

# management ethics

## The Companies We Want

Allan C. Hutchinson

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In May 2005, Dominic D'Alessandro offered a stern message to the shareholders of Manulife Financial Corp., Canada's largest insurance company. As its top executive, D'Alessandro warned that recent changes to the regulatory climate are a sign that the corporate governance pendulum "may have swung too far". Bemoaning the spiralling costs and the heavy burden of increased regulation on public companies, he was particularly troubled that new reporting rules seemed to build on a mistaken belief that executives are a greedy lot that cannot be trusted to act in the best interests of their investors. He stated that "it is now becoming fashionable to believe that corporate behaviour should always be viewed with suspicion" and that "this is a very dangerous premise upon which to develop a governance regime." In particular, D'Alessandro opined that, doing so, "we run the risk of imposing onerous and impractical restraints that will stifle entrepreneurial activity."

I do not think that the corporate governance pendulum "may have swung too far". Indeed, it is less that the pendulum is swinging and more that we need an entirely new clock. Apart from D'Alessandro's stance, there is little evidence to suggest that the task of reforming corporate governance has even begun to be taken seriously. As things stand, corporations are not thought of as being part of a more encompassing commitment to democracy; they stand apart from its general aspirations and ambitions. Indeed, democracy is often made to comport itself to the demands and agendas of large corporations. This is entirely the wrong way round. If society is to improve itself and to make good on its democratic promises, large corporations must be re-formed so that they better fit and square with democratic theory and

vision. This is an immense, but heroic undertaking and entirely worthy of our collective energies.

### A Cultural Change

There is more to being good than not breaking the law. A huge difference exists between the goals of seeking reasonable returns on one's economic ventures and of striving to squeeze excessive profits from business enterprises. This is especially the case when those exorbitant benefits are accrued while others receive minimal rewards from their involvement in the same undertakings or, worse, are laid-off. A democratic sensibility leans towards the idea that fortune, good and bad, is to be shared in the community.

I believe that the corporate organization can be redeemed and made to serve rather than frustrate the ambitions of a democratic society. Because modern corporations are so powerful and pervasive in their influence, they present themselves as the most suitable site at which to advance most substantially the democratic project. Unless we are prepared to accept that challenge, we are as good as helping to push the corporate hand-cart on its way to its hellish destination.

By transforming the basic structure of corporate governance, it might be possible to stimulate an institutional context within which deeper and more lasting changes occur. However, there are definite limits to what legislative reforms and regulatory initiatives can achieve. After all, the Criminal Code has not done away with crime. It is naive to believe that asking present corporate officers to be responsible will be sufficient or that making structural changes without some accompanying ethical shift will achieve fully what

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# The Companies We Want

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is required. No rule or principle is sufficient on its own. This educational ambition cannot simply be legislated into being. However, the democratic wager is that, as the institutional structure and personnel begin to change to represent a more diverse range of interests, the dominant mind set of business will itself begin to change. Exposed to different values and required to advance different values, the board of directors might itself begin to undergo a relative metamorphosis in its collective and individual commitments. The hope is that the corporation might become in substance



what it will become in form – a vibrant community of assorted people and interests who coalesce to re-define the corporation and its approach to the business of doing business. Substantial progress towards a more democratic practice of corporate governance will occur, therefore, not only by changing institutional structures, but also by modifying people's attitudes and values.

As with any meaningful efforts at far-reaching reform, a democratic model of corporate governance will constantly have to question whether its initiatives and interventions have had a real effect on outcomes and behaviour or whether they are merely empty symbols which put a fresh face on the same old activities and mentality. Changes in line with a democratic mandate must not be seen as simple add-ons or expedient grafts to existing institutions and enterprises; it is not a case of 'business as usual'. When properly understood, the democratic approach demands not simply a compliant

mentality and stance to laws, codes, regulations, etc. It insists upon cultivating a pro-active commitment to the worth of civic values. In the spirit of democratic transformation, it is about collaboration and involvement which involves "understanding business as a public culture, not 'concerned' with values and human rights, but more thoughtfully aware of how it shapes the cultural politics (and economics) of those values."<sup>1</sup>

