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DANIEL MALAN: Onerous ethics rules miss the point

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PUBLISHED: 2010/03/04 07:39:02 AM

DRAFT companies regulations, published in December, requiring public and state-owned companies to appoint a social and ethics committee, as well as a social and ethics advisory panel, should be opposed.

Although there are certain exemptions, this means public companies need to create new structures to monitor and report on issues that are already highly regulated, such as transformation, corruption, environmental health and safety, consumer relationships, labour and employment.

According to the regulations, a company's social and ethics committee should have no fewer than three company directors and be supported by an advisory panel of employees, experts and community representatives.

The social and ethics committee is supposed to monitor the company's activities — mainly related to compliance. In addition, the committee has to consult the panel and report to the board and shareholders.

In other words: appoint a committee to monitor what you are (legally) required to do and what you are probably monitoring already through other committees, and then appoint an advisory panel to assist it to do this. There is no requirement to incorporate any of these aspects into any existing reporting practices.

Rather, the committee has to draw matters to the attention of the board "as occasion requires" and report to the shareholders at the AGM. In tough times this will not come cheaply. The regulations state clearly the company must pay all the expenses "reasonably incurred" by the committee, as well as the costs of the advisory panel.

This approach is flawed. First, while the intention of a more structured and focused approach to social and ethical issues should be applauded, the introduction of two new layers is the wrong way to achieve this.

In practice, there is probably going to be a long list of companies applying for exemption, arguing that the issues are already adequately addressed. If new committees are formed, there is likely to be duplication, turf protection and substantial waste of resources.

When it comes to the advisory panel, there is likely to be a scramble to get some familiar faces drawn into a formal structure, with a few meetings a year allowing companies to tick the box, as opposed to a more comprehensive and continuous stakeholder engagement process.

On a more fundamental level, the regulations should be seen within the context of the debate about voluntary and mandatory standards. Those in favour of voluntary standards argue that companies will be more effective if they self-regulate, that more innovation will result and that customisation will allow more effective approaches at the individual company level.

On the other side, supporters of mandatory standards argue that companies are too lazy or greedy to be trusted with self-regulation, and that mandatory standards will result in standardised and comparable performance and information.

This debate is raging specifically with reference to sustainability reporting, but also applies in this context. It is not an either/or debate, but more about striking a balance between the two. While regulation is a necessity in most areas addressed by the regulations, it should be acknowledged that there is already effective existing regulation, and that most companies have compliance functions to manage this.

Effective social and ethics management is not about compliance, but about building an ethical corporate culture. This is explained eloquently in the third King Code of Governance's practice notes on ethics management, which ascribe most of the proposed functions of the social and ethics committee to the company's internal audit function, which is more appropriate.

Companies can be forced to comply with the law as the state can introduce severe penalties for infringements, but they cannot be forced to be ethical. When social and ethics committees are introduced in response to sound ethics management and ethical leadership, they can be very effective. When they are introduced to comply with the law, they are doomed to fail. Companies should get this message across to legislators before it is too late.

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