Preventing disaster by building a risk-prevention ethic into corporate governance

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The recklessness, or reckless indifference, of corporate entities often causes disasters. It is certainly the case that modern corporations and business enterprises are bound by strict legal responsibilities that require them to operate in a safe fashion. The consequences for those entities whose conduct falls outside of the acceptable parameters of the law, however, are difficult to construct, given that corporate entities are artificial 'persons', and given that the required mental element attaching to corporate criminal conduct is difficult to establish let alone prove. The mere setting of legal and administrative rules to control reckless behaviour, either by legislation or by organisational rules and policy, may be necessary, but it is not sufficient, for, as history records, accidents and tragedies still occur. In this paper the authors show how corporate entities can and should employ principles of corporate social responsibility in framing their organisational culture. The task of lessening the risk of corporate irresponsibility may best be achieved, they conclude, in linking social responsibility as a fundamental principle of corporate governance.

Introduction

To say, as many corporate controllers do, that their companies are abiding by the letter of the regulatory law under which they operate, is no longer an acceptable response to the threat of corporate irresponsibility, if it ever was. An example is provided by the story of the roll-on/roll-off passenger car ferry *Herald of Free Enterprise* which sank soon after leaving the Belgian port of Zeebrugge, en route to Dover on March 6, 1987. Five hundred and thirty-nine people were on board, and at least 188 people lost their lives. The *Herald of Free Enterprise* had capsized because her bow doors remained open as she left port. The ferry ended up half submerged in shallow water. Only a fortuitous turn to starboard in the last moment prevented the boat from moving to deeper water, which would have meant her sinking completely[1]. The *Herald of Free Enterprise* had been a member of the Townsend Thoresen Car Ferries fleet. Townsend Thoresen had become part of the P&O fleet in January of that year (Boyd 1990).

Justice Sheen conducted a formal investigation into the disaster between April and June 1987. His Honour concluded that the accident was partly caused by the 'serious negligence in the discharge of their duties' by the captain, chief officer and assistant bosun. Suspensions of Certificates of Competency were ordered. He also found the company had been at fault, remarking that

> ' … a full investigation into the circumstances of the disaster leads inexorably to the conclusion that the underlying or cardinal faults lay higher up in the Company. The Board of Directors did not appreciate their responsibility for the safe management of their ships. They did not apply their minds to the question: What orders should be given for the safety of our ships? … The Directors did not have any proper comprehension of what their duties were. There appears to have been a lack of thought about the way in which the *Herald* ought to have been organised for the Dover-Zeebrugge run. All concerned in management, from the members of the Board of Directors down to the junior superintendents, were guilty of fault in that all must be regarded as sharing responsibility for the failure of management. From top to bottom the body corporate was infected with the disease of sloppiness … [revealing] a staggering complacency … Individually and collectively they lacked a sense of responsibility.' (Boyd 1990).

In October 1987 the Coroner's inquest into the tragedy delivered a verdict of 'unlawful killing', and in June 1989, after a 15 month police investigation, seven individuals were charged with manslaughter and the company P&O European Ferries[2] was charged with corporate manslaughter[3]. But on October 19, 1990, after only 27 days of a trial expected to last 6 months, the judge instructed the jury to find the defendants not guilty, and dismissed the case against the individual and corporate accused. The judge had become satisfied early in the prosecution case that it had failed to establish that the defendants should have perceived the possibility of the ferry sailing with its bow doors open to be 'an obvious risk' (Boyd 1990, Crainer 1993).

This outcome was perhaps not surprising. In the UK and in Australia a corporate manslaughter prosecution must show that someone who represents the controlling 'mind' of the company is also guilty of the offence. Hence, the chance of a corporate conviction is always slight (Cahill and Cahill 1998, Bergman 1998).

