative

Improving corporate behaviour is vital to sustainable development. The Global Reporting Initiative can help show the way.



The current crisis in confidence over corporate financial reports raises questions that go well beyond a company's financial sustainability. Business failures provide a vivid reminder of how fundamental corporate activity is to the lives and livelihoods of people and communities worldwide. As shareholders, institutional investors, trade unions and policymakers take stock of the social repercussions of the Enron and WorldCom affairs, and with the UN World Summit on Sustainable Development (WSSD) still fresh in our minds, it is time for governments to address the limits of financial reporting.

By most assessments, there were two main elements underlying the events that have prompted widespread calls for a higher ethic of corporate responsibility. The first was a failure of accounting systems. The second was a breakdown of corporate governance. Business collapses in recent months were in part attributable to poor audits of required information. But, equally important, they resulted from a fundamental reality of financial reporting: even sound numbers that comply fully with required standards do not deliver all that shareholders and others need to know to assess the true health of a corporation.

As they currently stand, financial reports meet certain narrow technical requirements and provide a glimpse of past performance – last quarter's earnings or last year's revenues. But what about the future? Where is the information on the firm's capacity to innovate, train and enrich its human capital, enhance its reputation, strengthen brands, alliances and partnerships? And what about measures of public trust and the quality of governance?

All these intangible assets, if reported at all, appear in non-comparable and inconsistent form. This is the reality, even though the markets clearly signal the growing importance of such intangibles as critical underpinnings of value in the marketplace.

The long-term sustainability of corporations rests on a complex balance of factors. While financial viability is clearly vital, so too are elements such as the ability to adapt in a changing market; to maintain official and public trust; to attract and inspire a workforce; and to retain and expand the support of local communities and the client base.

But financial accounts rarely assess the full environmental impact of a company's activities or products. Nor do they weigh up how its human resources policies may influence the workforce, or how public opinion about its social and human rights record may affect consumer attitudes to its products. This is starting to change, as many corporations seek ways of measuring their so-called "eco-efficiency" performance. They are doing this by using "sustainability reports" as an adjunct to their financial statements.

The concept of "triple bottom line" reporting, such as that offered by the Global Reporting Initiative (GRI) – an assessment of a corporation's performance in relation to profit, people and the planet – is increasingly welcomed by financial analysts and investors because it helps them make better judgements about the true value and prospects of a company across a broader range of assets. Moreover, it enables management to anticipate and exploit opportunities to strengthen the firm's market competitiveness and boost company transparency.

Whether firms like it or not, a company's non-financial performance can directly affect its financial health too. The link between human rights or environment and share value is already well-documented. Four of the world's major stock markets – New York, London, Hong Kong and Johannesburg – have implemented or are proposing changes to disclosure rules that will require information on corporate governance, environmental liabilities, HIV/AIDs programmes, and human capital issues from basic working conditions to policies on child labour. This development signals a growing recognition that non-financial information linked to sustainability performance is an essential ingredient in forecasting and securing a company's financial prospects.

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Fortunately, a variety of tools are now available to make possible an ever-closer alignment between enhanced financial reporting, sustainability reporting and principles of corporate governance. With the release of its 2002 *Sustainable Reporting Guidelines*, the GRI provides a flexible mechanism for such enhanced reporting, offering a detailed methodology for performance disclosure. The GRI guidelines can be seen as complementing other instruments, like the OECD Guidelines on Multinational Enterprises and its principles of corporate governance, which guide good business practice. The GRI guidelines have been developed since 1997 in a consultative process involving thousands of representatives from the business, accountancy, labour and NGO sectors around the world. They provide a ready-to-use, consistent and comparable framework designed to reinforce traditional financial reporting.

What kind of information do new GRI-based reports contain? Companies that use the guidelines will report on a broad array of issues, including corporate governance; financial flows from the company to the community where it operates, including taxes, payments, salaries, etc.; materials and energy use; and carbon emission and biodiversity. The reports will also cover labour practices and human rights; bribery and corruption policies; and product stewardship (how the company handles its responsibility for the whole product life cycle and supply chain).

