

Remarks by Alan Willis

Corporation 20/20 Lunch Seminar, October 13, 2010

Tellus Institute, Boston

“What is an accountable corporation in the 21st century”

Good day to you all. And thank you to Allen White for inviting me to offer a few comments on the question “What is an accountable corporation in the 21st. century?” These days there’s ample evidence of a shift in thinking about the purpose of the corporation, what it is accountable for and to whom. Corporation 20/20 is a leader in promoting this shift and exploring its possibilities. And there is an abundance of literature to stimulate our thinking about what a corporation should look like and how it should behave in the world of the 21st. century – some such works might be called evolutionary, others revolutionary. Indeed, we are lucky enough to have with us here today Jim Post, himself a renowned author and thought leader in this field.

I myself first ventured into writing about corporate governance and accountability back in 1994 , shortly after presenting a paper on new performance measures in New York at a Conference Board conference on corporate governance. In short, I asserted that boards need an appropriately broad range of performance measures in order to evaluate progress in meeting the expectations of investors and other stakeholders to which the corporation and its directors are accountable. I went on to propose the development of an expanded version of the famous Kaplan & Norton Balanced Scorecard to achieve this.

In the next few minutes I’m going to offer some personal thoughts on:

- The fundamental nature of accountability
- Accountability, transparency and the future of corporate reporting
- Future progress towards 21st.century corporate accountability

Before talking about accountability and transparency, however, I am going to comment briefly on what Corporation 20/20’s Principle 5 refers to as participatory governance and look at trends in legal recognition of stakeholder interests in corporate governance. Some discussion of stakeholders and their interests seems to be an essential prelude to any meaningful discussion about accountability and transparency.

I plan to confine my remarks to mainstream shareholder-owned corporations in capital markets, not to cooperatives or other innovative forms of enterprise and governance structures. And of course I shall be making several references to Corporation 20/20's Six Principles.

I must say that I found it difficult to find anything new to add about accountability, since people like Allen White, Bob Massie, Jim Post, Marjorie Kelly and a score of others seem to have said everything already. And as an audience many of you have heard and read it all before! So I hope that in what I have to say you will find a few points for us to discuss or explore further – maybe even disagree with!

Let me state up front one basic view I have about accountability: I think accountability is ultimately all about a state of mind that drives behavior. If I know I am going to be required to account to others for my decisions and actions, I will almost certainly factor that into the decisions I make and actions I take.

In 2001, The Canadian Democracy & Accountability Commission offered the following simple, clear definition of accountability:

“Accountability is the requirement to explain and accept responsibility for one’s actions.”

If I know I am subject to such a requirement, I think I am likely to behave and make choices about my actions differently than if no such requirement existed – in which case I may feel free to do as I please without having to answer to anybody. I do of course have a conscience and perhaps a moral disposition to do the right thing anyway, and I may have a faith that has me believe I will ultimately be answerable to a divine being. Most if not all of the time as adults we accept responsibility for our actions and are clear as to whom we must be prepared to explain them.

But you and I are natural persons, whereas corporations are not. A corporation is an abstract legal construct; in itself it has neither conscience nor faith. A corporation can only make decisions and take actions and accept responsibility for them through the will and judgment exercised by its board of directors. To whom a corporation should explain its actions and decisions, and what responsibilities it should accept are therefore central to any discussion of corporate accountability. So too is the discussion of how corporations should explain their actions and describe the matters for which they accept responsibility.

To the extent that society is broadening the concept of corporate responsibility, even its purpose, and to the extent that there is a more informed understanding of the nature, breadth and complexity of the network of stakeholders with whom any company is connected, then corporate accountability too is surely changing and broadening.

Next let's take closer look at Corporation 20/20's Principle 5. It bundles together four concepts or principles that are linked but are not in fact equal or exactly comparable. Principle 5 speaks of governance that is participatory, transparent, ethical and accountable. All very desirable qualities no doubt, but each deserving closer consideration as to how they fit within a workable system of governance and how they should be captured within the structure of a corporate charter. I found the late Russell Ackoff's 1994 book "The Democratic Corporation" an excellent source of wisdom to help me explore these terms more closely.