There are, of course, other examples that quickly come to mind, two of them occurring within two days in July 1997. Firstly, 12 year old Katie Bender was killed on July 13 when struck by debris while watching a demolition of the old Royal Canberra Hospital in a fun day organised by the Canberra City Council. The next day, the collapse of a make-shift bridge at Ramat Gan stadium, Tel Aviv, just as 370 Australian athletes were entering the arena for the start of the Maccabiah Games killed 4 and injured 60 other competitors. Three years later the civil and criminal liability questions arising out of both

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1. The death toll was the worst for a British vessel in peacetime since the sinking of the Titanic in 1912.
2. The name Townsend Thoresen was changed in October 1987.
3. A first for British law, although the possibility has been there since 1965: refer *Northern Strip Mining Co Ltd, The Times,* 2, 4 and 5 February 1965. The French have had corporate criminal liability since 1 March 1994 and the rules apply to other organisations like trade unions and local authorities (Cahill and Cahill 1998: 23).

incidents remain to be fully resolved. Any criminal proceedings, assuming prosecutions proceed and succeed, are unlikely to achieve anything more than scapegoating individuals for what may be systemic failures. The same outcome is a probable final scenario for the Swiss canyoning disaster of 27 July 1999 (21 drowned including 14 Australians), and the Paddington, London rail crash of 5 October 1999 where over one hundred died when a Thames train bound for Bedwyn collided with the Great Western Express at Ladbroke Grove. Rarely is there any satisfaction with the way in which the legal processes drag on, and the lost lives can, of course, never be recovered.

Each of these tragedies provides a good illustration of the weaknesses of the criminal legal sanction as a regulatory tool. It has become evident that in order to *prevent* corporate irresponsibility, indeed, to attempt to prevent the phenomenon of 'corporation as victimiser' (Elias 1996) and to limit the broader social implications of the dangers of corporate disasters[4], the threat of legal sanction to punish individuals (after the event) if things do go wrong is cumbersome and largely ineffective[5]. It has long been the view of researchers that proactive management systems, put in place by senior executives[6], are far more effective in the fight against irresponsibility than reactive measures (Sarre 1995, Sarre and Fiedler 1999).

Corporate responsibility as a way of business life

With Western governments withdrawing from active participation in the operational economy, commercial organisations are moving inexorably into areas previously undertaken by the public sector. At the same time, there is growing pressure on corporations to become more accountable for their actions. Facing up to accountability is the community's perspective on corporate responsibility[7]; from a manager's perspective, corporate responsibility also implies minimising corporate risks[8]. Its self-regulatory aspects bring it within modern notions of the ideal forms of corporate governance, which forms have been the subject of much research and theoretical exploration in the last decade (Berns and Baron 1997, Bosch 1990, Ermann and Lundman 1992, Frank and Lynch 1992, Haines 1997, Prosser and Miller 1997, Ramsay 1999 and Wells 1993)[9].

In order to understand the concept of corporate responsibility, it is valuable to review some aspects of its development. The 1970s saw the introduction of much 'social' legislation designed to ensure corporations acted responsibly. Examples include consumer protection legislation (for example, Part VA of the Commonwealth *Trade Practices Act* which came into effect in July 1992, extending the liability of manufacturers for defective goods), environmental legislation (the importance of the Commonwealth *Environment Protection (Impact of Proposals) Act* 1974 in the development of Australian environmental law cannot be over-stated), and equal opportunity legislation (for example, the Commonwealth's *Sex Discrimination Act* 1984 and *Disability Discrimination Act* 1992). However, during the increasingly competitive 1980s and 1990s, further globalisation of world trade and the threat of merger or acquisition forced a stronger focus on shareholder value and financial responsibility. While this may appear at odds with the demand for social responsibility, some are now linking the two. Explaining his environmental consulting firm's decision to work with Shell, a company that has provoked anger from both environmentalists and human rights activists in recent years, John Elkington wrote, 'At the heart of the emerging value creation concept is a recognition that for a company to prosper over the long term, it must continuously meet society's needs for goods and services without destroying natural or social capital' (Elkington 1998). In other words, financial responsibility to shareholders is dependent, in the long term at least, on both responsible environmental management and responsiveness to societal needs and demands[10].

Despite the dominance of 'economic rationalism' in developed countries, with its connotation of remorseless pursuit of profit, the idea that corporations are responsible to more than just shareholders is gaining ground[11]. The Australian Prime Minister John Howard has made corporate/community relations a high priority, arguing that 'business has a strong stake in ensuring that communities remain dynamic and prosperous. Enterprises can only be as strong as the communities in which they operate. A company that derives profit from the community has an obligation to contribute to its development' (Howard 1998)[12].