Knowing, for example, how much greenhouse gas a company is producing is important not only for the environment, but also for shareholders, especially if such emissions are taxed or subject to carbon trading. In the same vein, corporate governance is no longer an arcane issue relevant only to boards of directors. It is fundamental to the very survival of the firm and to the well-being of its workers, suppliers and communities.

The fact that GRI guidelines are now used by more than 150 companies worldwide, including ABB, General Motors, Royal/Dutch Shell, Eskom, Rabobank, South African Breweries, Nissan and Ford, underlines the growing recognition of this reality. As the business case for sustainability reporting is further articulated and understood, the number of companies issuing GRI reports is likely to reach thousands within a few years.

Sustainability cannot be reached without the robust and focused input of a healthy business sector, working in close collaboration with governments and the rest of civil society. At the Bali preparatory meeting for the WSSD in June 2002, ministers specifically agreed, in the draft Plan of Implementation for the summit, on the need to enhance corporate environmental and social responsibility and accountability, "taking into account such initiatives as ...the Global Reporting Initiative guidelines on sustainability reporting...".

As was evident in Johannesburg, there is a near-global consensus that companies should go beyond financial philanthropy and apply their expertise and technology to solve social problems.

Judging from media reports and public opinion polls, the level of public trust in corporations is at an all-time low. The disruption and loss to workers, investors and communities associated with the recent corporate failures have taken a severe toll on economies and societies. Not only is there a clear sense that corporations have a responsibility to provide a full and more accurate account of their financial situation, but also that they must make more earnest efforts towards sustainability if they are to win back public support. This is clear from widespread calls by major NGOs for an international, legally binding mechanism to hold transnational corporations accountable for their behaviour.

Governments must make every effort to assist businesses to meet these challenges. The GRI Sustainable Reporting Guidelines can play a vital role. ■

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Better governance for sustainable business*

Philip Watts, chairman of the committee of managing directors, Royal Dutch/Shell group and chairman of the World Business Council for Sustainable Development

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Cleaner image

Sustainable development is not against business interests. In fact, business can profit from it.

Ten years ago at the Rio Summit, 50 business leaders pledged a commitment to sustainable development. That was the start of the World Business Council for Sustainable Development (WBCSD). Since then, we have trebled in size and hugely amplified the voice of business in widespread dialogue.

Business is good for sustainable development, and sustainable development is good for business. It should be at the heart of business thinking and government policymaking.

What does that mean? Well, it means tough choices and new thinking. For instance, you choose to work by a set of declared principles and to stick to them whatever the circumstances.

You say "no bribery of any kind". You make sure it's clear to everyone that you mean it and if anyone goes against it you ask them to leave. If you can't win business without bribes you go without. If necessary you leave the country or you get out of joint ventures – even if there are short-term financial hits.

You set environmental standards and keep to them. If you have an important project that is likely to fail those standards, you tell your people "no go" unless they find ways to get the environmental element in line. You'll be amazed at the innovation a challenge like that can unleash. If they can't do it, you leave it.

You put people and communities in the frame. If you are working in a developing country and your staff take it for granted they will use the usual international contractors, tell them to think again. Make it the norm to find local firms, build local capacities.

I can hear you thinking "that's the best way to lose business, to lose out to competition, that I've heard in a long time." Not so, in the long run. Once people know you won't bribe, once you make eco-efficiency standard practice, once you have developed local, more cost-effective, contractors, your competitive edge will be enhanced.

We need partnerships for progress between business, governments and civil society, and we need them urgently.

Care for the environment and social justice should be an integral part of the economic development that funds progress. Demonstrating this in action helps us meet societies' expectations, and that is an increasingly important part of our commercial challenge. Being seen to share societies' concerns attracts and motivates people to join and stay with a company. Equally, it boosts that company's reputation with a range of interested parties who will often be opinion leaders.