Ackoff discussed "Participatory" governance in the second chapter, entitled the Enterprise and its Stakeholders. He offered the following Participative Principle: *Either all those who are directly affected by a decision, the decision's stakeholders, or representatives they select, should be involved in making that decision.* Clearly this has interesting, not to mention, complex implications for the structure and composition of corporate boards and similar governing bodies, advisory councils and so on. In particular, representing the interests of stakeholders such as young people and those yet to be born is a major challenge but an ethical imperative.

The late Willis Harman, in his (An) Incomplete Guide to the Future published in 1976 stated: *Full participation means that every citizen must be able to contribute to decisions regarding social goals.* Although this statement referred to decisions at a societal level, the same chapter reveals Professor Harman's views that powerful business and labour organizations will ultimately have to bring their goals into alignment with humane and far-sighted societal goals, and that much will depend on whether these large corporations assume an active responsibility for creating a healthy world society and a habitable planet. A new social contract is being written between large corporations and society, he wrote. In the end good business policy must become one with good social policy. Ergo, participatory governance will be inevitable, whatever form it takes.

No examination of corporate democracy, stakeholder theory and possibilities for employee engagement in participatory governance would be complete without studying the rich discourse in

Marjorie Kelly's "The Divine Right of Capital", especially chapter 10, "New Citizens in Corporate Governance" and its ideas about alternatives for governance of what she terms the "vernacular corporation".

Corporation 20/20's Principle No.1 seems to align closely with these arguments about the public interest, especially when taken together with the Participatory element of Principle No. 5. So participatory governance and corporate democracy seem to have important implications for considering who a company's stakeholders are and to whom a company is therefore accountable.

Let me skip "transparent" for a moment, and move on briefly to "ethical" governance. The concept of ethics or morals is about making choices between what is seen as right and what is seen as wrong. This is the realm of values such as those associated with human rights, labour practices, anti-corruption, integrity in business, fair trade. These values too evolve over time – most societies today have banned slavery, but use of forced child labour is not yet universally taboo in all countries, and corruption is rampant in many. And respecting, not compromising, the rightful ability of future generations to meet their own needs is clearly an ethical or moral imperative. Indeed, Corporation 20/20's Principle No. 3 expressly states this imperative. In other words, corporate values regarding ethics are now expected to align with those of society, at least of the society that granted them their charter and of their key stakeholder constituencies, both direct and indirect. So here we might conclude that the 21st. century corporation, as a corporate citizen, is accountable not only to its immediate stakeholders but to society in general for ethical business conduct, and is obliged to be transparent in disclosing how it has satisfied this expectation.

In fact, the Canadian Securities Regulators have since 2005 articulated in their corporate governance guidelines a recommendation for boards to adopt a written code of business conduct and ethics and to monitor compliance therewith. Listed companies in Canada are then required to file annual disclosures about the extent to which these guidelines have been followed.

I'm pleased to say that Ackoff devoted quite a few pages in his chapter on the Enterprise and its Stakeholders to the question of stakeholders' values and ethics. I should also observe that Corporation 20/20's Principles 2, 3, 4 and 6, as well as the ethical element of Principle 5, all seem to me to speak to ethical conduct, for which the 21st. century corporation must be held accountable. The Global Compact concisely underscores these value and principles.

Let me re-cap where I think I've got to so far.

I've said that "Accountability is the requirement to explain and accept responsibility for one's actions." But I have not said much so far about to whom today's corporation is accountable, or exactly for what, or what accountability reporting should look like.

I've said that participatory governance must involve all affected stakeholders, and that ethical governance is governance that aligns the corporation's moral values with those of the society within which it exists – that's to say the ultimate stakeholders.

In making these statements I think I have implicitly recognized a shift from a purely shareholder model of the enterprise to a stakeholder model. Stakeholders are a common thread in all I've said about participatory and ethical governance. They are a common thread in all six Corporation 20/20 Principles. A shift towards legal recognition of stakeholder interests has been evident for some time, not just in America, but in other countries and regions too – the UK and Canada for example.