## Towards Good Governance

Commentators and theorists have lavished almost endless attention on corporations as legal entities and as economic units but the time has come to shift that attention and reflect upon corporations as democratic institutions – what policies and practices will best enable large corporations to become part of the general commitment to advancing democracy in Canadian society? This will not mean that less effort will have to be put into the organizational details of their legal structures and economic strategies, but that such considerations will have to be understood and re-worked so as to comply with and serve the interests of a democratic conception of corporate governance. In particular, this will entail re-defining what counts as 'good corporate practice'. This occurs when all interested parties play an informed role in determining what is the best way to organize and run the corporation as a public-regarding institution so that as many interests as possible are advanced in a way that is consistent with or, at least, not antithetical to the public good. There is, of course, no guarantee that any one group of corporate stakeholders will be able to strike upon the public good in any better or more compelling way than any other group: the best that can be hoped for is that they will make a good faith effort to do so. After all, the 'public good' is an essentially contested concept and will never lend itself to easy or uncontroversial calculation. If it did, there would be no real problem in the first place.

There is no real reason that corporations could not, if so minded, put their considerable power to better and more socially-beneficial use. The fact that they choose not to is, therefore, less about legal constraint and more about attitude and ethos. By changing the class of persons to whom corporations are responsible, it might



be possible to change the mind-sets of those who run corporations. As presently construed and operated, they are first and last economic conglomerates. When they do act in ways which are considered socially-beneficial or ethically-noble, it is largely because this is good business. However, once corporations become accountable to a more encompassing and less restricted group of persons, they might begin to reflect a different set of ideas and interests.

Although the bloom may well be off his personal rose, Tony Blair's original vision of corporate governance captures the kind of democratic spirit and direction which I have tried to promote and implement. It is a stirring idea which already has a toe-hold in popular consciousness and practice:

"Successful companies invest, treat their employees fairly, value them as a resource not just of production but of creative innovation. We cannot by legislation guarantee that a company will behave in a way conducive to trust and long-term commitment. But it is surely time to assess how we shift the emphasis in corporate ethos – from the company being a mere vehicle for the capital market, to be traded, bought and sold as a commodity, towards a vision of the company as a community or partnership in which each employee has a stake, and where the company's responsibilities are more clearly delineated. ... We need to build a relationship of trust not just within the firm but within society. By trust, I mean the recognition of a mutual purpose for which we work together and in which we all benefit. It is a stakeholder economy in which opportunity is available to all, advancement is through merit and from which no group or class is set apart or excluded." <sup>ii</sup>

An important part of effecting this cultural shift in corporate governance will require attention to the professional ethics and obligations of the supporting professions. Both law and accountancy choose to present themselves as essentially neutral operatives who deploy their talents and experience for a variety of clients. However, when lawyers and accountants devote themselves disproportionately, as they do, to the cause of large corporate clients, they become part of that corporate community and work towards both entrenching the power of such institutions and obtaining every possible advantage and edge for their clients. Moreover, by committing their considerable

prestige to corporations, the accounting and legal profession become standard-bearers for them and often strive to withstand on their behalf those legislative or policy initiatives to alter the status quo. Accordingly, any change towards a more democratic culture in the world of corporate governance will have to involve the educational training and professional duties of lawyers and accountants. Because they are entrusted with enormous public trust and civic responsibilities, lawyers and accountants must be obliged to ensure that they function not only as the hired hands of private interests, but as the guardians of the public interest and democratic justice.

My aim is to push the envelope and, where possible, to bring about transformations in the postal system itself. I adopt an openly reformist agenda in which the main goal is not to do away with the corporation entirely, but to revise its nature and operation in line with a genuinely democratic mandate. All strategies carry risks that they will turn out to legitimize that which they are intended to discredit. But, unless people are prepared to settle for self-induced paralysis or opt for out-and-out revolution, there is no other or better way to go than incremental and step-by-step proposals for democratic transformation. The move away from a debilitating corporocracy towards greater democracy must eschew complacency or convulsion; it must itself be achieved through the more moderate channels and initiatives of democratic governance itself. 'Transformation' is the watchword of democratic change. And large corporations are as good as or better than any place to make good on that commitment. Their size and influence might increase the democratic challenge to be met, but its ultimate achievement will be all the greater for it.

### Conclusion

Although corporate governance in Canada is in a poor condition and engenders low public confidence, this state of affairs has at least opened up a space to think seriously about how it might be possible to turn these failings into transformative effect. Indeed, with effort and imagination, it might presently be possible to bring to an end the Age of the corporation as a private-controlled agency for wealth accumulation. In its place, there might be generated a new Age of corporate governance

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# A New Year - No New Resolution

by Julie Walsh

**W**e are fortunate at this time of year to be able to pause and reflect on the events of the year gone by. But reflection inevitably brings evaluation and at this particular juncture, we must ask how much progress we have truly made over the course of 2005 in addressing issues of poor governance, lapses of ethics, accountability and transparency in corporate conduct.