In my view there is no doubt that economic, social and environmental improvement is best nurtured in open, competitive international markets where governments set stable and pragmatic frameworks for business investment. However, the benefits of markets must be extended further towards the world's poor.

Briefly, one of the keys to sustainable progress in developing countries is foreign direct investment (FDI). But only about 5% of FDI goes to the 40 least developed countries. If that investment is to increase, especially in Africa, there must be an emphasis on establishing good governance, stable regulatory systems, pragmatic economic policies and accountability mechanisms.

But investment alone is not the answer. Linked to it is the challenge of developing Africa's human and natural resources to the African peoples' advantage with minimum adverse impact. We need partnerships for progress between business, governments and civil society here, and we need them urgently. For me, it's just as urgent for business to take on board the essentials for pursuing sustainable development. Let me highlight a few of them.

We have to learn to change. We need to stimulate innovation that allows us to create wealth in ways that reflect changing concerns and deep-seated values. We should be taking on eco-efficiency as a management strategy – seeing how we can create more value with less impact in terms of energy and material. And we should be informing consumers about the environmental and social effects of the choices we offer them.

We have to demonstrate action to remain credible. That's why the WBCSD is developing initiatives on sustainable mobility and sustainable livelihoods. And why we are partners in a project to make this summit "climate-neutral".

Sustainable development isn't an easy option. We need to support each other, to share problems, experiences and ideas. That's the aim of two recent publications.

The first sets out the WBCSD's blueprint for action. It's called "Walking the Talk" and it illustrates the argument with 64 case studies. Ten years after Rio we know we are on a tough journey of continuous learning. WBCSD members see action to build a sustainable future as part of their commercial responsibilities. But we can pursue that most effectively in partnership with governments, political leaders, NGOs and international bodies.

If you can't win business without bribes you go without. If necessary you leave the country or you get out of joint ventures – even if there are short-term financial hits.

The second comes from Shell and it's a collection of sustainable development case studies from around the world – from working for biodiversity in Gabon to pioneering cleaner fuel in Thailand, from community development in Nigeria to reducing gas flaring in operations there. It is called "There is no Alternative".

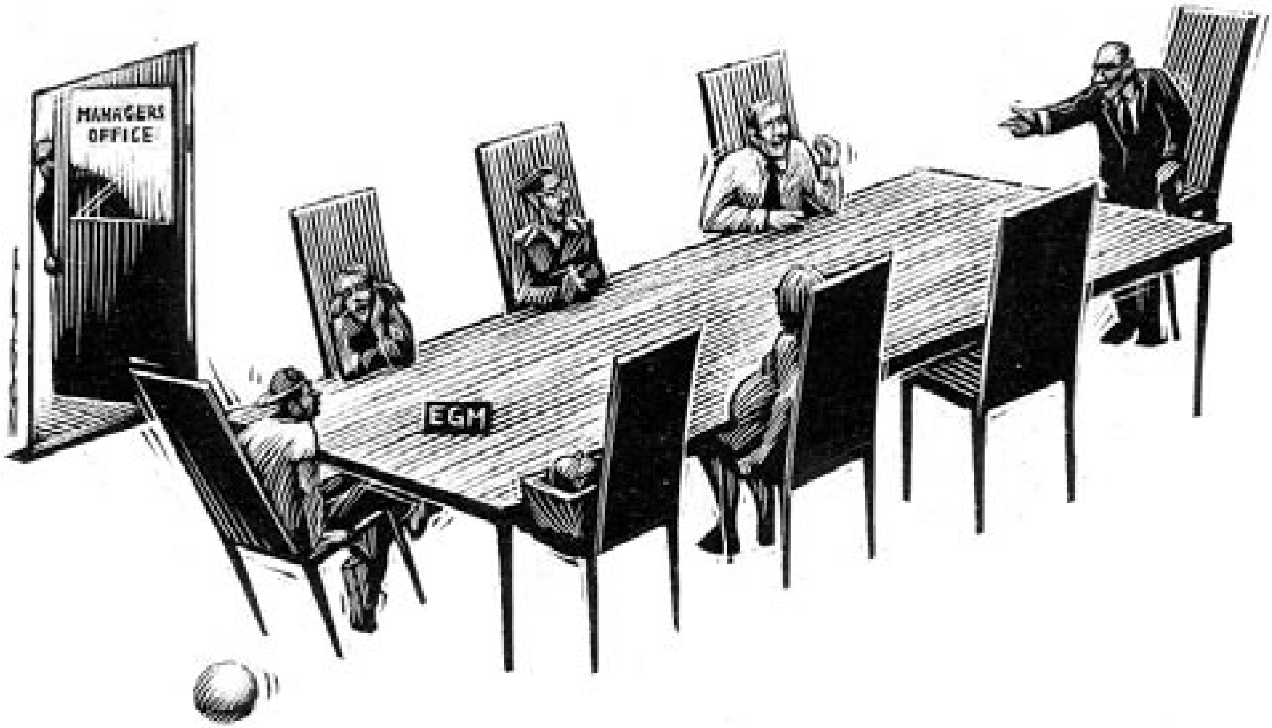
We need more initiatives like the partnership in China with the United Nations Development Programme (UNDP) on the West-East gas project. This project will be built by a joint venture with Chinese and international involvement.

