NICG Network for Innovative Corporate Governance

Board Dynamics

Predicting Rain and Building Arks

we are curious and
free spirits,

NICG 2024/1

NICG – Network for Innovative Corporate Governance

Anticipation. Adaptation. Application.

Having a crystal ball that accurately predicts the future would be invaluable for any board. Knowing how customer needs will evolve, how competitors, suppliers, and regulators will behave, how geopolitical events will unfold, and how technology will change would provide an immense competitive advantage. Unfortunately, such a crystal ball does not exist – no one knows what the future holds.

While change has always been the only constant, its pace and scope have undeniably accelerated. More than ever, the long-term success of a company hinges on its board's ability to anticipate future developments and to guide the company with proactive, well-informed, and forward-looking decisions.

«Predicting rain doesn't count. Building arks does.», Warren Buffet

Although a crystal ball would be a useful tool, it is clear that accurately predicting future developments is not enough; the company must also respond appropriately. Since no company can always predict the rain and build its ark in time, the board must prepare itself and the company for unforeseen events and crises. It is important to know how to swim when the tide comes in.

Reflecting on the analogy of Noah's Ark, you might ask yourself: how can I strengthen my ability to predict the rain, build arks, and swim in the flood? While there is no silver bullet solution, one thing is certain: relying on past success will certainly not be enough.

Stay hungry for new knowledge, never stop learning, keep yourself informed, read extensively, engage in discussions, and approach the role of a board with the necessary humility.

The NICG, a curious academic network full of free spirits, wholeheartedly embraces a collaborative spirit. Our 2024/1 Board Dynamics edition emplifies this once again. The multi-faceted articles, written by both experienced experts and young, talented researchers, vividly illustrate the diverse and challenging nature of corporate governance.

We wish you an inspiring and enjoyable read.

Kind regards

Prof. Dr. Michèle Sutter-Rüdisser
Director Institute for Law & Economics
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Dr. Cornel Germann
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[...]

Tailored to the needs of active board members and senior executives of primarily listed companies, "Board Essentials" offers key insights about best practices related to corporate governance.

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NICG Network for Innovative Corporate Governance

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Multi-Stakeholder Engagement

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Participation fee: CHF 80

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Board Talk: Hikmet Ersek

On January 19, 2024, as part of the Board Essentials program, Prof. Dr. Michèle Sutter-Rüdisser conducted an interview with the former CEO of Western Union, Mr. Hikmet Ersek.

Mr. Hikmet Ersek
Board Member at Voya Financial and Waterdrop, Honorary Consul of the Republic of Austria in Denver for Colorado, New Mexico, and Wyoming, Advisor at the Vienna University of Economics, and former CEO of Western Union (NYSE).

Prof. Dr. Michèle Sutter-Rüdisser: Hikmet Ersek, your curriculum vitae is truly impressive. Could you add a personal introduction? Please briefly share your career path.

Mr. Hikmet Ersek: I consider myself a global citizen. This global identity is not by choice — it's simply my reality. My father is Turkish, my mother Austrian, and I spent the first 19 years of my life in Turkey. I was raised bilingual, fluent in both Turkish and German. My academic and professional journey began in Vienna, and I have always worked for U.S. corporations, including ten years at Mastercard, five years at GE Capital, and twenty-two years at Western Union. I was fortunate to ride the wave of globalization — a wave that, regrettably, is now receding. When I started my corporate career, borders were more permeable; goods and people moved globally, and corporations expanded internationally. Given my multicultural background, I embraced these changes, leveraging them to propel my career forward. I wasn't hesitant to visit regions like Uganda, Tanzania, China, or Russia — places where many executives might hesitate to go. For the first eleven years at Western Union, I was Head of International. Later, I served as the CEO for 11 years. During that time, I thrived on minimal sleep — just 4.5 hours per night — managing a global company that operated in 200 countries. This role required constant attention across various time zones, and a profound understanding of global markets. The country profile was very diverse and the second largest market after the US was only 4% of the revenue, so all 200 countries were very important for us.

Prof. Dr. Michèle Sutter-Rüdisser: Let us talk about the benefits of your personal background. Would you say that being international from home is a prerequisite for a successful career in such a global environment?

Mr. Hikmet Ersek: Being raised by a Catholic mother and a Muslim father has certainly given me a unique perspective, aiding my understanding of diverse customer needs. However, it is not a prerequisite. It is more about cultivating cultural competence within your team. This multicultural understanding is critical when you're running a global company. It is not about where you are from; it is about how open you are to understanding and meeting customer needs. That is key to effective leadership.

Prof. Dr. Michèle Sutter-Rüdisser: Can you elaborate on the benefits and challenges of leading a culturally diverse board?

Mr. Hikmet Ersek: Having a diverse board is crucial, especially for a global company like Western Union. Diversity encompasses various aspects — not just gender, but also differing backgrounds and skill sets from various geographical areas. It is vital that the board's composition truly reflects the diverse needs of the customers, as this alignment helps the board to better understand and serve the market effectively. From Europe to the US and beyond, each member's unique perspective enriched our understanding and decision making capacity. While a diverse board brings many advantages, it also presents challenges due to varying perspectives. Our board included experienced executives from companies like McDonald's, PepsiCo or JP Morgan, who often had strong opinions. It was crucial to align these diverse views by making my ideas resonate with theirs. This involved careful preparation and communication. For example, instead of unilaterally changing the CFO, I involved the board in the decision making process, gradually building consensus. At every board meeting, I began with one constant: the voice of the customer. We would either dial in to hear directly from a customer or listen to a recording. This practice not only kept us connected to our customers' needs but also actively engaged the board in being part of the solution. Another constant in my board practice was my monthly half hour call with each board member. These calls were scheduled, giving both parties the opportunity to discuss their agendas. Before each call, I sent them a half page of pre read material to review, ensuring they were well prepared for the upcoming board meeting. By keeping no surprises and preparing the board for each issue in advance, we ensured that our meetings were productive and outcome oriented.

Prof. Dr. Michèle Sutter-Rüdisser: Can you discuss the one-tier versus the two-tier systems in corporate governance? Do you have a preference?

Mr. Hikmet Ersek: I might be biased, having primarily worked for US listed companies. There is a difference in how US listed companies are driven compared to European ones. In the US, everything starts with a shareholder driven mindset from the CEO down to the employees, emphasizing that the company's success directly correlates with shareholder success. In contrast, European companies sometimes offer five year CEO contracts, providing security but less alignment with immediate shareholder interests, which is something I find less effective. My own compensation structure, mostly variable, was heavily tied to stock performance, underscoring my commitment to shareholder value. I also find that the two-tier system, can make decision making slower compared to the US one-tier system. In the US setting I prefer a non-executive chairperson. A non-executive chairperson better separates governance and management responsibilities, leading to more agile and responsive leadership.

Prof. Dr. Michèle Sutter-Rüdisser: Regarding leadership style, given your international background, do you observe distinct patterns in Central European versus Anglo American settings? What are the advantages and disadvantages of these cultural influences on leadership styles, or do individual traits play a more significant role?

Mr. Hikmet Ersek: Naturally, each case is unique, but from my experience, there is a noticeable difference between Central European and Anglo American leadership styles. Central Europe tends to focus on learning from the past, which is beneficial for industries like automotive and horology where precision and incremental improvements are crucial. In contrast, the U.S. prioritizes looking forward, emphasizing future possibilities and innovation. This forward thinking approach encourages risk taking and agility in decision making. In my career, I've observed that Europeans generally adopt a more cautious approach, often involving extensive discussions that can become bureaucratic.

On the other hand, in the U.S., there's a stronger inclination to focus on market driven actions. This cultural difference extends to business expansion and innovation. European companies tend to be more reserved, potentially missing out on global opportunities that American companies, driven by a 'let's do it and see' attitude, are quicker to seize.

Prof. Dr. Michèle Sutter-Rüdisser: Let's shift our focus to strategy. From your experience, could you identify the key success factors for an international business strategy, and the role of the board in this?

Mr. Hikmet Ersek: My journey was somewhat facilitated by being a product of globalization. At Western Union, we were accustomed to operating across 200 different regulatory environments, which demanded a truly global mindset from all levels of management, from the CEO to the board members. A critical lesson learned was the need to adapt our strategy and personnel to local markets rather than trying to manage everything from a distance and react quickly to external factors. For example, when I became CEO in 2010, I faced the reality of the financial crisis, which required a complete overhaul of our business model towards compliance and regulatory adherence. Initially, our compliance department was about 200 people. By 2013, we expanded it to 2'700 people, with a significant investment in IT for better data intelligence. This shift wasn't easy — the company's stock dropped almost by 30% on the day of the announcement, placing immense pressure on the board. But it was the right thing to do, to respond to the regulatory requirements and to drive the long term shareholder value. Additionally, to keep up with the rapid fintech innovation after 2012, I opened an innovation office in San Francisco. This was not just a strategic move but a necessary one to stay relevant and proactive in the fast changing global market. This office became a critical driver for Western Union's continued growth and adaptation to the new business environment.

Prof. Dr. Michèle Sutter-Rüdisser: The challenge of knowing your local market while creating a global revenue stream has been widely discussed. Could you share your insights on this topic?

Mr. Hikmet Ersek: The situation is worsening as markets become more protective and governments push for regulations to secure electoral wins. This complicates launching global products locally, given diverse regulations in different countries. Managing such fragmentation is challenging—it's hard to be cost efficient or expand under these conditions. Ideally, I'd advocate for a return to a global movement where businesses think of serving 8 billion people, not just limited country markets. The current protective stance by many governments tends to create disparities, limiting access to products for certain populations, which I believe is a short sighted approach. To successfully operate locally, hiring local talent is essential. For instance, in 2012, instead of opting for the typical tech archetype from the Bay Area, I hired someone from Africa to lead our innovation office in San Francisco. This decision enhanced the relevance and adoption of our products in diverse regions like Africa, China, and South America. By understanding and integrating into the local environment from both a product development and managerial perspective, businesses can truly meet global customer needs.