Over the past few years, we have experienced a deluge of new rules and regimes addressing corporate conduct and the actions of company representatives. In 2005 we saw increased focus on enforcement actions by regulators for corporate misconduct and unprecedented sentences for malfeasance. Arguably, this is progress. The implementation and adherence to the new rules and regulations overcome many past weaknesses and problems in dealing with transgressions by corporations and other players in our capital markets. Again, this is progress. But perhaps the area where we made the most progress in 2005 is the acknowledgement that the search for good governance does not end in the myriad of new rules; rather, it must continue in the new landscape of best practices and increased regulation with a new focus. This focus for companies must be that they must do the right thing. That precarious balancing act of doing well by doing right is nothing new. But now we must adjust our focus on how we define what is right.

It seems absurd, when there is an abundance of credible evidence that well-run and well-regulated companies with a sound governance culture prosper, that we must still debate the merit of regulation and corporate governance reform,

whether regulation stymies economic profit and how this affects a company's responsibility and accountability as a citizen. The case for "doing the right thing" should in fact never be stronger... but what is "right" and for whom it should be considered "right" remains the million (or billion?) dollar question.

Winston Churchill once asked his scientific advisor, Professor Frederick Lindemann, to explain quantum theory to his children in single syllable words and in under five minutes.



A novel request of a world-renowned physicist. But apply it to our question of analysing what, and to whom something is right. If you were to sit down and explain to your children, in single syllables, a business decision or particular course of action that you were contemplating or had undertaken – could you? What would the message of that story be? Would it be one that you wanted your children to apply in their own world? Or would the explanation and the justification be difficult to unite? A simple approach to a complex issue... but sometimes there is merit in simplicity.

Our contributors in this edition provide some interesting insights on certain governance issues, including, to whom should companies

be accountable and by increasing the multitude of rules and regulations governing companies, are we at risk of causing a retreat of entrepreneurial spirit and discouraging participation in North America's capital markets? These articles intertwine with perennial themes the Centre seeks to address – the framework for corporate accountability, the relationship between ethics and good governance and the merits of principles versus rules governing corporate behaviour.

As I hand over the role of editor to Flip Oberth and wish her well in her new position at the Centre, let us ring in the New Year resolving to continue to work toward increased accountability by corporations for their actions in the communities in which they operate, greater transparency about their governance practices, and the recognition of a corporate culture where economic value and a fundamental morality of doing what is right are no longer distinguishable goals. ✨

## Larry Hebb

*We would like to thank Larry Hebb for the matchless energy and enthusiasm with which he has served the Centre over the past decade. Larry was first elected to the Board in April 1995, and served until May 2003, during which time he also served as Chair from 1997 to 2000. More recently, Larry was co-editor of Management Ethics from 2004 until our Fall 2005 edition. On behalf of the Centre, we wish Larry and his family all the best as he settles into a more "full-time" retirement and look forward to his continued inspiration and involvement in the Centre's work.*



# Corporate Governance

## - One Size Does Not Fit All

by Dean Williams

**C**onsider that foreign listings on the New York stock exchange are down. A decline in willingness or need to participate in U.S. markets that NYSE CEO John Thain says is due, at least in part, to the time, effort, and resources required to be in compliance with Sarbanes-Oxley (“SOX”).

While the U.S. is still “the powerful engine of global capitalism, no birthright dictates that we will remain so,” Thain said candidly. “In the 21st Century economy, great forces of competition and technology are accelerating change and the mobility of capital.”

Thain, however, also points to the growing attractiveness of Japan’s recovering markets, the booming economies of China and India, and the European Union’s progress toward becoming a stronger, more sophisticated and cohesive market – markets that have significant governance shortcomings by American standards.

### The Global Challenge

When it comes to corporate governance, no single country has a monopoly on best practices, said Deloitte Global CEO William G. Parrett. While that may be true, governance in some of the markets that are attracting capital are far from examples of best practices.

Japan’s corporate culture and informal approach to governance is different on so many levels from Canada, the U.K. and the U.S. Nevertheless, in December 2004, the Tokyo Stock Exchange introduced a Charter of Corporate Behaviour. Even though the

document reads as more of a wish list than a firm set of rules or even guidelines, the delisting of scandal tainted Seibu Railway was a rare but promising turn of events. Corporate scandal and poor corporate governance plagues China’s market, but it hasn’t deterred hundreds of billions of dollars in foreign investments from flowing into the economy. On a positive note, as the 2006 deadline approaches for China to open fully to foreign competition, prison sentences have become much harsher in an effort to deter wrongdoing.