The UNDP has carried out a survey to better understand the likely social impacts on people who live along the route of the pipeline. It will be part of the decision-making process. That kind of independent consultation gives invaluable input and helps avoid future, often costly, problems. ■

** This is an extract from a speech given during the Business Day at the World Summit on Sustainable Development in Johannesburg, 1 September 2002. Mr Watts has also participated in the OECD Round Table on Sustainable Development. More by Mr Watts can be found at www.shell.com*

When corporate governance is a family affair

Robert Zafft, OECD Directorate for Financial, Fiscal and Enterprise Affairs



Family-run firms tend to believe that principles of good corporate governance do not really concern them. This is a mistaken view. The question is how to convince them.

Corporate governance has become an industry – and a growth one at that. Conferences spring up like mushrooms after rain. Technical assistance money gets spread around like so much fertiliser, and acres of rain forest end up as expert papers on "new and improved" corporate-governance frameworks. Policymakers and investor groups seem to love it. But do the real decision-makers – business owners and managers – actually need or want corporate governance, and, if not, why should we expect them to buy into it?

Most corporate governance experts concentrate their attention on divergent incentives of managers and shareholders. Disclosure rules are intended to stop managers from inflating company performance. Boards of directors are established to guide managers' business strategy, to monitor their reporting systems and to ensure that managers do not overpay or entrench themselves at shareholder expense. In general, the corporate-governance world pictures owners and managers as sitting on opposite sides of the table.

But what happens when the owner is the manager? This situation is more widespread – and more relevant to large companies – than many might think. Family-run businesses account for more than 85% of all firms in OECD countries. Such businesses make up 30-40% of the 500 largest companies in the United States. The 30 OECD member countries contain at least 244 family-run firms with annual revenues of more than US$1 billion, not counting giants like Microsoft or Berkshire Hathaway that are still managed by their founding generation. OECD family-run businesses with annual revenues of several million dollars probably number in the tens of thousands.

In a family-run firm, a single person or group enjoys a controlling interest and can appoint family members as managers, or can unilaterally appoint, monitor, compensate and fire third-party managers. This situation may threaten minority shareholders with exploitation, but offers the controlling family the best of both worlds: it can run the business as it sees fit and gamble, at least partly, with other people's money. As a consequence, if the purpose of corporate governance is to constrain managers and control shareholders, one may well ask whether a family-run firm would ever really want it.

The answer to this question is "yes", but not necessarily for the reason most commonly given: better access to capital. One often hears the argument that, when investors refuse to put their money in companies with bad governance, the cost of capital for such companies goes up, making them uncompetitive. Eventually, so the argument goes, the owners/managers of such companies must either mend their ways or go out of business.