Prof. Dr. Michèle Sutter-Rüdisser: Can you discuss the circumstances under which a local crisis evolves into an international crisis?

Mr. Hikmet Ersek: There is no distinction between local and global crises in our interconnected world—every local crisis affects a global brand. Effective crisis management is therefore an important success factor for a global company. At Western Union effective crisis management meant regularly engaging with our executive team and external advisors to simulate various crisis scenarios — be it terrorism, regulatory changes, consumer protection issues, or data breaches. We rehearse not only what to do but also who to contact, when to do it, and what to report. In crisis communication, it's vital to have dedicated staff trained for various scenarios — who speaks to the media, how shareholder communications are handled, etc. I believe that every company, especially global ones, must have a crisis handbook. It's not about anticipating every possible crisis, but about having a tested process in place. This preparation is what separates a manageable crisis from a corporate catastrophe.

Prof. Dr. Michèle Sutter-Rüdisser: Let's pivot back to discussing the board. We've spent quite a bit of time reflecting on the essential skills and traits of a board member. One key attribute we seem to agree on is independence. Could you delve deeper into why this is so crucial?

Mr. Hikmet Ersek: Independence is paramount for any board member, particularly in publicly traded companies where you are entrusted to represent shareholder interests. Too often, people join boards thinking about the prestige it brings, forgetting their fundamental duty to act independently and prioritize the interests of shareholders, like a teacher who invests their life savings in the company. Remember, when you're making decisions or attending meetings, it's about representing these individuals. Beyond independence, personal compatibility with the board and the company is crucial. Never join a board solely for its reputation. Before I commit to a board, I interview each member to understand their views and assess any ongoing issues like major lawsuits or regulatory challenges. I also ensure I thoroughly understand the company's strategy and products — even if they are complex — by reviewing their annual reports, attending earnings calls, listening to Q&A sessions, and reading analyst reports. Interacting with major shareholders to gauge their expectations is also invaluable. Ultimately, board membership boils down to the people. Despite all strategic or regulatory considerations, it's about working well with and understanding the team.

Prof. Dr. Michèle Sutter-Rüdisser: I really appreciate the thorough assessment you conduct before joining a board. It's crucial, yet often overlooked. I've had a similar experience where, despite offering to sign a non disclosure agreement, I was denied access to necessary information by a board due to confidentiality concerns. This led me to halt the process. It's essential to know the people you'll be working with—both the board and management. It matters whether they view you as a sparring partner or merely want your name as a figurehead. The latter can be a precarious situation.

Mr. Hikmet Ersek: Imagine joining a board and facing a massive crisis within a month because you skipped due diligence. It's a common mistake — people get dazzled by the company and its people. The result? Sleepless nights. There are individuals who have ended up testifying before a senate, unprepared, all because they didn't thoroughly vet the board beforehand.

Prof. Dr. Michèle Sutter-Rüdisser: Could you share your perspective on the future of corporate governance on an international scale?

Mr. Hikmet Ersek: I'm not very optimistic. There will be more and varied governance requirements, which might discourage companies from actively pursuing growth due to the perceived risks. From conversations with fellow CEOs, I sense a growing reluctance to take even calculated risks, which isn't a good development for business. In Europe, differing regulations may inhibit companies from being innovative and growth oriented. The U.S. seems to be in a slightly better position due to its large market. Today's CEOs, wielding significant power and responsibility, need to actively engage with politicians and the public. Remember, we're dealing with global issues that know no borders — environmental problems, for instance, affect everyone worldwide. Global CEOs are ideally positioned to lead these discussions and address these challenges head on.

The Curious Director: Try, Fail, Learn, Succeed – Repeat

Patrick Zbinden
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Have you ever wished you could ask a customer a question during a board discussion? How about your employees, competitors, partners, shareholders, or even historical figures like Plato or Aristotle, or those of individuals not yet born?

Steve Jobs certainly had: «Unfortunately I can't ask Aristotle a question. I mean, I can, but I won't get an answer. Imagine how cool that would be. My hope is that, in our lifetime, we can create a new kind of interactive tool that will allow us to capture what someone such as Aristotle has said and make it possible to ask questions and receive answers.»[1]

- In this article you will discover a way to turn Steve Jobs' wish into reality. How? Through the use of generative artificial intelligence (AI).
- You will learn about VITAL, Aiden and Mika, neither of whom is human, but all hold leadership positions within companies.
- As time waits for no one, this article serves as a call to action, urging you to begin experimenting with AI in your daily board activities.
- Finally, this article is an invitation. Join us as we kick-start a new AI Think Tank as part of the Network for Innovative Corporate Governance (NICG).

1 AI in the Boardroom: Where Do We Stand?

Ten years ago, Deep Knowledge Ventures, a Hong Kong based venture capital fund, appointed an AI persona named VITAL to its board. Though VITAL holds only observer status due to legal constraints, it has voting power in every investment decision.[2,3] In February 2024, the largest listed company in the UAE, International Holding Company (IHC), followed by establishing a board observer position for an AI persona named Aiden Insight. This makes Aiden the first AI board observer in the Middle East.[4,5]

1 Steve Jobs. (1985). Steve Jobs visit at Lund University in 1985. Lund University.
2 DKV. (n.d.). Structure.
3 Zhao, J. (2022). Artificial intelligence and corporate decisions: fantasy, reality or destiny. Cath. UL Rev., 71, 663.
4 Abu Dhabi Media Office. (2024, February 27). Artificial intelligence board observer appointed by International Holding Board of Directors.
5 Kole, A. (2024, April 21). A new governance paradigm is necessary for AI-powered boards. Harvard Law School Forum on Corporate Governance.

Similarly, Dictador appointed Mika, the world's first AI-powered CEO.[6]

Examples such as VITAL, Aiden and Mika are likely to provoke many different thoughts in you. Questions may arise about the type of AI technology on which they are built. You might doubt that AI is advanced enough to be a successful CEO or board of director, and even speculate that they are merely marketing tricks to get attention – something all three certainly achieve. On the other hand, these examples could spark great fascination. You might believe it is possible that one day AI could bring to life Plato's omniscient and benevolent (corporate) philosopher king and solve major challenges such as climate change. Or, on the contrary, you might see such initiatives as the greatest threat humanity has ever faced.

However, while fascinating to think of, it is important to stress that examples like Aiden, VITAL and Mika remain rare. There is surprisingly little empirical data on the current use of AI in boards and for board work. A recent literature review highlighted that most corporate governance research on AI is theoretical, focusing on potential benefits and challenges without real-world testing.[7] Additionally, descriptive studies on AI-use lack specificity in the context of boards.

Nevertheless, our experience clearly suggests that most boards are still in the very early stages of AI integration. As consulting firm Korn Ferry puts it, «most directors (...) are still trying to wrap their heads around what AI really is».[8] Fairly, one should respond to this critique by asking, who is not? Ultimately, we are all still at the beginning. Otherwise, we would not do justice to AI's unprecedented potential.

Although all are still at the beginning, there are certainly significant differences, with some being more advanced and others lagging behind. This is supported by a large US study by PWC, which reveals that only 35% of executives believe that AI receives sufficient board time, indicating that current board practice is not fully exploiting the potential of AI.[9] We believe it is time to change that.

6 Reuters. (2023). Drinks company appoints AI robot as CEO
7 Ahdadou, M., Aajly, A., & Tahrouch, M. (2024). Enhancing corporate governance through AI: a systematic literature review. Technology Analysis & Strategic Management, 1-14.
8 Coleman, S. (2023, May 17). AI is everywhere, except on boards.
9 PwC. (2024). C-suite insights for board effectiveness.

2 Time Waits for No One, Not Even for You

AI is not a particularly new notion. It dates back to the 1956 Dartmouth Conference organized by John McCarthy, where the term AI was first introduced.[10] Therefore you might first ask why now? We argue that something has changed on November 30, 2022. This date marks the official launch of OpenAI's ChatGPT. Since then tools such as ChatGPT have democratized AI, heralding a transformative era in the field.

It seems clear to us that being a laggard in this AI revolution not only jeopardises the success of your company, but also your own career. The pace of change has never been faster. New AI applications are springing up like mushrooms, creating previously unimaginable technical possibilities. We firmly believe that AI will not replace you as a board member soon, but a person using AI could! Studies already indicate that the use of AI among knowledge workers can lead to significant increases in productivity, improve customer satisfaction, strengthen employee loyalty, and promote employee learning.[11,12]

The good news is that it is not too late to get ahead of the crowd. The topic is new for everyone, not just for you. The bad news is that time waits for no one, not even for you.

3 Get Your Hands Dirty

We are encouraging you to get excited about AI. See it as a privilege to be part of such a fascinating era. Isn't it amazing to experience a new AI-driven world full of unimaginable technological possibilities, almost like a child discovering the world for the first time? Isn't it puzzling how this is even possible and how far we, as humans, have come?

This is a call to experiment with AI in your individual board work and collectively in the boardroom. Like a child: experiment, fail, learn, and eventually succeed. Starting to experiment with AI does not require you to be a programmer, statistician, or technical expert. AI is accessible to all, regardless of age, educational background, digital proficiency, or financial means.

10 Rockwell, A. (2017). Can Machines Think. Harvard Graduate School of Arts and Sciences. Retrieved from The History of Artificial Intelligence – Science in the News (harvard.edu).
11 Dell'Acqua, F., McFowland, E., Mollick, E. R., Lifshitz-Assaf, H., Kellogg, K., Rajendran, S., ... & Lakhani, K. R. (2023). Navigating the jagged technological frontier. Harvard Business School Technology.
12 Brynjolfsson, E., Li, D., & Raymond, L. R. (2023). Generative AI at work.

