Sustainability Meets Integrity

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"Business Sustainability" has become an important addition to board/management discussions in recent years. While the term "sustainability" has long had environmental implications, sustainability has become an umbrella for many topics, including agriculture, food, deforestation, energy resources, various human rights issues, carbon and other emissions comprising a global concern for meeting society's current interests and needs in a manner which does not compromise the interests and needs of future generations and is protective of the planet. "Business sustainability" focuses on a company's ability to conduct its activities and build shareholder value over the long-term, balancing the need for short-term results while adapting business strategies and operations to assure long-term value creation consistent with sustainable business practices. Inherent in meeting these challenges, companies are required by law to maintain a culture that embraces ethical values and legal compliance.

Issues with corporate conduct have been with us since corporations became a recognized means of amassing capital for a business activities while at the same time limiting the risk of those who provided the capital and conducted the business activities. However, in the late 1900's and early 2000's, from Enron to the present day, the challenges of business misconduct, and failures of business integrity, have attracted the media, the courts, regulators and lawmakers. *Sarbanes Oxley* was passed in the wake of Enron and the many corporate failures which occurring at that time. *Dodd Frank* was passed following the financial crisis precipitated by widespread misconduct in the financial services industry. Currently, as we experience the misconduct of Volkswagen and Wells Fargo, it is clear that the promotion of corporate integrity defies legislative and regulatory solutions. What's needed is a redoubling of board and management initiatives to focus on achieving a high standard of corporate integrity on which a company's shareholders and many other stakeholders can safely rely.

Integrity is the foundation on which sustainable businesses must be built. Without integrity as the fundamental principle, there can be no sustainable business, there will be no culture of ethics and legal compliance. What shareholders and other stakeholders most need from boards of directors, as the governing bodies of the companies serve, is the assurance of their companies' integrity. Specifically:

- That the company has a clear business mission and values formed on balancing short-term performance with long-term enterprise sustainability, adaptability, viability and performance.
- That the company's business model is sustainable and that the long and short term risks and opportunities which accompany that model have been carefully vetted by the board, and that its strategic plans, operating plans and business conduct embrace the governance, ethics, environmental, energy and social practices essential to long and short term value creation and performance.

- That the company's financial and nonfinancial reporting has integrity, and can be clearly understood and relied on by those responsible for assessing, financing, working for and doing business with the company.

- That the company's public disclosures and the comments of senior management and the board have integrity and are reflective of the true state of the company's values, business activities and financial and nonfinancial results.

- That company's CEO , selected, compensated and regularly evaluated by the board, and the senior management team engaged by that CEO, would above all of their responsibilities, see that the company's affairs are conducted in a manner which serves rather than detracts from, the company's integrity and reputation.

- That the compensation and perks awarded to board members and senior management, which directors alone approve, will not in actuality or perception, corrupt their judgment, compromise their independence, corrupt the company's culture or otherwise detract from the company's integrity and reputation..

- That the company's compensation and incentive plans for non-management employees and those doing business with the company will promote rather than corrupt ethical conduct on the part of all employees, suppliers and customers.

- That directors and management will avoid actual or perceived conflicts of interest which would detract from the integrity of the company and its governance.

- That management has in place compliance systems and procedures that will provide warnings of activities that would threaten the integrity and sustainability of the company, proactively overseen by the board, and when warnings come that management and the board will investigate the issues fully, independently and without compromising restrictions, use the results to transparently address issues and needed corrections.

The bottom line of a sustainable governance system and sustainable business conduct, is that the company's ultimate authority, i.e. its board of directors, is proactive and vigorous in taking responsibility for the company's integrity. From Enron to Volkswagen and now Wells Fargo, many of the corporate scandals occurred because boards failed to take responsibility for the company's integrity, long-term value creation and ultimate sustainability. The directors apparently did not see the company's integrity as an extension of their own, and ultimately this is a critical point.

Given that boards are responsible for overseeing and assuring the development and maintenance of a culture of integrity, ethics and legal compliance they must be proactive in the use of the tools at their disposal for this challenging task. Key among these tools are:

- Recommending the election of capable directors, persons known for their integrity, ethics, commitment to legal compliance, and understand that these are critical elements of a sustainable company; persons who understand what it means to be a fiduciary and their fiduciary duties; persons who are knowledgeable about governance and oversight and possess the skills, time, energy, judgment, leadership and courage to effectively discharge their responsibilities. Everything starts with Board composition.

- Periodically refreshing the board with directors having a variety of skillsets, including an awareness of contemporary subjects applicable to the company, its shareholders and other stakeholders such as cyber risk, social media usage and business sustainability and social responsibility.

- Selection of independent board leadership with the knowledge and skills to assist the board in meeting its responsibilities.