While the founder of a family-run firm might believe that raising money or diversifying wealth will never pose a problem, one thing he does know for sure is that some day he will die.

But firms can obtain external financing in a number of ways besides issuing shares to the public, such as reinvesting profits, borrowing money or selling shares through private placements.

In such cases, providers of non-public sources of capital (banks, pension funds, insurance companies, venture capitalists, private-equity investors, etc.) expect to look out for themselves. They will want to secure their loans with company assets, to be able to accelerate repayment of loans if the company's performance falters, and to review books and records directly. They will seek direct assurances from the company's auditor and officers, or personal guarantees from the company's owners. They will demand the right to approve major transactions or money transfers. For these capital providers, typical corporate-governance practices, such as board review of transactions between management and the company, board committees, non-executive directors, or separate CEO/board chairmen, hold little interest.

Data on family-run firms raise additional questions about the access-to-capital argument. Of those 244 OECD family-run firms with revenues of US$1 billion or more ("large firms"), only half are publicly traded. At the same time, the average ages of publicly traded and privately held large firms are about the same, suggesting that large private firms have been able to access sufficient capital without inevitably "evolving" into publicly traded firms.

This observation is bolstered by European data showing that the average company operates for 40 years before going public, and that when such a company does go public, nearly 60% of the money raised from its initial public offerings goes into the pockets of family shareholders rather than into the business. In many cases, therefore, wealth diversification or liquidity may be a greater issue for family-run businesses than financing operations.

Studies indicate that the stronger a country's corporate governance, the more robust its capital markets and the higher its level of external financing as a percentage of GNP. However, while these findings may persuade policymakers, at the level of the individual family firm the slogan "embrace corporate governance in order to access capital" can remain a tough sell.

Fortunately for the corporate-governance industry, a compelling case for corporate governance can still be made, and it involves the greatest challenge family-run businesses face: management succession. Succession issues resonate strongly with business owners. While the founder of a family-run firm might believe that raising money or diversifying wealth will never pose a problem, one thing he does know for sure is that some day he will die.

Will his children be interested in running the business? Will they be capable? Will they get up as early, stay as late, and work as hard as the founder did?

Keeping a business going across generations is hard. In fact, North American and UK studies indicate that only about one in six family-run firms survives to the third generation. Failure to maintain the family business can stem from any number of causes. Divisions form between those relatives enjoying both salaries and dividends and those receiving only dividends. Jealousies emerge as some family employees rise higher than others or work less hard for the same pay. Supervisors find themselves incapable of firing an under-performing subordinate who is a child or a sibling or a cousin.

As the business grows and markets evolve, finding sufficient managerial talent and experience within the family becomes harder. Where the family decides at last to hire an outside manager, failure to motivate and monitor him can damage or destroy the business.

Corporate governance goes to the heart of these problems, though many family-run firms have never thought of it in these terms. Families need corporate governance both to operate the business and to promote family harmony. This means putting in place decision-making and monitoring procedures that are open and fair, as well as possibly hiring non-family members as advisors, managers and directors.

It is not an overnight exercise, and often, by the time the need for corporate governance has been recognised, family relationships or the business's prospects have deteriorated beyond repair.

Family-run businesses can represent the work – and the wealth – of several generations. If business owners want to preserve, enlarge and pass on this legacy, they need to make corporate governance a family affair.

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Globalising workers' rights

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More could be done to strengthen the OECD Guidelines for Multinational Enterprises to ensure global workers' rights receive the attention they deserve in policy and business decision-making.

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Globalisation has drawn serious attention to the importance of core workers' rights on a global basis. There is a strange paradox in the treatment of labour when it comes to mainstream debates about globalisation. Surveys on foreign investors' intentions suggest that in most sectors market access, good governance, skills and education levels are more important in attracting investment than low wages or submissive workers. Yet rather than improving living and working conditions, globalisation appears to pressure governments into reducing workers' rights to minimise labour costs and attract foreign investment.