Not that long ago, in the late 90's and early part of this millennium, the UK went through a major review of its company law, considering various possibilities for accountability to stakeholders and their implications for corporate law and charters. In the end they settled for accountability to shareholders under the concept of "Enlightened Shareholder Value" but the new Companies Act 2006 recognizes that in carrying out their fiduciary duty to promote the success of the company, directors must take into account the interests of, business relations with and impacts on other specified stakeholders. These include employees, suppliers, customers, the community and the environment.

In Canada, we have two recent Supreme Court decisions that arguably push Canada towards the UK model. I refer to Peoples v. Wise in 2004 which permitted but did not require directors to take into account stakeholders' interests in their decision making, and to BCE v. 1976 Debenture Holders in 2008. The latter judgment is somewhat vague and situation specific, but nonetheless includes language that introduces the concept of the corporation as "a responsible corporate citizen" and the need to act accordingly. The fiduciary duty of directors in company law continues to be to act in the best interests of the corporation, but if case law establishes that a

company is to be a responsible corporate citizen one has to think about the implications of this for consideration of stakeholder interests. For an outstanding legal analysis and discussion of these two cases and their implications I can do no better than refer you to a 2010 paper in the Osgoode Hall Law Journal, *Peoples, BCE and the Good Corporate "Citizen"* by Ed Waitzer and Johnny Jaswal.

In the USA, it is my understanding that, outside of Delaware, many states have enacted constituency statutes that, like the *Peoples v. Wise* case in Canada, allow for but do not require consideration of non-shareholder interests in corporate decision making. Connecticut goes a bit further I believe, requiring consideration of non-shareholder interests in certain specified business transactions. I know that Corporation 20/20 members have studied this field extensively and include many proponents of such legislation. And people in this room can interpret far better than I the current state of play in Delaware since *Revlon* as to consideration of non-shareholder interests in board decision making. One other point to note is that unlike Canada and the UK, the USA does not have a federal corporation statute under which companies can be chartered.

Finally, on the topic of stakeholder interests, I have to say how much I am indebted to Jim Post for all he has to say about Organizational Wealth and the Stakeholder View in chapter 2 of his landmark 2002 book "Redefining the Corporation". And I was especially pleased that he too looks to the possibilities of the balanced scorecard in measuring organizational wealth in broader dimensions than conventional financial reporting permits. As I said earlier, it's hard to find anything new to say about these topics!

So how about accountability and transparency?

Regarding the accountability of the 21st. century corporation, Corporation 20/20's Six Principles for Corporate Design in effect provide the "what" to define what corporations are accountable for. More specifically, as I've already indicated, one can look to Principles 2, 3, 4, 6 and the ethical part of number 5 for a clear summary of what the 21st. century corporation should be required to accept responsibility for and to report about and explain. All six principles imply, to me at least, that corporations are accountable to a far wider set of stakeholders than simply today's shareholders.

Regarding transparency, are today's corporate reporting requirements and practices adequate for rendering satisfactory accountability reports for the 21st. century corporation? Of course not.

Concerning transparency to stakeholders, in 2007 I wrote a paper for Corporation 20/20's first Summit, entitled "Transforming Corporate Reporting: Envisioning a new reporting framework that serves multiple stakeholders". I wrote:

"It becomes readily apparent that today's corporate reporting model is inadequate for a company's expected disclosures to stakeholders in a Corporation 20/20 world. The information presently required to be reported to shareholders and capital markets, even if considered adequate for that context, [and that's a very big "if"] hardly informs a broader assessment of the company's sustainability or its conformity with the societal expectations embedded in the six Principles. And there is currently no requirement for companies to issue a sustainability report of any kind."

The mandatory financial statements, MD&A and other legalistic 10K filing contents plus, where provided, the occasional voluntary sustainability report, even if in accordance with the GRI Guidelines, do not together result in a comprehensive, meaningful accounting for what society holds the corporation answerable for even today, far less for our new 21st. century corporation. Indeed, today's corporate reporting requirements were never designed from the perspective of accountability to stakeholders for information about corporate stewardship responsibilities beyond generating returns for current and prospective shareholders.