However, this is a decision that you must make yourself and that requires direct involvement and personal commitment.

Before you plunge into the vast field of AI experimentation, two things are recommended:

1. Firstly, ensure that you create a safe playing field. It goes without saying that it is not advisable to feed sensitive data into an AI-application without checking the necessary requirements for its use in a company. We recommend first assessing the type of information you intend to use and evaluating its sensitivity. Depending on the data's sensitivity, appropriate data security measures should be chosen. However, do not use data security concerns as an excuse to delay getting started; there are solutions available. In the case of ChatGPT, for example, the enterprise versions «ChatGPT Enterprise» and «OpenAI API» allow for Data Processing Agreements (DPA). In addition, the terms of use contain a confidentiality obligation on the part of OpenAI. At this point, however, it should be noted that it remains a risk decision for the company itself as to whether it trusts the provider and discloses business secrets or not.[13] That being said, 92% of the Fortune 500 companies already use OpenAI in their business operations.[14] Looking at these figures, it is very likely that you as a board member also have access to a safe «playing field».

2. Secondly, create a basic understanding of AI. There are numerous terms circulating in the field of AI, but surprisingly few people are able to categorise them precisely and know how they work technically. Before you jump into experimenting, developing basic AI literacy is advisable. This does not require deep technical expertise, but enough knowledge to grasp the fundamental concepts.

Once these two steps are done, it is time to get your hands dirty. You may be wondering where to start. We recommend that you do this in a structured way. Do not just prompt a few questions occasionally on ChatGPT and then think you have done your bit. A helpful way to structure your AI experimentation journey is to first outline your personal workflow, then assess where AI could support you, and finally decide where you are most likely to use it.

13 Vischer. (2024). Teil 2: Gängige KI-Tools: Wie steht es um den Datenschutz?. Vischer.

14 OpenAI. (n.d.). ChatGPT for enterprise | OpenAI.

4 Role-Prompted AI-Personas

Next, we would like to introduce an elegant, easy-to-implement way using ChatGPT to incorporate examples such as Aiden and VITAL directly into your board. This approach can enhance your board's diversity, foster creativity, increase customer centricity, and lead to better-informed decisions.

The proposed idea builds on a concept from Amazon, a company renowned for its focus on customer centricity. Rumor has it that company founder Jeff Bezos has introduced a rule whereby one chair is left empty at every meeting to symbolize the presence of the customer. This symbolic gesture should ensure that customer perspectives remain central to every discussion, reminding executives and boards to integrate the voice of the customer into their decision making.

Figure 1: Own illustration of role-prompted AI personas

Building on the «empty chair» approach, with the help of AI, you can take it a step further. Why don't you put an AI persona on that empty chair? Unlike an empty chair, an AI persona can be asked questions, provide helpful insights, and even intervene in decisions. This approach doesn't have to be limited to the voice of a customer. Consider giving other stakeholders a virtual seat in your board, such as employees, shareholders, suppliers, competitors, NGOs, philosophers, experts, or even someone representing a future generation. The options are limitless.

As promised, this is technically very easy to implement. Simply use ChatGPT to «role-prompt» an AI persona. This means instructing ChatGPT to imagine being an employee or someone from a future generation. Let us provide you with two examples:

Role-promoting a member of a future generation: «Imagine you are Futura, a member of a future generation, born in the year 2075. You are deeply concerned about finding and maintaining a planet worth living on. You value sustainability and innovative solutions to environmental challenges.»

Role-promoting an employee: «Imagine you are Tom, an employee who has been with the company for 25 years. You value goal-oriented work and prioritize dedication. You strongly believe that loyalty and hard work should be financially rewarded. You are convinced that nothing can surpass real human work experience.»

If you want to go one step further, such role-prompted AI personas could even take on a position on the board, like VITAL or Aiden. This demonstrates a tangible and feasible way in which an AI board of director could be realized within your company. When you start experimenting with AI personas, you will quickly realize that this concept is far from fully developed. The input from the AI personas might not always be helpful. But is this any different from the input of real humans? Do not be too hard on your new colleagues; take your time to get used to each other and be patient.

You will encounter many questions that need to be addressed, including but not limited to:

- Who can initiate LLM role-prompting?
- How are the AI personas trained?
- Who holds authority over the training data?
- What is the level of participation of the AI persona? (e.g., advisory role, veto right, or full decision-making power)
- How are the AI personas operationally integrated into the board processes?

5 Let's Shape the Future of Governance

AI-prompted personas are not the only way to experiment with AI in your board work. For instance, you could use AI to handle the overwhelming amount of preparation data by identifying relevant patterns in large company documents. Consider using AI in strategic processes, market research or brainstorming sessions.

We highly recommend getting creative and to come up with your own ideas. Have the courage to try things out, even if they are unconventional at first. As boards of directors are generally rather static, we recognise this as a particular challenge. Do it despite these challenges. Be a curious director! Because one thing is certain: «You miss 100% of the shots you don't take.»[15]

NICG AI Think Tank

Are you a curious director eager for innovation? Join us in launching the pioneering AI Think Tank under the Network for Innovative Corporate Governance. Together, we will connect theory with practice and explore AI use cases that can transform governance tasks.

Curious?

Get in touch with us at info@nicg.net.

15 Wayne Gretzk, former Canadian ice hockey player.

Win the Game

Dr. Stefan Legge
Vice Director, Head of Tax & Trade Policy at the Institute of Law and Economics (ILE-HSG), Lecturer at the University of St.Gallen

1 What happened since the 1990s?

Remember the good old days when «the business of business was business»? The time when all that managers needed to think about was the various business aspects of leading a company: hiring people, dealing with suppliers, fighting off rivals, and so on. Today, it seems as managers should on top of all this also solve societal problems such as various inequalities, climate change, and geopolitics. Executives are called to take positions on a variety of political questions as well. This is demanding. The Economist in 2023 caricatured the «overstretched CEO».[1] Many wish back the 1990s.

Alas, a clear separation of business and politics never fully materialized. The job of managers has never been just business. The very fact that Milton Friedman wrote his famous 1970 New York Times article – for many the go-to reference for the good old times – indicates that even half a century ago people expected managers to address problems beyond the business.[2]

Still, in the 1980s and 1990s a certain idea got generally accepted: free markets do a better job than government intervention. The US won the Cold War, capitalism beat socialism. Privatization, liberalization, and globalization were the way to go. They were the ideas of the time.

We should not underestimate the power of such big ideas. John Maynard Keynes wrote in 1936 that «The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood.»[3] And we can get a sense of the leading ideas, the general sentiment in the 1990s and early 2000s by looking at best-selling books of the time: The End of History, The Death of Distance, The World Is Flat, The Global Village. More importantly, governments followed: they did liberalize, privatize, and globalize. Markets got the upper hand.

1 The Economist (July 27, 2023) «The overstretched CEO».
2 Friedman (September 13, 1970) «The Social Responsibility of Business is to increase its Profits», New York Times.
3 Keynes (1936) «The General Theory of Employment, Interest and Money».

But then things went wrong. Many would say that markets «failed». Yet, that is not correct. Instead markets – as a mechanism – delivered, predictably, results that many people dislike. We saw the dotcom crash of 2001, when a stock market bubble popped. Then came the Global Financial Crisis of 2007, a result of moral hazard. We witnessed the Eurozone debt crisis, a result of governments borrowing, effectively, in a foreign currency. Climate change became an increasingly big problem because interdependencies were not priced in. Supply chain disruptions highlighted that international trade requires trust and well functioning institutions. And income inequality, caused by market prices reflecting scarcity instead of fairness, was seen by many as too high. In short, markets did what markets do: Lacking good complementary policy they produced unfavorable results – and lost a lot of their appeal.

But there is more that went wrong. Some noticed early the coming trouble. Former Secretary General of the UN, Kofi Annan, said in December 2001 that «We entered the third millennium through a gate of fire.» He referred to the 9/11 attacks. About a quarter century later, we can conclude that geopolitics indeed is not over, we have not reached «the end of history». Democracy and freedom have been in decline for almost twenty years straight, according to Freedom House. And even in rich Western nations much of the social fabric has been eroding. Families, neighborhoods, friendships, clubs, Christianity – key institutions are in recession. Drivers of this development are urbanization, individualism, mobility, a desire for flexibility, and social media.

2 Why does it matter for firms?

These developments of the past twenty-five years do not just pose societal challenges but also create ramifications for managers. The business environment changes and companies must adjust accordingly. When several key institutions are in decline, and those institutions are not entirely useless or obsolete, we need substitutes.

One possible substitute is the state. Pension systems have replaced implicit family obligations to provide for the elderly. Industrial policies are said to fix market shortcomings. A sense of belonging and purpose can be created by political tribalism and nationalism. However, not only are such approaches imperfect, but they also cost money. It is no coincidence that we observe a bigger financial footprint of the state and new measures like, for instance, the Global Minimum Tax for corporations.

A second potential substitute for the declining institutions are companies. Perhaps they can supply people with purpose, they can address various inequalities, and they can solve problems like climate change by innovating and financing green technologies.

Both substitutes imply a larger role for business. To better understand this we should establish a simple framework. Firms operate in markets which itself are operating in a business environment. While the «market arena» is populated by players such as competitors, suppliers, buyers, unions, and so on, the «non-market arena», or business environment, is defined by governments, society, NGOs, scientists, religious leaders, or the media.

Managers are typically well aware of the players in the market arena. They understand what game they play, how they think and operate. However, the players of the non-market arena are very different. They are not stupid, but they have distinct ways of thinking and operating. They play their game. Politicians want to win elections, journalists get attention for their work, et cetera.

