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Different worlds: Corporate governance and the ethics and compliance officer

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Ethics & compliance officers (E&COs) and corporate governance systems share a common goal, namely to ensure that the company is well managed and that company scandals are prevented. Moreover, the way the governance of an organization is structured is essential for the effectiveness of the E&CO. Therefore, I am surprised and also slightly bothered that the E&CO is not mentioned anywhere in corporate governance codes. This needs to change.

What is corporate governance?

According to the Organisation for Economic Co-operation and Development (OECD), corporate governance determines the procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization, such as the board, managers, shareholders, and other stakeholders, and lays down the rules and procedures for decision-making. The term "corporate governance" is used for both corporations and not-for-profit organizations.

Corporate governance models

By and large, two different corporate governance models can be distinguished.

The Anglo-Saxon one-tier model

In this model, there is usually one board that consists of both executive and non-executive directors. The board has an executive and a supervisory role. Often there are one or more committees that predominantly consist of independent non-executive directors. Usually there is an audit committee, whose members have relevant financial expertise. Sometimes there is also a compliance committee, that either reports to the audit committee or directly to the board. In the Anglo-Saxon model, the governance of the organization aims to safeguard the interests of the shareholders against the interests of the management. This model is sometimes also characterized as the shareholder management model.

The Rhineland two-tier model

This is the dominant model in most of continental Europe. Usually there is an executive board, consisting of a handful of full-time executive directors, and a supervisory board, consisting of part-time non-executive directors. The executive board determines the strategy of the organization and is responsible for the day-to-day management. The supervisory board advises and supervises the executive board. It can hire and fire executive directors and determines their remuneration. The supervisory board usually establishes a number of other committees, such as the audit committee, the remuneration committee, and the nomination committee. These committees report to the supervisory board. The nominations and remuneration usually have to be approved during the shareholders meeting. In the Rhineland model, the interests of the various stakeholders, like the interests of the management, employees, shareholders, clients, suppliers, banks, the government and society at large, are taken into account and balanced against each other. This model is sometimes referred to as the stakeholder management model.

The corporate governance structure influences the role and position of the E&CO. In a U.S. context, for example, it is not uncommon to argue that the E&CO should have a seat at the table where the decisions are made. If there is a one-tier board consisting of 10-20 executive and non-executive directors, I can indeed imagine that the E&CO joins the board meetings. However, in that situation, Compliance may no longer be a second-line of defense function, but instead is one of the decision makers. This may also have consequences for the independence and the personal liability of the E&CO. In the Rhineland model, it would be very unusual to give the E&CO a seat at the table, because the executive board usually consists of only 2-6 people. And in most cases, the E&CO will be the real, second-line of defense function, who only advises and assists the management and does not make decisions. However, in this model it may be more difficult to ensure that the E&CO is properly informed. If there is a management team that operates directly below the executive board, it would seem natural that the E&CO is part of that team.

In reality, the distinction between the two governance models is not always that clear. It also seems like they are growing towards each other. The company scandals that occurred in continental Europe caused people to raise questions about the functioning of the supervisory board. Have the non-executive directors been sufficiently able, independent, informed, involved, critical, and firm? The expectations regarding non-executive directors are rising, and as a result, they are supervising the organization more closely, operating closer to the daily operations. In the one-tier model, we notice that the role of the president and the CEO of a company in an increasing number of cases is not combined anymore, and more and more often, the president of the company is a non-executive director. We also notice that an increasing number of organizations with a one-tier board nowadays have a majority of non-executive directors on the board, and as a result, the non-executive directors can outvote the executive directors.

In the one-tier governance model, it is the principal goal of the organization to make money for its shareholders; therefore, one would expect that it may be more difficult for the E&CO to get priority for ethics. This is not necessarily the case, if the management is convinced that good ethics also leads to better long-term business results (see below), or just wants to do the right thing.

One would expect that in the two-tier model it would be easier for the E&CO to make ethics an integral part of the business, as the organization also takes the interests of clients, suppliers, employees, the government and society at large into account. In practice, listed companies in continental Europe also face the pressure from analysts and shareholders. And if they don't perform financially, they may be taken over by a private equity firm or a competitor. So again, in practice there may not be much difference between the two governance models.