

# Business Conduct – The need for self-regulation

Conduct failures surround us. In public and private organisations, collective and individual misdemeanours abound. Personal or organisational conduct is the single most important factor influencing trust and confidence, and so reputation. It is increasingly recognised that reputation can no longer be simply inherited; it is an asset that needs constant, structured and conscious management. Yet rarely is business conduct (or indeed reputation) an explicit item on the management agenda; standards at best usually remain high level words of aspiration and actual performance is seldom able to be articulated and demonstrated.

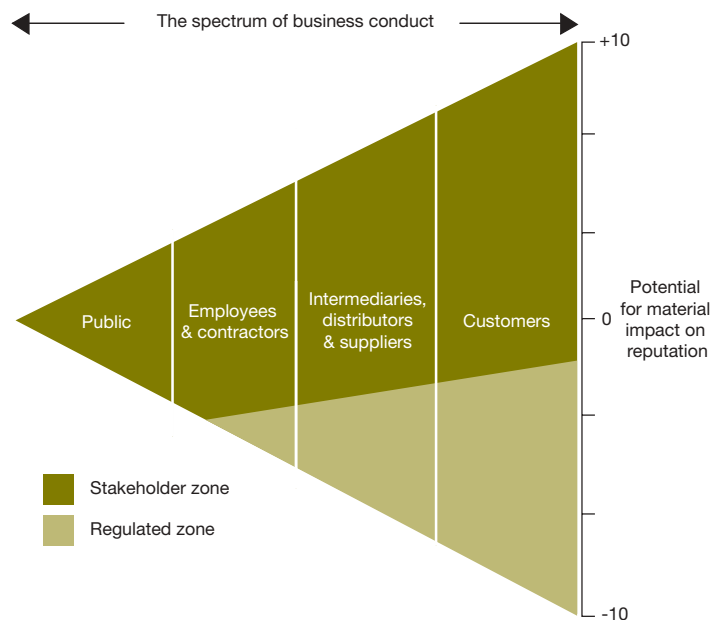
## The challenge originates in the subject

Conduct has no limits. It applies to every interaction with an internal or external party (this includes the human and physical environments). Judgements on suitability of conduct are subject to individual interpretation and, further to this, are affected by the personal position within the interaction (for example the customer conclusion on the suitability of conduct may be entirely counter to that of a shareholder evaluating the same decision). Furthermore, conduct does not fit neatly into organisational structures, it cuts across divisional and department boundaries with abandon.

## Regulators have responded

The FSA's principles have been in existence for a considerable time. The SEC (through Sarbanes) and wider governance rules make implicit and explicit reference to business conduct. Through these statutory instruments there is increasing focus on developing a structured and demonstrable response to conduct. Although the responses are still work in progress needing more time to develop, there are some signs that conduct is being addressed with a response of 'form', which could prevent a response of 'substance'.

This was not the intent of the regulators. Their goal was to catalyse a substantive reaction by raising this issue up the regulatory agenda in the form of principles. In the short term a response of form will be commended but there will be an expectation that this materialises into substance over time and so effects some changes in practices and behaviours. There are some early indications that this expectation has not been fully appreciated.



## From regulators to investors... to management

This is a difficult space for regulators to be prescriptive – law works best where there is a wrong and a right. The potential for so many permutations creates some dependency on the emergence of case law and further regulation is unlikely to be helpful except to stipulate details in specific areas.

The investment community has recognised the gap and its own direct self interest. Through increased inclusion of extra financial information in their research and valuations, and consideration of quality of management in determining stock ratings, investors are cutting to the heart of the challenge and putting responsibility onto companies to identify and manage material issues. Those organisations that respond with both form and substance should capitalise through improved stock rating, higher share valuation, greater investor confidence and so improved access to, and cost of, capital.

Conduct needs to become a core, explicit issue for internal governance. Management needs to accept accountability for defining what constitutes appropriate conduct and making sure it is achieved. Management decisions are essential to achieve a conduct outcome that balances conduct expectations with the fundamental need to secure sustainable commercial success. Executive and non-executive directors and senior management cannot afford to leave conduct as a matter for others.

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