Managers' first inclination might be to stay away from that non-market arena. After all, it is unfamiliar territory. However, it might not be possible to avoid interacting with non-market players – they may seek to draw businesses into their games. On top, managers might choose to voluntarily engage with the non-market arena because they win more if they do. For example, politicians can tilt the playing field in the market arena.

The question each manager should ask is this: How do you win your game? Certainly not by playing too many games, trying to please too many stakeholders. Instead, managers must understand how exactly the elements of the business environment contribute to their companies' success.

3 How to navigate in this environment?

The rising influence of the non-market arena has first-order implications for executives. They no longer get away with «just» managing the business (i.e., production, sales, finance, etc.). More is expected.

Fortunately, academia has development tools and frameworks which help managers navigate in this more complex environment. Well-known concepts such as Michael Porter's Five Forces should be enhanced by David P. Baron's Integrated Strategy.[4] It allows executives to quickly decide if and why a non-market development / event is relevant and how to respond to it. What threat or opportunity does it create? Who ultimately decides if it materializes? Who are other actors that support or oppose it?

Again, to win the game managers must understand the players involved and their objectives. Importantly, firms' position toward non-market actors should align with that towards market players. For example, if McDonald's in France fights regulation mandating reusable packaging it might backfire if the same packaging is praised in advertisements. In addition, shareholders must be aware that policy objectives such as meeting ESG metrics might be easier than delivering a profit.

In many cases, and especially those of geopolitics, it might be best for companies to stay out of the game – if possible. After all, the Fifth Amendment, the right to remain silent, is valuable to managers, too.

4 Outlook

What's past is prologue, so where are we heading? The public sector achieved big territorial gains. At the same time, we observe many shortcomings, many failures. Industrial policies do not deliver the promised results, geopolitical reengineering of supply chains is too costly, the fight against climate change makes little progress. And in a way, we already observe a pushback of markets, or reality if you like. Politicians once again realize that working against market mechanisms is like fighting gravity.

While the share of tax revenue to GDP reaches record highs in many countries, success is scarce. State capitalism in China looks increasingly unattractive. Hence, the battle between markets and states, which defined so much of the 20th century, will continue. At the same time, geopolitical rifts increase, values diverge. This makes it likely that the global business environment will remain challenging.

Executives have no choice but face this murky reality. But if they understand the game well, their chances of winning are still high.

4 Baron (1995) «Integrated Strategy», California Management Review

The Rise of ESG Litigation and ESG Regulatory Investigations

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ESG litigation and ESG regulatory investigations are on the rise. In recent years, the focus has shifted from mainly targeting States to targeting companies. The importance of a suitable and robust ESG corporate governance is and will remain key as legislative developments might lead to an increase in both liability and litigation risks. In a complex landscape of overlaying national and international laws, standards, guidelines and principles, recommendations can soon change into obligations, and members of the board as well as senior management must foresee (potential) ESG litigation and ESG regulatory investigation risks in the company's risk and compliance framework.

In the following, the most important factors of an ESG regulatory investigation are first discussed, followed by a presentation of recent developments in ESG litigation, and a summary of key take-aways for members of the board and senior management.

1 ESG Regulatory Investigations

1.2 Triggers for Investigations into ESG Issues

Triggers for investigations into ESG issues can be diverse and can concern internal (e.g., customer complaints, whistleblowing reports, compliance or audit reports) and external factors (e.g., enquiries by NGOs, internal leaks to NGOs or the media). While it is still evolving, what falls into the three pillars of ESG, the following potential triggers for investigations of ESG issues are the most common:[1]

- Supply chain issues: Regulators worldwide are increasing their demands that manufacturers and retailers know and understand all aspects of their supply chains as they relate to ESG goals. Allegations of bribery, corruption, and violation of human rights are often at the center of investigations related to supply chain issues.

1 See GODDHARD EMILIY / KIRKPATRICK ANNA / LAKE ELLEN, § 47 Environmental, Social and Governance Investigations, in: The Practitioner's Guide to Global Investigations, Volume 1: Global Investigations in the United Kingdom and the United States, Sixth edn., Law Business Research 2022 897 et seqq.

- Greenwashing: Allegations of greenwashing increasingly result in the opening of an investigation. In its Guidance 05/2021 on preventing and combating greenwashing, FINMA sets out its expectations and current practice regarding the management of sustainability related collective investment schemes at both the fund and institutional levels.[2] In addition, FINMA warns financial service providers who offer sustainability related financial products of potential greenwashing risks in the advisory process as well as at the point of sale.

- Discrimination, harassment, and culture: Especially for regulated entities in the financial sector, non-financial conduct is increasingly considered as failing with the regulatory requirements. Poor corporate culture and alleged misconduct at the workplace often involve elements of discriminatory behavior or sexual harassment.

- Environmental accident: Examples include an explosion at a pharmaceutical manufacturing plant or an oceanic oil spill.

ESG-related investigations have generally a broader factual scope than «traditional» internal investigations, and as a result, what is key is the involvement of various experts from a law firm's different legal practice groups and from a company's diverse departments.

1.3 Challenges of ESG Investigations

Legal and Regulatory Framework

In the context of ESG, it can be particularly complex to ascertain, prior to an investigation, what benchmark must be applied in assessing the subject matter. There is a need not only to focus on hard law but also on various soft law issues (e.g., the UNGPs and OECD Guidelines for multinational enterprises)[3] and other frameworks (e.g., the entity's internal ESG related policies and procedures).

Stakeholders

Interacting with many stakeholders during an investigation may be challenging with respect to keeping matters confidential and privileged.[4] This challenge arises mainly because ESG-related investigations regularly involve external parties affected by the conduct under investigation whereas «traditional» internal investigations tend to focus more on the inward nature of a company.[5]

Cross-border Investigations and Worldwide Prosecution Risk

ESG related investigations often require international cooperation with other jurisdictions. Authorities from different jurisdictions may also be interested to learn about the outcome of a particular investigation, which can push a company toward a worldwide prosecution risk. Also, gathering evidence can be burdensome because of the extended global responsibilities attributed to companies regarding ESG (e.g., supply chains in different jurisdictions).

1.4 Transparency, Reporting, and Legal Privilege

At the outset, companies should not assume that materials produced along the way will necessarily be withheld from publication at a later stage. A company will regularly have to make transparency commitments (i.e., publishing some forms of investigative findings, such as a written report to the attention of various stakeholders). Also, various jurisdictions may require some level of reporting on non-financial issues (see below para 2.1). Finally, a company intending to have the benefit of legal privilege must set up the investigation team according to the requirements of the relevant jurisdictions.[6]

1.5 Remediation and Lessons Learned

Because ESG issues may not always be remedied quickly, it is important to track recommendations and actions arising as the investigations progress.[7] Remediation typically also includes disciplinary sanctions as well as implementing mechanisms and reporting channels to facilitate the identification and resolution of potential future incidents.

2 See <https://www.finma.ch/~/media/finma/dokumente/dokumentencenter/myfinma/4dokumentation/finma-aufsichtsmitteilungen/20211103-finma-aufsichtsmitteilung-05-2021.pdf> (last visited on 1 May 2024).

3 See <https://www.oecd.org/corporate/mne/34873731.pdf> (last visited on 1 May 2024).

4 ROMAN HUBER, Interne Untersuchungen und Anwaltsgeheimnis: Entwicklungen und Eckpunkte einer «Best Practice» für Unternehmen, GesKR 2019, 65 et seq.

5 GODDHARD / KIRKPATRICK / LAKE (FN 1), § 47, 904 et seqq.

6 ROMAN HUBER, Das Anwaltsgeheimnis bei internen Untersuchungen, § 51 N 6 et seq., in: Rita Pikó / Laurenz Uhl / Sara Licci, Handbuch Corporate Compliance, Basel 2022.

7 GODDHARD / KIRKPATRICK / LAKE (FN 1) § 47, 910 et seq.

2 ESG Litigation

2.1 Increase of ESG Litigation Risks in Particular due to Increased Reporting Requirements

ESG litigation risks are increasing in Switzerland due to the following three main factors:

- There is an increasing number of ESG regulations worldwide[8]: New laws and regulations in Switzerland and abroad require companies to disclose their ESG performance and to explain or take steps to improve it. These new steps are creating a more complex regulatory landscape.

- ESG factors become more and more relevant to investors and consumers: Investors are increasingly demanding that companies disclose their ESG performance while consumers are also becoming more ESG-focused. This new scenario is putting pressure on companies to measure, communicate, and improve their ESG performance; it also makes them more vulnerable to ESG litigation.

- Growing awareness of ESG issues in the public: the availability of data and the focus of activist NGOs increases the likelihood that ESG commitments or ESG-related misconduct are litigated.

According to Art. 716a para. 1 no. 1 Code of Obligations («CO»)[9], the overall management of the company is one of the non-transferable duties of the Board of Directors. This duty also includes to define the strategy with regard to non-financial matters. Large businesses (Art. 964a CO) are required to include ESG interests in their annual reporting, with false claims and insufficient transparency potentially leading to fines (Art. 964a et seqq. CO). According to Art. 964c CO, the report on non-financial matters must be approved both by the supreme management or the governing body, as well as by the body responsible for approving the annual financial accounts. In the case of public limited companies (Art. 620 et seqq. CO), it must therefore be approved by the Board of Directors and the General Meeting.