In my 2007 paper I asked whether today's corporate reporting model could provide the information needed for stakeholders of any type to answer satisfactorily the following questions based directly on Corporation 20/20's Six Principles:

1. Is the company functioning in a way that is consistent with harnessing private interests to serve the public interest?
2. Is the company accruing fair returns for shareholders, but not at the expense of the legitimate interests of other stakeholders?
3. Is the company operating sustainably, meeting the needs of the present generation without compromising the ability of future generations to meet their needs?

4. Is the company distributing wealth equitably among those who contribute to its creation?

5. Is the company governed in a manner that is participatory, transparent, ethical, and accountable?

6. Is the company infringing on the right of natural persons to govern themselves, or infringing on other universal human rights?

My answer was obviously “no”.

That paper went on to propose a new model for corporate reporting that in hindsight bears uncanny similarities to what is now being proposed for a very new initiative, the recently established International Integrated Reporting Committee (IIRC), not to mention the ideas set forth in the recent book called *One Report* by Bob Eccles and Mike Krzus.

This initiative and its multi-stakeholder international committee proposes to develop an overarching reporting framework that would connect and present in a single high level report the most important, relevant elements of the existing mosaic of fragmented and in many cases inadequate corporate reporting documents or filings. Such a report would be supplemented by detailed disclosures about key aspects of interest to particular stakeholders, such as financial statements for more detail about financial performance and sustainability reports for more detail about environmental and social performance.

The aim is to enable readers of such a report, be they shareholders or other stakeholders, to see and understand financial performance results and related narrative business disclosures right alongside information, such as that in sustainability reports and governance disclosures, in a way that allows them to connect relevant information and assess the balance or relationship between value creation for shareholders and human, social, natural and economic value creation (or erosion) in the interests of other stakeholders and society in general. Key collaborators in the IIRC are the GRI and the International Accounting Standards Board, whose IFRS have been adopted in most countries worldwide other than the USA.

If you think this integrated reporting initiative is over-ambitious, please be aware that in South Africa today companies listed on the Johannesburg Stock Exchange are required to disclose the extent to which they have complied with the recently introduced King III Code of Corporate Governance. This includes a requirement to prepare and issue an integrated report such as that described above, as well as

requirements for directors' decision making to factor in sustainability and the interests of stakeholders other than shareholders.

You may also be interested, even encouraged, to know that the co-chair of the newly established IIRC is Professor Mervyn King of South Africa, creator of the King Code and chair of the board of the Global Reporting Initiative. Speaking of ambitious initiatives, there were probably some in 1998 who said that the GRI was over-ambitious, yet its G3 guidelines are now widely accepted worldwide as the de facto standard for sustainability reporting.

Transparent governance (or governance over transparency) therefore relates to the responsibility of the board of directors to ensure that those to whom the corporation is accountable receive the disclosures and explanations to which they are entitled. In fact, a case can be made that corporations that excel in this respect of stakeholder engagement actually build stakeholder trust and thereby create a valuable intangible asset.

We know today what was not known 150 years ago about the global as well as local environmental and social impacts of a company's operations, products and services. Had we known then what we know now, perhaps corporate charters and their license to operate with limited liability for shareholders would have entrenched clauses to declare the corporation's obligations to stakeholders beyond just capital providers and cause them to be accountable to all societal stakeholders, with concomitant transparency requirements. Such requirements would have been reflected in statutory definitions of the fiduciary duty of directors.

In passing, I would note that other institutions besides civil society have influential roles to play and voices to be heard in the evolving accountability and stakeholder landscape. These include churches & organized religion, governments and supra-national bodies like the UN and the World Bank. And we should not forget individual citizens whose votes elect our legislators, but who, in developed countries exhibit excessive and destructive consumption habits and waste practices. These in turn fuel industries and corporate growth without regard to the long term environmental and social impacts, the cost of which is ultimately borne by society. Consumers are not always responsible stakeholders.