Take export-processing zones (EPZs) where semi-manufactured or raw materials are processed into goods for export by foreign companies, outside the normal laws and regulations of the host country. They may operate very differently in different parts of the world, but they tend to have one overriding characteristic in common: trade unions are tolerated in few, if any, of them. This is disturbing. An update in 2000 to an OECD report on trade and labour standards noted that the number of EPZs worldwide had risen from some 500 in 1996 to about 850, not counting China's special economic zones. EPZs have become commonplace in many parts of Asia and Central America and are now spreading to Africa as a development model.

Multinational companies may also simply decide to switch country, or at least threaten to do so, when faced with labour dissatisfaction or the prospect of a cheaper labour market, and this in good as well as in hard times. A study by Cornell University in 2000 found that, despite the longest boom in US history, workers were feeling more insecure than ever before. More than half the firms surveyed, when faced with union action, had threatened to close the plant and move to another country. In some sectors, the figure rose to 68%. The fact that only 5% of firms actually moved away does not lessen the perceived risk of the threat, increasing the imbalance of relative power of unions and employers in the labour market.

The trade union response to globalisation must be to ensure that, in terms of labour conditions, we start a "race to the top" and stop the "race to the bottom" between multinational companies. At the level of TUAC, we are giving priority to maintain and encourage enforcement of the OECD Guidelines for Multinational Enterprises, revised by governments in consultation with labour unions, businesses and NGOs in 2000. The guidelines are recommendations for good corporate behaviour, primarily addressed to corporations based in countries that adhere to them but applying to their operations worldwide, that cover 85% of total foreign direct investment.

The MNE guidelines may not be binding in a legal sense at the international level but they are not optional either. If companies could simply pick and choose among the provisions of the guidelines or subject them to their own interpretations, then the guidelines would have no value. Nor does their application depend on endorsement by companies. The OECD's MNE guidelines are the only multilaterally endorsed and comprehensive rules that governments have negotiated, in which they commit themselves to help solve problems arising with corporations. Most importantly, the ultimate responsibility for enforcement lies with governments. This makes the guidelines more than just a public relations exercise.

To judge by experience of the past two years since the MNE guidelines were revised, we have made some tentative assessment of how they are functioning in practice and what can be done to improve their implementation. One problem is that probably still less than half of the signatories of the OECD guidelines have really functioning National Contact Points (NCPs), which are meant to vet the implementation of the guidelines. Though an improvement on the situation before 2000, we have still not arrived at a critical mass of governments who take their responsibilities seriously.

A study by Cornell University in 2000 found that, despite the longest boom in US history, workers were feeling more insecure than ever before. More than half the firms surveyed, when faced with union action, had threatened to close the plant and move to another country.

Another problem is that the guidelines still need to be better known compared with other instruments, like the UN Global Compact. Within TUAC we have organised a project to raise awareness among trade unions, including a users' guide for trade unionists which is now available in several languages. With our partners, we are running workshops and seminars on the guidelines, particularly in non-OECD countries. But we feel governments could do much more. Also, although cases are now appearing before NCPs, they are often being dealt with very slowly. Of the 20 cases which have been raised over the past year by trade unions, as of June 2002 only five have been resolved or have led to recommendations being issued.

One might ask whether the OECD could not devote more resources to the implementation of the MNE guidelines. If the OECD does not take them more seriously, who will?

There are other instruments in an evolving "toolbox" that the global union movement can use to counteract the social downside of globalisation. They include work by the Global Unions Federations to develop collective bargaining relationships with companies at an international level. Some 20 global framework agreements have been concluded – most in the past two years – between the federations and companies in sectors such as mining, chemicals, food, forestry, services and automobiles.

TUAC is also part of a joint Global Unions committee reviewing the social performance of enterprises in which workers' pension and saving funds are invested, and it is beginning to train union trustees.