- Selection, compensation and evaluation of a CEO known to be ethical, and screened for past integrity, legal and ethical issues, who is experienced and committed to building and maintaining a corporate culture of integrity, ethics, and legal compliance, and has demonstrated an ability to balance short and long term value creation and performance.

- Periodic independent assessment of the company's culture, ethics, values, compliance with laws and regulations, and effectiveness of training programs designed to instill appropriate corporate values, familiarize employees with the company's expectations as to ethics, compliance and integrity, as well as systems designed to test the effectiveness of those training programs.

- Recognizing that in every company there is an enterprise wide culture and many subcultures, including the boardroom culture, the board/management culture, and cultures within subsidiaries, divisions and workgroups. It is important to harmonize these cultures with the overall enterprise culture and values and to assess the degree to which that has occurred.

- Periodic one-on-one interaction with key senior executives and mid-level managers, internal and external auditors, compliance personnel (particularly those responsible for company hotlines and complaint gathering systems), key group and division leaders, internal and external legal counsel and the executive in charge of human resources, to gain insight into the company's culture, and the elements of integrity, ethics and legal compliance.

- Assurance that management has in place processes and procedures for preventing and detecting integrity lapses, ethical issues and violations of laws, regulations, company governing documents, including codes of conduct and other company policies, and for assessing risk and risk mitigation followed up with oversight over, and periodic assessment of, the efficacy of those processes and procedures.

- Oversight over the evaluation, hiring, firing and compensation of employees who are key to assessing, shaping and managing the corporation's financial reporting, legal resources, human resources, risk assessment, ethical and legal compliance environment (e.g., the CFO, controller, internal auditor, risk manager, investment relations officer, internal counsel, heads of human resources and information technology/security, and person in charge of sustainability matters. Periodic one-on-one interviews with these individuals are an essential board/committee assessment and oversight tool.

- Engagement by the board of independent auditors and compensation consultants, as well as oversight over management's engagement of outside legal counsel and other key advisors to assure that the loyalty of these advisors is to the company, the board and not primarily to the personnel of the company who engaged them, and confirming that they recognize their responsibilities to the board and its committees and their roles in enhancing the effectiveness of the board and its committees.

- Periodic engagement of independent third parties to advise the board and its committees on matters with respect to which the board requires a "second opinion" or advice from a source which is not regularly engaged to serve the company under management's direction.

- Use of tools such as business intelligence and balanced scorecarding to assist with monitoring the company's operations.

- Use of corporate and outside investigatory and research resources to scan the backgrounds of key people and companies which the company is engaging directly or as outside vendors.

- Engagement with management in vigorous, candid dialogue regarding strategy, opportunities, operations, sustainability issues and risks and rewards associated with the same, and seeking dialogue with various management personnel regarding concerns about corporate direction.

- Constantly seeking to understand risks, paying attention to warnings and confronting problems promptly and forthrightly. Policies and procedures for assessing and monitoring risks are essential and directors must assure that they are in place and functioning well. Warnings need to be heeded and promptly investigated. Investigation means a thorough effort to obtain all relevant information using independent resources where necessary to assure objectivity. History, including Volkswagen and Wells Fargo, provides ample lessons of the disastrous consequences of cover-ups and understanding financial and nonfinancial impact once a problem is discovered.

- Monitoring the company's public disclosures and management comments for integrity and reputational impact, as well as credible third party commentary regarding the company, its goods and services, the performance of and conduct of its key people, and its reputation for business conduct and integrity.

- That the public disclosures by the company, and comments of senior management and the Board regarding material company affairs have integrity.

Key to markets for talent, goods and services, investment, financings, corporate transactions, and ultimately the sustainability and long-term value creation of companies, is the integrity of the company, the goods and services it produces, and the information it provides, and the people it employs. Serious lapses in corporate integrity have resulted in substantial, sometimes tragic, financial and nonfinancial consequences for employees, vendors, customers, financing parties, shareholders and other stakeholders. Boards must redouble their efforts to assure the integrity of the companies they govern. Ultimately, the sustainability of our free enterprise system depends on it.

John Stout is the Immediate Past Chair of the Business Law Section's Corporate Governance Committee. He currently serves as Vice Chair of the Section's Corporate Social Responsibility Committee and is a member of the Section's Governing Council. Stout is an Officer and Shareholder of the Midwest regional firm of Fredrikson & Byron where he Co-Chairs the Corporate Governance Group with Elizabeth Dunshee, and Chairs the Business Sustainability and Social Responsibility Group. Stout is an Adjunct Professor at the University of St. Thomas Law School, teaching Corporate Governance, and periodically serves as an expert witness on governance matters.

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