	Non-financial matters (Arts. 964a / 964b / 964c CO)	**Raw Material Companies** (Arts. 964d / 964e / 964f / 964g / 964h / 964i CO)	**Minerals and Metals from Conflict-Affected Areas and Child Labour** (Arts. 964j / 964k / 964l CO and DDTrO[8])
Responsible	Approval and Signature of the supreme management or adminstrative body and the approval of the governing body responsible for approving the annual accounts.	Approval and Signature of the supreme management or administrative body.	Preparation by the supreme management or administrative body.
(Criminal) Sanctions	(Art. 325ter CC) • false information in the reports in accordance with Articles 964a, 964b and 964l CO or fails to make the required reports; • fails to comply with the statutory obligation to retain and document the reports in accordance with Articles 964c and 964l CO. • fine not exceeding CHF 100'000 or CHF 50'000 (neglicence).	(Art. 325bis CC) • false information in the report on payments made to state bodies in accordance with Art. 964d CO or wholly or partly fails to make the required report; • fails to comply with the statutory obligation to keep and retain reports in accordance with Art. 964h CO. • Fine not exceeding CHF 10'000 (Art. 106 para. 1 CC).	(Art. 325ter CC) • false information in the reports in accordance with Articles 964a, 964b and 964l CO or fails to make the required reports; • fails to comply with the statutory obligation to retain and document the reports in accordance with Articles 964c and 964l CO. • fine not exceeding CHF 100'000 or CHF 50'000 (neglicence).

8 See for example, the Climate and Innovation Act, which comes into force on 1 January 2025, obliges companies to achieve net-zero emissions by 2050 and encourages companies to draw up transition plans.

9 Federal Act on the Amendment of the Swiss Civil Code (Part Five: The Code of Obligations) of 30 March 1911 (SR 220).

10 See also Ordinance on Due Diligence and Transparency in relation to Minerals and Metals from Conflict-Affected Areas and Child Labour of 3 December 2021 (SR 221.433).

While criminal law provides for corresponding sanctions in the event of a breach of reporting (Art. 964a et seq. CO / Art. 325bis and Art. 325ter Criminal Code [«CC»][11]), the Code of Obligations does not provide for an explicit basis for (civil) liability in the event of insufficient due diligence related to reporting duties.[12] Possible bases of (civil) liability, however, for the enforcement of statutory transparency obligations of companies include the directors' and officers' liability law and tort law.

Fines against the company, on the other hand, are not provided for. This would have required an amendment to Art. 102 CC, which presupposes a felony or misdemeanor for the subsidiary criminal liability of the company. Art. 325ter CC, however, is an offense merely because only a fine is threatened.[13] Neither does the the parallel criminal liability apply under Art. 102 para. 2 CC, as Art. 325ter CC is not mentioned there. If, on the other hand, the erroneous reporting also constitutes an offence under Art. 152 CC (e.g., untrue statements about commercial trades), the company may be punished under Art. 102 para. 1 CC, as this is an offence.

2.2 ESG Court Cases in Switzerland and Abroad

ESG litigation relating to the environment, and climate change in particular, is a rapidly growing area of law. It includes lawsuits challenging the enforcement of climate-related laws and policies, but also binding lawsuits based on human rights. These legal disputes are not only directed against States, as is traditionally the case, but increasingly also against the responsibility of companies and private corporations. Not only have the number and diversity of cases related to climate change increased, but the geographical scope of these disputes has also expanded.[14]

Switzerland

Apart from numerous criminal cases against climate activists for protest through civil disobedience (e.g., road blockades, sitins, trespassing), the following Swiss disputes are of particular interest:

- Romero case: criminal charges against Nestlé executives for failing to prevent crimes by Colombian paramilitary groups or for failing to protect trade unions. Note: Decision of non-admissibility of the claim (confirmed by the Swiss Federal Supreme Court).[15]

- In October 2016, the association KlimaSeniorinnen Schweiz and others sued the Swiss federal authorities based on the Swiss Federal Constitution and the European Convention on Human Rights (ECHR) for failure to take measures to abate climate change and to ensure Switzerland's contribution to achieving the 2015 Paris Agreement's goals. The national courts declared the action non-admissible for lack of standing.[16] On 9 April 2024, however, the Grand Chamber of the European Court of Human Rights (ECtHR) delivered a landmark decision.[17] In an unprecedented ruling on a complaint brought by four individual women and a Swiss association of more than 2,000 elderly women above the age of 64 (Verein Klimaseniorinnen), the Court found that Switzerland had breached its positive duties under the ECHR by failing to take sufficient action to mitigate the adverse effects of climate change on human rights. In particular, the ECtHR held that there had been a violation of Article 8 (right to respect for private and family life) and Article 6 (right to a fair trial) ECHR. The ECtHR's ruling was the first time an international court found a state in breach of its human rights obligations in the context of climate change.[18] Klimaseniorinnen and others v. Switzerland confirms the growing scrutiny of States' climate policies, which is now established as a human rights issue. The impact of this ruling on Swiss climate policy and regulation remains to be determined, as does its potential effect on companies.

11 Swiss Criminal Code of 21 December 1937 (SR 311).

12 See Art. 69 Federal Act on Financial Services (SR 950.1), however, as an example for another potential basis for liability regarding information that is inaccurate, misleading or in violation of statutory requirements in prospectuses.

13 Art. 103 CC.

14 As reflected in the updated Global Climate Litigation Report 2023 (the UNEP Report) that was published on 27 July 2023 by the United Nations Environment Program (UNEP), the number of climate change litigation cases is growing in various jurisdictions including Switzerland, see <https://www.unep.org/resources/report/global-climate-litigation-report-2023-status-review?gad_source=1> (last visited on 1 May 2024).

15 BGer 6B_7/2014 of 21 July 2014.

16 Cf. BGE 146 I 145.

17 Verein Klimaseniorinnen Schweiz and others v. Switzerland, no. 53600/20, Judgment of 9 April 2024 (Grand Chamber), available at: <https://hudoc.echr.coe.int/eng?i=001-233258> (last visited on 1 May).

18 Cf. also the ECHR's information on climate change cases, available at: <https://www.echr.coe.int/web/echr/w/grand-chamber-rulings-in-the-climate-change-cases> (last visited on 1 May 2024).

- In June 2021, farmers and farmers' widows from central India filed a product liability lawsuit at the Civil Court in Basel against the Swiss agrochemical company Syngenta for damages claiming severe poisoning by a Syngenta insecticide. Until now, the Civil Court confirmed its jurisdiction to hear the case and granted free legal aid to all claimants.[19]

- In July 2022, four residents of the Indonesian island Pari sued the Swiss cement company Holcim for a violation of their personality and tort. They requested compensation for their losses due to climate change, financing of anti-flooding measures and a staggering reduction of Holcim's CO_2 emissions. The action is currently pending at the cantonal court of Zug.[20] It is the first lawsuit against a carbon major in Switzerland, but it is in line with a global trend.

Selected Court Cases in Foreign Jurisdictions

- Notre affaire à tous, et al. v Total S.A.: In January 2020, five French NGOs, several municipalities, and one region filed a lawsuit based on a breach of obligations under the «loi sure le devoir de vigilance» of March 27, 2017 and Art. 1252 CC.

- Milieudefensie et al. v. Royal Dutch Shell plc: Shell was sentenced in the first instance in the Netherlands to reduce CO_2 emissions (of the entire group) by 45% by 2030 compared to 2019. Royal Dutch Shell has lodged an appeal against this far-reaching intervention in its business model, so the appeal decision remains to be seen.

- Saul Lucian Lliuya v. RWE: In the case of the Peruvian mountain farmer Lliuya against the energy company RWE, the lawsuit is (only) aimed at a pro rata assumption of the costs of protective measures that are said to be necessary due to climate change.

19 Latest information from the claimants' supporting NGO, available at: <https://www.publiceye.ch/en/news/detail/yavatmal-pesticides-poisonings-swiss-judicial-system-takes-victims-complaints-seriously> (last visited on 1 May 2024); from the defendant: <https://www.syngenta.ch/public-eye-gegen-syngenta-kein-interesse-zielfuehrendem-dialog> (last visited on 1 May 2024).

20 Information from the claimants' supporting NGO, available at: <https://callforclimatejustice.org/en/> (last visited on 1 May 2024); the defendant does not seem to publish case information.

These examples are just a small selection. Statistically, ESG litigation is a growing phenomenon. Outside the USA, there are more than 400 lawsuits against governments relating to climate change and more than 100 lawsuits against companies and individuals.[21]

3 Key Take-Aways for Members of the Board and Senior Management

This article has shown that companies and their members of the board are well advised to take seriously the growing ESG litigation risks and the requirement for ESG regulatory investigations as a matter of risk management and compliance and as an integral part of corporate governance. Essential elements of a robust ESG compliance program include specific internal policies and regulations regarding internal investigations related to ESG matters. The results and material gathered during a thorough and well-planned (internal) investigation into ESG issues may also build the foundation for a defense or at least prepare for a litigation plan in case the company is confronted with ESG litigations before a state or arbitration court.

Looking afresh at the corporate governance of a company, a number of measures must be addressed from a risk management and compliance point of view, including:

- Monitoring domestic and international legislative developments that might lead to an increase in liability and ESG litigation risk;

- Establishing a robust ESG compliance program (e.g., specific climate change due diligence processes, state-of-the-art reporting, ESG regulatory (internal) investigations framework etc.);

- Evaluating the company specific climate change litigation risk; and

- Ensuring sufficient knowledge of ESG-related matters at Board of Directors level, if necessary, by seeking advice by internal and external legal counsel and other experts.

21 See further: Global Climate Change Litigation - Climate Change Litigation, <https://climatecasechart.com> (last visited on 1 May 2024).

Ethics and Integrated Assurance: The Challenge of Building 'Trust'

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For many years, corporations (both private and state-owned) have struggled to build long-lasting trust with society. Next to general scepticism of globalisation, and generation and distribution of profit, there is the perception that corporations lack ethical standards or are unable to consistently adhere to them.

Corporations are perceived from the outside as 'monolithic', but in fact consist of a group of diverse human beings working under a common brand. As an integral part of society, corporations must acknowledge the constant tension between the human element and unified corporate behaviour. This means that building trust will always be a challenge – but that is no excuse to avoid addressing the root causes of corporate misbehaviour.