We have also been working closely with the European Trade Union Confederation and the European Parliament to ensure that, at the European level, initiatives can be taken to achieve better enforcement of the MNE guidelines and linkages developed with European Works Councils.

There are also non-government activities in which unions are participating, such as the Global Reporting Initiative's (GRI) work to establish common international standards for corporate reporting on social and environmental sustainability (see article p.14), or certification schemes such as SA 8000.

The International Labour Organization itself is having to define its own role in the area of corporate social accountability – one task for the newly established ILO World Commission on the Social Dimension of Globalisation.

For labour perhaps the greatest danger is not globalisation itself; it is rather to argue policy paralysis as a result of it. Some of the tools to prevent this paralysis are there – it is up to the union movement to make sure it uses them effectively, but governments cannot absolve themselves from their own ultimate responsibility for managing markets globally. ■

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Japan: in search of a winning formula

Risaburo Nezu, Senior Executive Officer at Fujitsu Research Institute and board member of the Research Institute of Economy, Trade and Industry, a research organ of the Japanese Ministry of Economy, Trade and Industry*

Teamwork, goals, out-of-bounds: sport is often held up as a model for business. Now, the success of a French sports personality in Japan may hold lessons for the country's corporate players.

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No longer the odd couple

A few months after the FIFA soccer World Cup, the fever with which the Japanese people watched their players in blue heroically reach the latter stages of the competition has not much dissipated in Tokyo. But the interest is moving quietly from that of a sports event to the personality of a foreigner who engineered the team's unexpected success and how he did it. He is Philippe Troussier, a 47-year-old Frenchman who coached the Japanese team for four years until stepping down just after the World Cup. His place has been taken by another non-Japanese manager, the Brazilian Zico. Mr Troussier has set a high standard.

In fact, his is the second French success story to take Japan by storm after Carlos Ghosn, the CEO of Nissan, who was sent by Renault to rescue the financially troubled second largest automotive company in Japan and now enjoys widespread respect in Japanese circles (see references).

Mr Troussier was invited to Japan four years ago when the country, together with Korea, volunteered to host the World Cup 2002. Doing well in football became a matter of national pride for both co-hosts. Humiliating defeat at an early stage of the competition had to be avoided. This was an ambitious goal for Japan, since it had never won a single game in the history of the World Cup! By 9 July, when the Japanese football team made it through to the final stages, Mr Troussier had become a national hero. Eventual defeat by Turkey would not change that. The emperor and prime minister each sent a message to express their personal thanks.

Mr Troussier's rise is full of lessons for Japanese managers working in large companies. When the Frenchman was chosen, there was considerable doubt and suspicion as to whether a foreigner should be allowed to coach a Japanese team at all. Moreover, Mr Troussier was largely unknown in Japan – nor was he a household name in France – and despite some success in Africa, his track record had not been that outstanding. Hardly a first choice candidate for a nation bent on avoiding embarrassing defeat. To cap it all, this Parisian had to speak through an interpreter.

How irrelevant all of this proved to be. Mr Troussier's first pleasant discovery was that he would work with several good young players with international potential. But because of the heavy culture of seniority and other background issues, they had not been given the chance to demonstrate their talents. He promptly replaced old players with these young people, making Japan's perhaps the youngest team in the competition. (Ironically, his own country France's dismal failure at the World Cup has been put down by many to a failure to do just that: renew an ageing team.)

Mr Troussier urged his players to think for themselves and act independently, rather than waiting for his instructions. A spirit of independence and mental toughness were the qualities he wanted to inject into the minds of the Japanese players.