Thus the managerial responsibility to minimise corporate risk and fulfil society's demand for accountability can be seen at three levels. The third strategy is the one that has the greatest potential benefit.

- Legal: by obeying the law, and meeting relevant standards and codes of conduct.
- Discretionary: by building goodwill through acting as a 'good corporate citizen'.
- Strategic: by contributing to global

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4. The fallout from corporate disasters—for example, industrial pressure, poor publicity, class actions, falling share price and criminal penalties—may not be limited to the organisation. There may be consequences for the wider community—for example, environmental catastrophe, dangerous or fatal activities, the collapse of allied industries and even potentially the economy.

5. A criminal trial is expensive, and the pursuit of a scapegoat from a corporation which has seemingly endless supplies of funding for legal assistance may be a choice which should be seriously questioned.

6. While a sense of corporate responsibility must pervade an organisation to be effective, it must begin with responsibility at the level of Chairman and Managing Director.

7. One definition of 'corporate responsibility' is the onus and obligation placed upon corporations and other business entities to conduct themselves in a fashion that makes them accountable for their choices. It is a broad and moveable notion encompassing established policy, management practices and organisational mandates within societal boundaries time and place. It often includes the notion that companies should make choices that are beneficial to the common weal, not simply those that have regard for the economic bottom line.

8. Risks can be categorised into three main areas: risks to people, risks to the environment and risks to the business. Corporate risks include: accidents, natural disasters, betrayals of trust, hostile takeovers, unpredictable behaviour of stock markets, the failure of alliances, pressures from advocacy groups, unfavourable political actions, product failures and the failure of market strategies (Francis 1997: 14).

9. And an excellent OECD website: http://www.oecd.org/daf/governance/principles.htm

10. This raises the fundamental question of the purpose of a company. There are two major schools of thought on this subject. Some agree with Milton Friedman (1962) that 'the business of business is business' and that pursuit of shareholder value and maximum profit is the only valid purpose of a company. Others, like management consultant Charles Handy (1991), suggest managers should think of themselves as custodians of corporate assets to be preserved and enhanced for a range of current and future stakeholders. In this sense, corporate assets refer not only to physical plant and equipment but to employee knowledge and skills, supplier goodwill, investor confidence, customer satisfaction and community respect.

11. For example, in the UK, there has been the development of the concept of 'stakeholder capitalism' that accepts capitalism as an economic framework but argues that there are multiple legitimate constituencies that should be involved and benefit from it.

12. On 26 March 1999 the PM announced a policy of paying Aus$50 million in tax incentives for those entities that played a role in their communities. "It will take more than tax breaks to encourage a love of mankind manifested as acts of practical benevolence, but they would help", (Editorial, *The Weekend Australian,* March 27-28 1999 p 20).

sustainability through responsible environmental and social management.

Legal responsibility

In a society that respects the rule of law, most companies will accept the need to obey whatever laws exist and to meet standards relevant to their industry and/or profession. However, while meeting legal standards is only a minimum requirement for corporate responsibility, even this is hard to achieve. The complex decision-making process of large modern organisations makes individual liability difficult to prove (Ridley and Dunford 1997), and if individuals are prosecuted, there is a likelihood they may be used simply as scapegoats. Also, the entire process takes an inordinate amount of time, which is less likely to have the deterrent effect offered by swift prosecution and penalty[13].

Discretionary responsibility

Good corporate citizenship is a growing concept that attempts to prick the conscience of individuals who lead companies. However, this relies on the ethical orientations of individual managers, and one could suspect a weak inclination in many industries to reciprocate trustworthiness generally (Cherney 1997). Also, not all corporations acknowledge the strategic advantage of fostering public goodwill.

Strategic responsibility

Strategically, corporate risk is reduced by minimising the possibility of society withdrawing the corporate 'licence to operate', a privilege accorded corporations through the laws of limited liability. The fiduciary duty of directors to have regard to the interests of shareholders is not related to present shareholders but rather to the general body of shareholders from time to time, and therefore to maximising company value on a sustainable basis (Goyder 1998). Sustainability involves responsible management of 'the commons' (the natural environment) as well as care of corporate reputation through ethical behaviour. However, it has always been notoriously difficult to get companies to focus on long term goals and persevere in their pursuit in the face of the market's demands for short term 'results'. Nevertheless, this third category of responsibility is crucial to our thesis, and is explained in the following section.