So, how can leaders best prepare their corporations to maintain compliance with laws and regulations, and manage reputational risks in areas of concern to society?

The answer, especially for multinationals in recent decades, has primarily focused on building a compliance programme around the three pillars of preventing, detecting and responding to misconduct. These programmes were typically implemented in regulated areas with a higher risk of significant fines, loss of business licence or debarment. Examples include anti-bribery, antitrust, anti-money laundering, health, safety, the environment and, more recently, data privacy compliance. In some corporations, implementation followed a thoughtful risk assessment process; in others, it happened reactively, driven by a public scandal or a major investigation by enforcement authorities.

In the event of a major compliance crisis, there is no remedy other than to quickly build a compliance programme to tackle detected deficiencies, including a solid control system. As an analogy, when you suffer a severe road accident, you need immediate intensive care. But what comes afterwards? Is the corporation committed to investigate deeper into why the 'accident' happened and whether existing compliance measures are sustainable and effective over the long term?

Recent decades have seen massive investments into compliance programmes, the creation of a compliance advisory industry, an abundance of guidance papers on how to build and maintain an effective compliance programme and development of audit standards. Yet corporations are still struggling to meet the growing expectations of regulators and other stakeholders. An example is the enactment of laws on how to conduct due diligence across corporate supply chains, including a broad range of human rights and environmental, social and governance (ESG) standards.

A traditional compliance organisation that focuses primarily on topics such as anti-bribery compliance will be unable to cover such a broad spectrum of risk areas or create the necessary process and systems. Firefighting one problem also carries the danger of creating a siloed compliance approach that could miss related risks. If a company's system for third party anti-bribery due diligence is not effective, it is hard to believe it will work any better for human rights, quality, trade sanctions or cyber security, for example.

1 A new organisational model

To address this complex situation, a small number of corporations have combined ethics, enterprise risk management and compliance into one function. The aim is to get the often isolated and fragmented risk and compliance functions out of their organisational and process silos, thereby providing executive management and supervisory boards with an integrated solution for how to address and manage regulatory and reputational risks across the enterprise.

To ensure this approach has an impact across all business units and functions, the board of directors needs to take the initiative and ensure that the function is empowered and sufficiently resourced. As a member of the executive leadership team, the function head should attend all relevant board sessions, especially of the audit, compliance and (if separate) risk committees. Another prerequisite is organisational separation from the legal department. Its role and responsibility as legal adviser to and defender of the corporation is distinct from an ethics, risk and compliance function that addresses and manages regulatory and reputational risk.

As the Office of Inspector General of the US Department of Health and Human Services recommended as part of its seven elements of an effective compliance programme, «the compliance officer should not lead or report to the entity's legal or financial functions, and should not provide the entity with legal or financial advice or supervise anyone who does. The compliance officer should report directly to the CEO or the board». This is even more relevant in the case of a comprehensive ethics, risk and compliance function that goes beyond a 'traditional' compliance setup. Indeed, what we are talking about here is an 'integrated assurance' concept.

2 The concept of integrated assurance

Assurance is often used too narrowly in the context of audit and accounting. Integrated assurance means a comprehensive and consistent taxonomy and accountability across the four dimensions of governance, risk management, compliance and internal controls. This is because these four areas are interconnected. Good governance sets the framework for an integrated enterprise risk management, which educates an effective risk based compliance programme based on internal controls with clear accountability. Governance provides assurance that accountability within the enterprise is clearly defined and that policies, controls and technology are well structured and linked.

Risk management provides assurance that organisational risks are being identified and managed effectively, and that a crisis and business continuity system is in place.

Compliance provides assurance that the organisation is complying with relevant laws, regulations and policies by applying a comprehensive 'prevent, detect, respond' approach to all compliance risks.

Lastly, internal controls provide assurance that an organisation's internal controls are effective within the risk and compliance framework.

Collaborating with the internal audit function is key to achieving a joint taxonomy and root cause analysis to enable management to exercise its duties and to keep the board informed to maintain proper oversight. Leveraging insights from data analytics, increasing efficiency out of centralised monitoring, audits and remediation, and continually screening new assurance topics (especially regarding evolving ESG regulations) are essential elements of an agile, developing assurance system.

3 The ethical component of integrated assurance

It is important to note that the success and impact of such a function depends on much more than solid organisational and process setup. It also requires courage to address ethical challenges and dilemmas with the humility to acknowledge that no single function within a corporation 'owns' ethics. It is the courage to take up the role of a 'catalyst' to foster an environment that supports doing what is right, based on principled decision making and behavioural science rather than too much control or regulation.

Bringing 'assurance' into the context of 'ethics' makes it clear that this is not a mechanical operational excellence exercise, but a focus on company culture and societal expectations. For example, the responsible use of artificial intelligence requires both ethical standards and a solid risk and compliance framework.

Additionally, during these times of change and disruption, the need for reliable, consistent and clear ethical principles as part of crisis response and business continuity management is imperative. Having an ethics and integrated assurance framework in place helps corporations to respond quickly and responsibly to a crisis, based on predefined principles and clear accountability. For example, when corporations engage in humanitarian support or make donations, speed is of the essence. But even the best intentions may be tainted down the line if fraud or corruption is detected.

4 Conclusion

When designed and implemented correctly, with support from senior management and the board, an ethics, risk and compliance function can drive an integrated assurance system that removes siloes in governance, risk management, compliance and internal controls, without creating unnecessary bureaucracy.

This function can also foster a cultural mindset within the enterprise that encourages discussion of ethical dilemmas in a structured way. Ethical dilemmas are part and parcel of every business, and are often complex. It is the duty of leadership to support their employees in knowing how to behave ethically.

The concept of ethics and integrated assurance does not provide insurance against every setback, challenge or crisis that a corporation may face. But it does have the potential to make corporations far more resilient in dealing with adversity and building trusting relationships.

Lessons on Corporate Governance from TV Miniseries

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Studying corporate governance often involves analyzing data from corporate disclosures and financial reports. However, this essay takes a different approach by examining two television miniseries, WeCrashed and The Playlist. These shows provide unique insights into the governance practices of two high-profile start-ups, WeWork and Spotify. By reflecting on these narratives, I aim to uncover corporate governance lessons that are evident to viewers but might be overlooked by analysts.

1 Introduction

Corporate governance is about people and power. More precisely, how power is distributed among people. Analysing power dynamics is notably complex and studying it through a set of measures metric can be challenging and limitating. Huse (2018)[2] explains that a stream of corporate governance research has conducted input-output studies – where the input is one of the «usual suspects» like CEO duality, independence ratio, and gender balance (see Finkelstein & Mooney, 2003)[3] and the output is corporate financial performance – and raises concern around the idea of identifying universal good practices. His argument is based on the assumption that corporate governance setups are so varied that looking for a one-size-fits-all corporate governance solution is not the preferred approach.

In this essay, I abandon the path of conventional management research to explore different perspectives on corporate governance. Instead of gathering data from corporate disclosures, I immersed myself in watching high-quality television shows. By leveraging two TV miniseries, I explore aspects of corporate governance that can be quite influential but are usually overlooked by scholars due to their concealed nature. I synthesize three corporate governance lessons that, as a viewer, are evident and identifiable but would be more subtle for a corporate governance analyst to spot otherwise.

1 This essay was prepared with the assistance of ChatGPT-4o, an AI language model developed by OpenAI. ChatGPT provided support in reviewing and editing the content to enhance clarity and coherence. All original ideas and the final composition of the essay are my own.

2 Huse, M. (2018). Value-creating boards: Challenges for future practice and research: Cambridge University Press.

3 Finkelstein, S., & Mooney, A. C. (2003). Not the usual suspects: How to use board process to make boards better. Academy of Management Perspectives, 17(2), 101-113.

Movies depicting corporate successes and scandals have been popular for a long time. However, recent years have seen a notable rise in filmmaking dedicated to tech ventures.
Around 2021, stories of companies like Uber, Teranos, and other notable technology-centred firms, began to be told through the camera lens, reflecting the growing public interest in the dramatic and often tumultuous world of technology start-ups.

Among these, WeWork and Spotify stand out as particularly compelling case studies. These companies have been brought to life in recent TV miniseries, offering an in-depth look at their unique journeys and the complex corporate governance issues they faced.

In 2022, Apple and Netflix released respectively «WeCrashed» and «The Playlist», two widely acclaimed television miniseries that tell the stories of start-ups WeWork and Spotify. Both shows chronicle the journey of these companies from their founding days. Through dramatic and behind-the-scenes insights, these series offer a rich narrative that goes beyond mere financial metrics and business strategies. This essay reflects on the main corporate governance takeaways from these miniseries, highlighting aspects about leadership, decision-making, and organizational culture that are often absent from traditional analyses.

The article continues with a short summary of the actual businesses before delving into how they have been captured and narrated through their televised portrayals.