Out of frustration, the Frenchman occasionally criticised Japanese attitudes, sometimes in rather acerbic fashion. "Those who wait until the traffic signal turns green are of no use on the pitch. You must go when there is no car coming," he once said. In many respects, this ran counter to the culture that had dominated the Japanese sports community, where collective achievement is given priority over individual success. He introduced a sense of competition among the teammates and caused a public uproar when he did not include some popular names in the final team sheet. In short, his management style and handling of problems were anything but Japanese. He was stubborn and from time to time caused tensions in the camp to rise. His abrasive style nearly cost him his job early on, but success followed success, with a runners-up spot for his youth team at the FIFA World Youth Championship Nigeria 1999, a quarter-finals place at the 2000 Sydney Olympics and victory in the Asia Cup the same year. How right he was to stick to his guns; in Japan, a polite and conciliatory coach would probably not have achieved as much.

If only Japan's companies could follow Mr Troussier's example. In the 1980s, Japanese firms dominated key global industries such as electronics and automobiles. Today, although information technology is still a strength, the world corporate directory is dominated by American and European names, like Nokia, Motorola, Microsoft and Dell. Korean electronics companies, like Samsung, are competing head-on with Japanese ones. (Incidentally, Korea also enjoyed World Cup success under a foreign coach, Dutchman Guus Hiddink.) And three of the five main Japanese automotive companies are foreign-owned. Japanese industry has without doubt lost ground.

But as the case of Mr Troussier shows, a leader from abroad can have a better chance of succeeding in driving industry forward where local managers fail. Insiders tend to shy away from a bloody reform. They are either too close to the people or too used to established working practices. Japanese CEOs have long been chosen from the inside. Continuity is too often seen as important, the fear being that a major break with the past would only result in confusion and a loss of loyalty and morale.

Another lesson from the experience with Mr Troussier, who never played for France and who has a Master's degree in sports science, is that playing and coaching call for very different talents. Selecting managers based on in-company record is a fundamentally flawed approach. Yet, this is what most Japanese companies still do.

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Mr Troussier made clear what he wanted from his team. He asked the same of his players, urging them to come forward and speak clearly. This is in sharp contrast with Japanese management practice where silence and evasiveness rule.

An international perspective was another quality that Mr Troussier brought to the job. European players are used to playing abroad, including in Japan's J-league, with teams like Grampus and FC Tokyo. But apart from Ichiro, a Japanese baseball player plying his trade in the US, Japanese sports people rarely play abroad. Under the Frenchman, several stars joined leading European clubs. Though the Japanese Football Association feared losing their top strikers, Mr Troussier was uncompromising.

The CEOs of leading global companies like Canon and Sony spent their early years in foreign subsidiaries. Ironically, such overseas posts were not mainstream career paths. Yet they created the bosses that now lead these successful companies.

This is what openness is all about. As well as trade liberalisation, foreign investment and international capital transactions, openness should apply to recruitment of managers and skills. In general, the Japanese are very cautious about immigration. They fear it would result in more crime and higher unemployment among locals. However, the success of Mr Troussier is leading people to think that foreigners can do some good after all.

Is it just a coincidence that Mr Troussier and Mr Ghosn are both French? Japan and France knew very little about each other. In fact, they were often at odds with each other, as well as with everyone else. The French viewed the Japanese as economic obsessives. One French leader famously likened them to ants scurrying around and invading with their industries. In turn, the French were hardly seen as an open, corporate lot, but rather as arrogant, with their own suspicion of foreigners and seeming respect for hierarchy probably making them quite like the Japanese. And while the Japanese were fond of French wines and fashion, they had never viewed France as a model business nation. Now the two nations enjoy each other's company immensely. For while Messrs Ghosn and Troussier have been opening Japanese corporate minds, Paris has become home to Japan's first major overseas cultural institute.

A good number of the Japanese players who excited the Japanese people in June 2002 left for Europe this summer. They will form the core of the World Cup team in 2006. The number of students leaving Japan to study abroad is also on the rise. Foreign companies in Tokyo are pleased with their increasing popularity among top-notch students who 10 years ago would never have thought of applying to them for jobs. A gradual but steady change is occurring in the business community of Japan. The World Cup 2002 probably helped accelerate this change. At long last, the Japanese have begun to appreciate the real benefits of openness. ■

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