Therefore, if we can have international accounting standards, global guidelines for sustainability reporting, international protocols for the internet, international rules for safe passage of air and

marine traffic, international agreements for movement of hazardous waste, international conventions for labour practices, a Global Compact and so on, is it possible also to think of a global charter for corporations? Of course it is, and more to the point, a recent paper in August 2010 by Allen White for the Great Transition Initiative, “When the World Rules Corporations”, envisages precisely that, and more!

Let’s come back to my opening definition of accountability:

“Accountability is the requirement to explain and accept responsibility for one’s actions.”

First, are corporations today ready to accept and acknowledge to stakeholders the social and environmental responsibilities they face? Do they even understand those responsibilities and the unavoidable realities of environmental sustainability, i.e. a finite planet and ecosphere upon which all human activity and welfare depend? – Mainly, no.

Are corporations today ready and able – never mind willing - to explain their actions to stakeholders within a broadened context of accountability and the corporation’s obligations for environmental sustainability and social justice? – Mainly, no.

I have said “mainly, no”. But if you asked me for just one successful company that exemplifies this acceptance of responsibilities to stakeholders and society as well as its stockholders, and reports accordingly, I’ve long suggested Johnson & Johnson, whose Credo has been their guiding business philosophy for over 60 years. Their recent hiccup regarding recall of smelly products is, I hope, something they will learn from but not become a permanent scar on their reputation. I am sure you can think of other examples of accountability leaders in the USA and elsewhere.

Company law as we know it today has been well over a hundred years in the making, blending statute with case law along the way. But we can’t wait another hundred years, or even twenty years, to achieve global consensus on corporate accountability and transparency norms and practices.

So how will we harness citizenry and social forces, business self-interest and government policy to enact the accountability principles and transparency requirements essential for the essential

balance between corporate enterprise and long term social and environmental sustainability in the mutual interests of all stakeholders?

The works of Willis Harman, Russell Ackoff, David Korten, Jim Post and countless others, including systems thinkers like the late Donella Meadows and economists like Herman Daly, need to be uppermost in the minds of business leaders, public policy developers, legislators, corporate governance advocates and sustainability champions everywhere. Boutilier's 2009 book "Stakeholder Politics" would be a useful resource. And I suggest that Allen White's paper on the global corporate charter deserves urgent consideration, if genuine progress is to be achieved.

In closing, let me ask you to look with me into my crystal ball and imagine with me a column in the Wall Street Journal in the year 2030:

"Republican president Thomas Amabo today signed into federal law the new Corporate Chartering & Accountability Act. This long-awaited and hard fought-for Act grandfathers all state-chartered corporation laws under a federal umbrella of harmonized statutory governance for all businesses operating in the USA, whether US or foreign registered. It creates a general burden of public accountability to shareholders and to other designated stakeholder categories, including lenders, employees, customers, suppliers, communities and future generations affected or likely to be affected by company operations. The SEC's corporate disclosure requirements such as the 10K have recently undergone accompanying changes to be fully aligned with the transparency provisions of the new act, as have the NYSE listing requirements regarding corporate governance disclosures. In effect, integrated reporting by US companies in accordance with the International Integrated Reporting Standard is now mandatory

President Amabo, noting that in Latin his name means "I will love", declared that this historic Act ranks along with the abolition of slavery and racial segregation in the evolution and democratization of US society. Recalling the time when books like "When Corporations Rule the World" were viewed as revolutionary, if not dangerous, ideology in many circles, the President professed his pride that the USA could now finally hold its head up high in the company of countries like Brazil, India, South Africa, China, Canada and the United States of Europe (including Russia), all of which had in the last two decades enacted similar legislation and SE listing requirements. Apparently they had done so, he said, not only without apparent harm to their long-term economic well-being but in fact stimulating enhanced productivity, innovation

and competitiveness. He referred to studies in those regions showing that public trust in the private (corporate) sector has risen steadily during this same period – a factor that has attracted another whole order of social and economic benefits.

Historians, lawyers, social reformers and governance gurus are meeting next month at Faneuil Hall in Boston to celebrate and discuss why it took so long – over 250 years since 1776 – for this groundbreaking legislation to be enacted.”

Now let’s hear what Jim has to say and then have some open discussion. Thank you.