In Europe, meanwhile, securities regulators have agreed to unprecedented co-operation, fearing SOX-like standards might gain a foothold in Europe. Regulators are anxious to ensure that enforcement action on International Financial Reporting Standards (IFRS) is consistent across Europe at a time when the U.S. Securities and Exchange Commission (the “SEC”) is preparing to scrutinize IFRS accounts.

### North America – Hardship and Complaints

On the domestic front, however, the SEC has been sensitive to the hardship faced by smaller issuers with limited budgets to review and document their controls. Overwhelmed with complaints about internal control reporting requirements of Section 404 of SOX, the SEC has extended the compliance deadline for smaller public firms yet again. Canadian regulators are watching closely to better understand the repercussions.

On a per capita basis, Canada is only second to the United States in the number of public companies but, as TSX CEO Richard Nesbitt pointed out in a letter to members of the Canadian Securities Administrators, “Canada’s market is characteristic of small-cap companies. Despite the benefits of harmonization with the U.S., Canadian initiatives should support the

Canadian public interest on a stand-alone basis.”

### New Rules, Regulations and Guidelines

#### Is the Cost Worth the Benefit?

U.S. studies conclude that SOX implementation costs a lot and the results haven’t been obvious. A New York Stock Exchange survey in August 2005 reported that 80 per cent of CEOs are spending more time on regulatory and compliance issues than five years ago. Almost 70 per cent say their most demanding governance task is meeting the terms set out by Section 404 of SOX.

According to a July 2005 report by professors at the University of Nebraska, audit fees for the Fortune 1,000 increased by an average of \$2.3 million, or 66 per cent between 2003 and 2004. 12 of the 648 companies surveyed rose by more than \$10 million each. Even without the requirements of Section 404, the demands on resources required for documentation and CEO/CFO certification have significantly increased costs and lowered profits for many Canadian and U.S. companies.

### A Threat to Competitiveness

“My own concern is Canada’s international competitiveness,” says Urmas Soomet, Dofasco’s corporate secretary and director of legal services, and president of the Canadian Society of Corporate Secretaries. “Business in Canada and the United States will be somewhat less efficient than their global competitors who do not have the same regulatory burdens to bear.” These burdens go beyond direct cost increases. There’s the hidden cost of distracting management from running and managing the business – preoccupying managers with internal control reporting. “They certainly have the potential to hurt productivity, efficiency, results and ultimately negatively impact share value,” says Bob Tait, president and CEO of the Canadian Investor Relations Institute. David

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# speakers' corner

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The Speakers' series for this Winter was once more outstanding. For those who were not able to attend some of these talks, we provide a brief summary of the remarks made by each speaker.

## **"Building Confidence: Lessons from the Corporate and Public Sectors"**

Rob Johnson, Hewlett-Packard (Canada) Co. and The Honourable Coulter Osbourne, Integrity Commissioner, Province of Ontario  
Thursday, October 27, 2005

At the October luncheon series, members learned how the public and corporate sector both strive for confidence and respect in the decisions their representatives make. If you need to ask the ethics commissioner if a potential action or decision is appropriate, you may already know the answer. This ethical sniff test was gleaned from the remarks of The Honourable Coulter Osbourne. The Office of the Integrity Commissioner aims to maintain high standards of ethical conduct by providing guidance based on the implementation of the Members' Integrity Act, 1994 which affects the day-to-day activities of elected MPPs in Ontario.

At HP (the Luncheon event's corporate case study) Rob Johnson noted that the "how" and "what" of management and success are driven by a common set of values. Using common values as a management tool and a driver for daily decision-making helps HP establish an organizational culture where confidence and respect can thrive.

Promoting confidence and maintaining respect are concerns of organizations in every sector. The common piece of advice drawn from the EthicsCentre's two speakers was the need for common expectations. Whether it is legislation to monitor local MPPs or a set of common values to manage employees of a global company, establishing expectations is an essential step in building an organizational culture that can deal with society's heightened scrutiny and pervasive cynicism.