Corporate responsibility as a tool of disaster prevention

With the weaknesses identified above in the legal and discretionary responsibilities especially, it is clear the concept of corporate responsibility requires further development, especially where corporate practices may involve serious, if not life-threatening, risks. Such development must include not only appropriate organisational policies, procedures and systems, but also ways to cultivate an organisational 'culture of mindfulness', including realistic awareness of the possibility of disaster, a personal ethic of care and assumption of individual responsibility, and the organisational empowerment to act when necessary to prevent or minimise damage. There must be an organisational commitment to the constant evaluation of corporate health, safety and environment practices to ensure they *conform* with the law and, at the same time, *perform* to a minimum standard that is both safe and environmentally sustainable. Since standards evolve with changing societal norms and technological developments, continuous improvement is essential. Evaluation must involve dialogue up and down the hierarchy. If this does not occur, businesses will not be sustainable over time (Doig 1999, South Australia 1999).

This is not an entirely novel approach. The report of the Treadway Commission (United States 1987) recommended public companies should develop and enforce written codes of corporate conduct in order to foster a strong ethical climate, to open channels of communication and to help protect against criminal activity[14]. In the allied discipline of fraud prevention, Braithwaite (1985) and Clarke (1987) found that simple business changes to structure reduced the opportunities for dishonest conduct. In some US jurisdictions, corporations can be penalised if they are *not* actively engaged in the development of an ethos or corporate policy in which law breaking is discouraged (Tomasic 1994). The US government, in its 1991 *Sentencing Guidelines*, makes the existence of an internal compliance program that seeks to minimise corporate crime a mitigating factor in penalty upon conviction for such a crime (Cahill and Cahill 1998). There is no reason why these sorts of approaches to corporate governance should not be further encouraged generally in this country as a means of encouraging safe and sustainable business practices.

However, given the limited ability of legal sanctions to regulate for a positive corporate culture, other constructive mechanisms should be sought. These might include market-based mechanisms, government incentives, or peer group approbation by industry bodies where companies demonstrate exemplary behaviour. The 'carrot' may be a far more powerful agent than the 'stick' in seeking change (Freiberg 1986). It might have saved the *Herald of Free Enterprise*.

Conclusion

Corporate social responsibility is an idea whose time has come. It involves encouraging and rewarding moves towards industry self-regulation, while at the same time insisting upon international harmonisation of standards and the building a culture of risk-management. Governments and industry associations alike must encourage — through incentives — risk-prevention propriety in day to day business affairs. The proponents of corporate social responsibility assume, correctly, that these types of initiatives are preferable to using, and thereby enlarging, the formal (and therefore expensive) apparatus of the criminal justice processes when something goes sadly awry.

Proactive corporate social responsibility strategies that are sensitive to commercial priorities and designed to encourage rather than constrain business performance should be pursued as a matter of priority by governments, corporate conglomerations and regulatory bodies alike. It is more likely than not that, in such an environment, risks can be reduced, business performance can be improved and corporate accountability can be assured. Indeed, explorations into different types of regulatory governance promise to provide much interest for academics interested in the phenomenon of corporate governance generally[15].

Notes

13. The Royal Commission into the Longford gas explosion that killed two Esso workers in September 1998 identified up to 18 breaches by that company of the Victorian *Occupational Health and Safety Act*. (Editorial 1999). Prosecution of Esso has now been launched (February 1 2000), 16 months after the explosion. There are 36 charges, against the company not individuals, arising out of the failure to provide a safe workplace and the failure to train and supervise workers adequately.

14. The Commission recommended the following steps:

-Establish and communicate specific goals articulating corporate ethical standards;

-Develop and implement procedures to use in achieving corporate ethical standards;

-Create and install reward systems that encourage acts of moral courage;

-Define and provide resources employees need to perform their ethical duties;

-Create a work environment where supervision at all levels is characterised by consideration and humanness, thereby serving as a role model.

15. Some researchers are currently reviewing the value of regulatory systems by hypothesis testing and theory building (Ayres and Braithwaite 1992, Grabosky 1997: 201, Sarre 1994).

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