2 Behind the Scenes: A brief outline of WeWork and Spotify actual stories

WeWork, founded in 2010 by Adam Neumann and Miguel McKelvey in New York City, aimed to become a global company providing flexible shared workspaces for entrepreneurs, freelancers, start-ups, and large enterprises. Initially positioned as a revolutionary concept in the real estate sector, WeWork envisioned to create a community-oriented work environment that offered more than just physical office space. The company focused on fostering a culture of collaboration and innovation, offering amenities such as high-speed internet, office supplies, and communal areas designed to encourage networking and creativity. WeWork's business model involved leasing large office spaces, renovating them into stylish, functional environments, and then subleasing them to businesses and individuals on flexible terms. Despite its rapid expansion and initial high valuation, WeWork faced significant challenges, including questions about its profitability, sustainability, and corporate governance. The company's ambitious growth strategy, combined with Neumann's controversial leadership, led to financial instability, culminating in a failed USD 47 billion IPO attempt in 2019. Later in 2020, the company's financial resilience was ultimately tested when Covid-19 pandemic's curfews and working from home policies made evident the imbalance between the assets and liabilities' duration: the Financial Times reported that while the typical lease with landlords had 15-year terms, clients could enjoy contracts of around 1.5 years on average.[4] As a result, recent years at WeWork have been very tumultuous, involving undergoing substantial restructuring, and ultimately filing for bankruptcy in November 2023.[5]

Spotify, founded in 2006 by Daniel Ek and Martin Lorentzon in Stockholm, is world's most popular audio streaming subscription service, with a community of 602 million monthly active users[6], that revolutionized the way people listen to music. The company offers a digital platform where users can access a vast library of songs, podcasts, and other audio content through both free, ad-supported and premium, subscription-based models. Spotify's business model disrupted the traditional music industry by providing an affordable and convenient alternative to purchasing individual albums or songs.

4 FT, WeWork: boxed-in flexible space group seeks new lease of life (2023).
5 FT, WeWork files for bankruptcy amid office market downturn (2023).
6 Spotify, Form 20-F for financial year 2023 (p.26).

Attribute	WeWork	Spotify
Founding year	2010	2006
Founder team	Adam Neumann, Miguel McKelvey	Daniel Ek, Martin Lorentzon
Founding location	New York City, USA	Stockholm, Sweden
Industry	Real Estate, Coworking Spaces	Music Streaming
IPO year	2021	2018
IPO valuation	USD 47 billion	USD 26.5 billion
Current market capitalization	USD 6.3 billion (as of 24 May 2024)	USD 61.3 billion (as of 24 May 2024)
Current CEO	Anant Yardi	Daniel Ek
Current number of customers	653 thousand members as of 24 May 2024	602 million monthly active users, including 236 million Premium Subscribers as of 31 December 2023

Spotify's innovative approach to music consumption not only provided a new revenue stream for artists through streaming royalties but also addressed issues related to music piracy by offering a legitimate way to access music.

Since its inception, Spotify has expanded its services globally, continuously adding new features such as podcasts, video content, and exclusive releases to maintain its competitive edge. The company went public in 2018 with a valuation of USD 26.5 billion and has continued to grow, reaching a market capitalization of approximately USD 61.3 billion as of May 2024. Under the leadership of co-founder Daniel Ek, Spotify remains at the forefront of the music streaming industry, continually evolving to meet the changing demands of listeners and creators alike.

3 Going beyond the «usual suspects»

Inner Circle: Key Figures Surrounding the Founders

One of the most striking divergences between the two stories is the influence of the people close to the respective founders. In the first scenes of The Playlist, co-founder Daniel Ek is shown in a dialogue with his mother, however the rest of the miniseries involves minimal influence from his family and little romance. In contrast, WeCrashed is on a completely different level. The subtitle of the miniseries, «A love story worth $47 billion», sets the tone already. Some may even argue that the relationship between WeWork co-founder Adam Neumann, played by Jared Leto, and his wife Rebecca Neumann, played by Anne Hathaway, is the actual focus of the series rather than the business itself.

The influence of a partner, family member, or friend on a leader is often overlooked and difficult for analysts to research and assess. Nonetheless, this reminds us that behind a charismatic leader, there is often a loved

one or an entire family helping to dissipate the stress and psychological pressure that comes with corporate roles such as CEO or Chair of the Board of Directors.While I am not suggesting that we start investigating family dynamics and mixing work and personal life, being aware of whether a leader has a supportive network to count on or is perhaps heavily influenced by a close person is of relevance.

In the case of WeWork, the role of co-founder's wife, Rebecca Neumann, has been under the spotlight. By watching WeCrashed, viewers might appreciate that some of her decisions may have distracted the management team from the core business. For instance Rebecca's ideological and visionary attitude seemed to have played a significant role in shaping the corporate mission, which was notably included in the original IPO prospectus, to «elevate the world's consciousness».

Extract from a 2019 WeWork blog post:

«Today, we're taking a step toward truly realizing our vision by beginning our next chapter. WeWork is announcing The We Company, bringing all of our business ambitions together to operate in service of how we work, how we live, and how we grow.

WeWork's mission is to create a world where people work to make a life, not just a living. WeLive's mission is to build a world where no one feels alone. WeGrow's mission is to unleash every human's superpowers.

The We Company's guiding mission will be to elevate the world's consciousness. Living a conscious life means choosing to live proactively and with purpose. It means being a student of life, for life, where we accept that we are always growing and in a constant state of self-discovery, self-growth, and change.

The idea that began in New York nine years ago was always about more than work—it was about supporting all aspects of life. As we've built WeWork, our community taught us that we are more alike than we are different. It taught us that we all thrive when we have a purpose. And it taught us that experiences bring more fulfillment and joy than material goods.

As we move forward, we will practice inclusivity, compassion, and open our hearts and our minds. In doing so, we can elevate ourselves and then the world.

Rebekah, Miguel, and Adam, Co-Founders The We Company»[7]

Even for advocates of the stakeholder approach (Freeman, 1984)[8], such mission might sound too fuzzy, no wonder the IPO was not one of the most successful ones.

Founders' values influence on corporate culture

Corporate culture is often described as a key enabler for success, at the same time, it can also predict failure quite accurately. As a firm grows, culture is shaped by employees and all stakeholders. However, in the early days one may claim that are the values and attitude of the founding team constituting the corporate culture. In a way, founders' value are antecedents of corporate culture.

Both miniseries are instrumental in showcasing how the imprint of the founders can set the direction for years to come. As described by The Economist, few chief executives can match Adam Neumann's ego and narcissism.[9] This was reflected in a culture of excess and drinking. Until 2020, this extraordinary vibe was also passed along to customers with free beer and kombucha[10] setting the desired working atmosphere. The show makes a good service in displaying how the company got too far with its «work hard, party harder» style. Scenes of hard-working employees at the office are not even frequent, while in-site and off-site parties are present in every episode. Many observers would agree that this is not just a style, but a reason for the lack of focus and skills in navigating business challenges.

The tone is completely different in The Playlist, which is organized into six chapters, each of of the key team members in the early days providing insights on how the diverse staff composition was instrumental in developing the core business.

7 WeWork. (January 8, 2019). The beginning of a new story". Retrieved from https://www.wework.com/newsroom/wecompany

8 Freeman, R. E. (1984). Strategic management: a stakeholder approach. Boston: Pitman..

9 The Economist, Why the WeWork fiasco makes for compelling TV (2023).

10 The Guardian, WeWork calls time on free beer and wine at North American sites (2020).

Spotify was not just solving a technological challenge (i.e., making the widest selection of songs available on a single platform), but also a legal (i.e., agreeing with the music industry on a new business model) and a stakeholder relevant one (i.e., having singers on their side by developing an acceptable «revenue sharing agreement»). By watching the show, one can recognize the relevance of co-workers' competence and how this allowed Spotify to win on multiple fronts and ultimately succeed. The dimensions described in this section are qualitative in nature and could be difficult to agree on how to assess them. Nevertheless, in most cases such information is not public and difficult to assess from an outsider perspective, even though it can make the difference between ultimate success or failure.

Bringing the context to the centre

Another insight from the miniseries is the interconnectedness and reliance of each business on its context – the environment in which it operates. In WeCrashed, which showcases an ambitious vision but relies on a somewhat weak business model, the monetary policy context – with ultra-low interest rates – allowed the firm to raise huge amounts of debt financing to sustain rapid expansion. A particular scene vividly illustrates how WeWork employees enlarged the portfolio of locations across the United States and worldwide convincing landlords by paying above market prices, committing to long-term leases, and often taking the bill for lavish business lunches.

This strategy, while facilitating swift growth, proved to be the original sin that eventually brought down the firm when interest rates began to rise post-COVID-19. The accommodative monetary policy environment was indeed an enabler of expansion, but the company's lack of discipline in achieving sustainable scale transformed it into a life sentence. The reliance on easy money led to a precarious financial position, illustrating how external economic conditions can critically impact business viability and longevity.

In a similar way, The Playlist shows how Daniel Ek and Martin Lorentzon managed to successfully grasp the key aspects of the context in which they operated and framed the problem with the right lenses. While Spotify is often considered just a tech start-up, it achieved much more than developing a successful app: it fixed a market failure. Ek and Lorentzon understood that the music industry was plagued by piracy. During the first two decades of the 21st century, the music industry was shaken by piracy websites that allowed users to freely download mp3 files of their favorite tunes. In this case, technological innovation was used to infringe the law at the expenses of record companies and musicians. The miniseries focuses an entire episode on tensions characterizing «The Industry» and narrates how Spotify managed to obtain the trust of record companies after prolonged and excruciating legal confrontations. In 2020, it signed a multi-year licensing agreement with Universal Music Group to align «the companies' efforts to foster groundbreaking new features providing value for artists and great experiences for music fans».[11] The Playlist successfully sets the context and help viewers appreciate how the true success of Spotify was solving a problem affecting an entire industry by leveraging technology.

Both WeCrashed and The Playlist are perfect cases to emphasise the contextual nature of corporate governance. The «usual suspects» are useful indicators but have to be taken in perspective. No matter how many appropriate «checks and balances» are implemented around a flamboyant CEO if the entire business relies on a fragile environment – or context – it may only be a matter of time... or interest rates.

4 Conclusion

To conclude, the careful reader has noticed the revealing nature of both titles. On the one hand, WeCrashed summarizes in a single word a story of a venture that for years seemed to possess the magical powers of the mythological figure of the unicorn but run its course with a loud crash. On the other hand, The Playlist pictures the winning proposition of allowing millions of customers to craft and always carry with them personalized playlists. Corporate governance is often seen as a reason for business failure, however, going beyond the «usual suspects» allows to appreciate that it can be a driver of success too.