## **"Integrity in the Financial System"**

Gordon Thiessen, Chair, Canadian Public Accountability Board (CPAB) Former Governor of the Bank of Canada  
Thursday, November 24, 2005

What are you doing to encourage and preserve high standards of ethical conduct in our economy and your organization? If you are a chartered accountant, your answer is of particular interest to the Centre's November Luncheon Speaker.

Gordon Thiessen's remarks bridged the delicate balance between advocating for regulations and the need for establishing common values. While regulation cannot ensure integrity, neither does an ethical culture eliminate the need for rules to prevent abuses. It may, however, lessen the invasiveness and the costs associated with monitoring and enforcement. Regardless of rigorous regulation or high ethical standards, the high cost associated with ethical failure, and therefore the importance of prevention, was made clear.

The capital markets and auditing profession require particular attention in the pursuit of confidence and trust, according to Thiessen. In order for an economy to be prosperous and competitive, all types of investors in the capital markets must be assured of fair treatment, efficiency, and integrity. At the Canadian Public Accountability Board, where Thiessen serves as Chair, the crucial role of audits in maintaining and enhancing this integrity and trust is paramount. Accordingly, the public responsibility of the accounting profession is profound and not to be underestimated.



## The Companies We Want

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in which the corporation becomes a site at which the project of democratic empowerment can make its most important contribution and advancement. This is a heady possibility. But the present conditions of decay and deterioration will only last for a short time. Given the chance, the old habits and entrenched arrangements might re-assert themselves. In the meantime, it is essential that those who take the democratic imperative seriously act quickly and decisively; the opportunity might not come again soon. Indeed, it might well be that, as goes corporate governance, so goes democracy. ✱

- i. D. Birch and M. Glazebrook, *Doing Business - Doing Culture: Corporate Citizenship and Community* in HUMAN RIGHTS, CORPORATE RESPONSIBILITY (S. Rees ed. 2000).
- ii. *Labour Party Manifesto* (1998). See also GAR ALPEROVITZ, AMERICA BEYOND CAPITALISM: RECLAIMING OUR WEALTH, OUR LIBERTY, AND OUR DEMOCRACY (2005).

*Allan C. Hutchinson is a Professor at Osgoode Hall Law School. This essay is an edited version of the final chapter to a forthcoming book, titled The Companies we Keep: Corporate Governance for a Democratic Age and published by Irwin Law.*

## Corporate Governance - One Size Does Not Fit All

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Beatty, managing director of the Canadian Coalition for Good Governance, says that directors are getting tired of always looking in the rear view mirror, preoccupied with formulaic compliance activities rather than looking ahead and leading their business.

### Potential for Real Benefits

“Obviously the first year or two of a new regulation or compliance takes more of the director’s time,” says Ann Mulé, Sunoco’s chief governance officer, assistant general counsel and corporate secretary. But she believes that “compliance will take a lot less time at the board level,” once directors are more comfortable with the processes.

While most CEOs question the balance between the investment required and the resulting benefits, the NYSE survey indicated that 66 per cent agree that SOX and Exchange governance rules help board members become more informed. 72 per cent of the CEOs also believe it makes them better engaged. “The companies that get the most benefit from this corporate governance process review are those who take it as an opportunity to consider their business processes and reporting functions, and examine whether improvements can be made to either streamline the process or make it more effective,” says Ross McKee of Blake Cassels & Graydon LLP.

### What About Ethics?

Of course, the real reason governance rules were enhanced was to restore and ensure investor confidence.

Pennsylvania law school professor David Skeel warns that we’re kidding ourselves if we think we can head off the next round of scandals. “SOX is about compliance, but good governance isn’t just about compliance,” says Janis Riven, president of the Institute of Chartered Secretaries and Administrators in Canada (ICSA) and lecturer at Concordia’s John Molson School of Business. “There are limits to the compliance approach.”

“Corporate governance is a hot topic, but we are overly optimistic about what corporate governance can do,” says Wharton legal studies professor Thomas Donaldson. “Simply rearranging the chairs at the higher echelons of a company will not prevent the types of fraud that have occurred over the past several years.”

In his testimony before the U.S. Senate during the SOX hearings, Donaldson reminded lawmakers that in all of the recent major corporate scandals, the companies in question had fairly elaborate corporate compliance program in place.

“We love to pin ethics to governance,” says Riven. “We have to be very careful of that because ethics is a very mushy area, and governance shouldn’t be mushy.” ✱

*Dean Williams is President of Williams Savvy & Associates, and the above article is based on a supplement that appeared in Canadian Business Magazine in September 2005 that was written for the Canadian Society of Corporate Secretaries.*



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