Public Submission in Response to the Interim Report

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As business ethics academics, we commend the Hayne Royal Commission on the findings and conclusions presented in the Interim Report. We have full confidence that these conclusions will result in appropriate policy recommendations and so we limit our submission to issues that broaden the scope of discussion to wider systemic issues and where we believe our expertise may provide insight.

The pursuit of profit over other purposes: First, the overall conclusion was thus: "*Much if not all of the conduct identified in the first round of hearings can be traced to entities preferring pursuit of profit to pursuit of any other purpose"* (p54). Much of the findings unearthed the financial incentives of brokers and customer-facing employees that drove the pursuit of profit over other purposes. We understand that the next phase of questioning will also unearth the financial incentives of senior executives and how these have been aligned with the incentives for customer-facing employees and brokers.

We point further to two issues that are systemically tied into the financial incentives for the pursuit or profit over other purposes. First, it is widely recognised that senior executives and board directors experience overwhelming short-term pressure from the share market for ever increasing profit growth. Notionally, senior executive remuneration is structured to allow for a balance between short-term and long-term performance expectations. Yet, the daily pressures experienced by senior executives, generated by analyst engagement and media exposure, emphasise the needs for next quarter performance. Poor customer conduct is then driven first by this pressure for short-term profit performance from the share market, that feeds into executive remuneration and then customer-facing employee incentive structures. This short-term pressure from the share market needs to be dealt with.

Unilever provides an example where they have responded to this pressure by actively seeking out longer term investors and refusing to release quarterly performance reports to discourage shorter term investors. We suggest that the framing of performance reporting should be mandated to emphasise longer term performance, and not performance over the next quarter. We also suggest the possibility of a 'Robin Hood tax' on share trading (e.g., 0.05%) would marginally reduce returns and thus discourage rapid and frequent short term trading.

Our second systemic point related to the pursuit of profit over other purposes is that this is the objective of the neo-liberal ideology of free markets and shareholder value maximisation. This has underpinned changes to the role of business over the last few decades, including privatisation and deregulation. It is supported by corporate law and fiduciary duties. We are therefore naïve to expect that corporations and their executives would conduct themselves any differently. They are expected and legally obliged to pursue profits over other purposes where unethical behaviour will maximise shareholder value. And they will be legally liable if they don't.

Of course, we have been here before. Business ethics scandals emerge time and time again, with much public admonishment, a little wrist slapping, and no change. Our last very big scandal was

James Hardie. This brought about two governmental inquiries[1] in 2006 into whether s181 of the Corporations Act should be broadened from prioritising shareholder interests to those of stakeholders, consistent with much of the research on Corporate Social Responsibility and later legislated in the UK. The conclusion of both inquiries was that the law should not be changed: that the 'business case' for ethical business was widely accepted and so the law allowed scope for responsible behaviours where they maximised shareholder returns. It was thus not appropriate for government to legislate for good management practices, which managers would adopt anyway out of enlightened self interest.

We point out that 12 years later the findings of this Royal Commission and many other scandals since show that the conclusions in the James Hardie inquiries were wrong. An acceptance of the business case for ethical business, where ethical business practice is aligned with shareholder value maximisation, does not guide business decision making sufficiently to guard against the conduct we have found so abhorrent in the Royal Commission. While there is a business case for ethical conduct, there is also a business case for unethical behaviour that drives the behaviours we have witnessed.

Strengthening penalties and strengthening the policing capabilities of regulators serves to positively change the equation of the business case. The Royal Commission also pointed out that more regulation to direct appropriate behaviour is not helpful in an already complex regulatory environment. These just serve to temper self-interested behaviour, fighting against the current of profit over other purposes. Regulations are often just something that business people need to find a way to get around.

We therefore suggest that s181 of the Corporations Act, as the underlying driver of executive decision making and behaviour, be reconsidered. One example is seen in the Benefit Corporation legal structure in the US[2] and other similar legal structures in other jurisdictions. Here, corporations are legislated to serve the interests of all stakeholders. Another option is that while there are short term trade-offs between ethics and shareholder value, the long term interests of shareholders are more aligned with those of society and other stakeholders. Specifying that managers and directors must act in the long term interests of shareholders, defined perhaps as more than 10 years, would help protect the value creation ability of the firm for shareholders and society. Furthermore, it would reduce the short term pressures that executives face that underpin current decision making.

Moral distance and Remediation. A consequence of economic specialisation, compounded by globalisation, is that individuals become 'morally distanced' from the effects of their decisions. They make decisions that affect people outside of their building and with whom they will usually never meet. They are therefore never exposed, especially emotionally, to the full consequences of their decisions, both positive and negative. The video of victims at the Royal Commission is emotionally powerful and likely much more so in person. When industry personnel are not exposed to this they are more likely to only see customers as simply numbers to be increased or reduced on a spreadsheet.

Compounding the harm created by financial institutions was the lack of or avoidance of remediation – people were bankrupted, their lives upended, and remediation was delayed and avoided. Remediation must be improved. It must be quicker, it must be independently organised, and it must

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[1] https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Completed_inquiries/2004-07/corporate_responsibility/report/index
http://www.camac.gov.au/camac/camac.nsf/byheadline/pdffinal+reports+2006/$file/csr_report.pdf

[2] http://benefitcorp.net/policymakers/how-pass-benefit-corporation-legislation

include compensation for the hardship caused over and above the financial damage. Graeme Samuel's suggestion for a standalone judiciary with expertise in corporate issues is appropriate. However, we suggest that remediation processes also serve to close the moral distance between victims and corporate decision makers. Community panels or restorative justice circles that bring together victims with decision makers may provide options.

Consumer responsibility and education. Finally, we note that while much of the behaviours can be considered legally unconscionable, customers vary in their vulnerability and so sometimes share responsibility for outcomes. This is especially in the overstating of incomes. We suggest that more education is required to increase the level of financial literacy across the population. This would need to take place in high school before leaving age.

Sincerely,

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