11 Spotify and Universal Music Group Announce Global, Multi-Year License Agreement (2023).

Future trends in corporate governance: Five questions audit committees should ask

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1 Uncertainty, complexity, and competing priorities: Factors influencing the work of audit committees

Today's businesses operate in a world exhibiting wide economic, societal, and environmental challenges. Companies have always been exposed to external influence factors. And the successful ones have found appropriate answers to the challenges which impact their business most. Yet, the work of audit committees is becoming more demanding, challenging and time consuming. Why is that?

The level of uncertainty has increased significantly since the early 2000s[1], accompanied by increased volatility in the markets. Inflation, geopolitical tensions, climate change, and new sources of risks created by artificial intelligence are a reality for most businesses these days – to name only a few developments which have added to the mix of challenges. As Christine Lagarde, president of the European Central Bank stated in October 2023: «There are all these balls in the air. We are not exactly sure where they are going to land.»[2]

Adding complexity is the fact that companies need to balance challenges arising in the short-term with long-term risks and opportunities, which are significantly different.

The Copenhagen Institute for Future Studies («CIFS») laid out 15 megatrends in its Scenario Reports[3] which may challenge today's way of doing business, including amongst others:

- Rise of the network economy: The digitization of society gives rise to the creation of value in a decentralized manner – both at local and global scale. Major examples of this trend include the sharing economy, crowd funding, and crowd creation. This benefits flat hierarchical structures and increases the importance of collaboration.

1 Refer to https://worlduncertaintyindex.com.
2 Darren Dodd (16 October 2023). Global economy faces new age of volatility. Financial Times. Delivered from: https://www.ft.com/content/e8d192d9-e927-4958-97a4-e3ad4e927e27, accessed May 2024.
3 Timothy Shoup et. al (2022). Scenario Reports NO 07: Global megatrends: Shaping the future of societies, economies, and values. CIFS.

- Use of AI and automation: «If a typical person can do a mental task with less than one second of thought, we can probably automate it using AI […].» This statement from Andrew Ng, computer scientist and professor at Stanford, demonstrates how machine learning and robotics are not only changing the fundamentals of how we do business, leading to increased productivity and reliability. They are also going to shift labor markets towards more difficult and judgmental tasks for the workforce and may change the way individuals learn and consume.

- Environmental change and sustainability: More extreme weather conditions, shifting climate zones, and a growing environmental consciousness are going to push for sustainability, including how companies seek growth without degrading natural resources. Circular economy is one of the concepts expected to gain significantly more importance for business makers – especially considering the existing circularity gap of over 90% in Switzerland.[4]

- More individualization and empowerment: Continued growing individual liberty, social media usage and collective activism increase the number of different ways of living, working and consuming. Therefore, businesses are going to see increased stakeholder engagement, such as from activist investors, and additional demands from society in the form of new legislations and regulations from policy makers.

Megatrends are very high-level drivers of change over the coming decades – and how exactly they shape the future of the economy is, again, highly uncertain. On the other end of this spectrum are the immediate short-term risks arising from inflation, armed conflicts, and the risks arising from limited labor and social mobility (i.e. lack of economic opportunity).[5] These may interrupt businesses' pricing strategies, international supply chains, or access to skilled individuals.

In consequence, business responses which may work today and in the next one to two years may not be relevant when companies take a ten-year perspective in developing their strategies. This requires companies, their management and their boards, including audit committees («ACs»), to be highly adaptable to new circumstances, flexible in their ways of working, and to apply forward-looking thinking.

Couple the requirement for successful businesses to balance short-term risks with long-term trends with the information overload most senior leaders experience in the digital age, and the complexity of doing business gets an additional layer. With more information being available fast, and at a significantly lower cost than in the past, audit committees need to challenge what information is decision relevant.

Looking at the tasks within the AC's realm, not surprisingly the challenges and priorities remain manifold according to Deloitte US' and the Center for Audit Quality's («CAQ») recently published Audit Committee Practices Report: *Common Threads Across Audit Committees*.[6] The top-two priorities identified for the next twelve months were Cybersecurity and Enterprise Risk Management. However, already the third priority for audit committees was not quite clear, including finance and internal audit talent, compliance with laws and regulations, and finance transformation. This was followed by sustainability reporting and artificial intelligence governance being mentioned as a priority for over 20% of the respondents.

With uncertainty, complexity and competing priorities on the audit committee's agenda: What are five questions ACs should ask themselves to ensure effective corporate governance in the future?

4 Andrew Keys et. al. (2023). Circularity Gap Report. Deloitte Switzerland. Delivered from: https://www2.deloitte.com/ch/en/pages/risk/articles/circularity-gap-report-switzerland.html, accessed May 2024.

5 World Economic Forum («WEF»). Global Risks Report 2024. Delivered from: https://www3.weforum.org/docs/WEF_The_Global_Risks_Report_2024.pdf, accessed May 2024.

6 Krista Parsons & Vanessa Teitelbaum (2024). Audit Committee Practices Report: Common Threads Across Audit Committees. Deloitte US/CAQ. Delivered from: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/audit/us-caq-deloitte-audit-committee-practices-report_2024-03-v2.pdf, accessed May 2024.

2 Five questions to help audit committees ensure the future effectiveness of corporate governance

Based on our collaboration with ACs and on the results of Deloitte Switzerland's study conducted on Swiss Best Practices in Corporate Governance[7], we see five areas which will be very likely impacted by the developments we have discussed: (1) the AC's ways of working; (2) its oversight on how the company considers the most prevalent developments in society which may impact its business; (3) its oversight over the company's value generation; (4) its communication and reporting with stakeholders, both external and internal; and (5) how ACs evaluate their own work, continue to educate themselves, and are supported by internal and external experts to enhance their governance. To assist ACs tackle some of the challenges ahead of them and help ensure the future effectiveness of their system of governance controls, we have developed a framework of five questions ACs should ask themselves – including some considerations which may help ACs as they work through their own responses. Figure 1 summarizes the five questions and key points for consideration.

7 Alessandro Miolo et al. (2023). Swiss Best Practices in Corporate Governance. Deloitte Switzerland. Delivered from: https://www2.deloitte.com/ch/en/pages/audit/articles/corporate-governance.html, accessed May 2024.

The Audit Committee Future Effectiveness Framework

Key Questions	Key Consideration Points
Ways of Working How can we increase effectiveness of our ways of working in the future?	• Diversity of thinking • Adaptability, agility, and forward-looking thinking • Scenario planning • Cultural aspects and «tone in the middle»
Society What societal developments may impact our business, and hence need oversight by us?	• Protection of data and personal rights • Sustainability (environment, social and governance) • Talent attraction, development and retention
Value Generation How does our company effectively sustain value generation in the future?	• Balancing short-term results with long-term investments • Comprehensive approach to enterprise risk management, including opportunities • Entrepreneurial corporate governance
Communication and Reporting How should we communicate and report in the future?	• Engaging dialogue with share- and stakeholders • Building trust • Integrated reporting
Maintaining Effectiveness How do we, as audit committees, ensure we remain effective?	• Conduct regular effectiveness assessment • Leverage internal and external resources and functions (e.g. risk, compliance, internal and external audit) • Continued education

2.1 How can we increase effectiveness of our ways of working in the future?

The AC's ways of working are highly characterized by the mindset and background each member brings to the committee, tools and techniques used to structure the discussion, and the culture it promotes within an organization.

To cope with the diverse future challenges, ACs are best served to increase diversity of thinking – allowing for an open discussion of alternative perspectives, diverging point of views, and an overall healthy challenge before consensus is reached. This requires AC members to bring relevant industry and leadership experience, in addition to finance, accounting and audit expertise.[8] It also requires adaptability, agility, and forward-looking thinking.

Ensuring the AC spends sufficient time on topics which are relevant to the future development of a company's business is achieved by agenda setting. Additionally, putting the mechanisms and protocols in place to meet ad-hoc whenever a topic calls for it – e.g. to discuss a major acquisition opportunity – allows ACs to remain flexible and get involved at the right time. However, forward-looking thinking also requires the use of appropriate tools, and here scenario planning can help.

Scenario planning is a tool which only recently started to get attention; however, it has existed since the 1970s and was first used in the industry by RoyalDutch / Shell.[9] Well executed scenario planning instills imaginative and creative thinking to better prepare an organization for the future – without having to go through detailed calculations, like computing «worst-case» and «best-case» forecast scenarios, also acknowledging they are likely not going to be accurate in the long-term. Rather, the goal of scenario planning is to «draw a circle around multiple possibilities and think about whether you are prepared to face the range of futures that might unfold».[10]

As such, the tool may also serve ACs in taking a step back, extend their view beyond the annual reporting cycle, reflect on key decision-making topics for the organization, and contemplate which critical uncertainties may affect the company – ultimately resulting in a better challenge of management.

Lastly, ACs will have to consider cultural aspects within the organization to leverage their agenda setting and in setting direction for the future (e.g., what the desired level of risk appetite is). Given the rise of network economies discussed earlier, with inherent flat hierarchies and decentralized decision-making, ACs will have to ensure the traditional «tone from the top» extends to middle management. This helps to establish an appropriate «tone in the middle» and to emphasize guiding decision-making principles to the broader organization, which is essential to protect the company's interest.

2.2 What societal developments may impact our business, and hence need oversight by us?

Every business is different, operating in different environments and jurisdictions, and so there is no universal answer that fits every company. However, there are three trends in societal developments which we believe every company should continue to observe, as they will very likely impact business making: (1) data privacy and personal rights; (2) governance over sustainability matters; and (3) talent attraction, development, and retention.

Acts such as the EU's General Data Protection Regulation («GDPR») or the California Consumer Privacy Act («CCPA») – both effective in 2018 – marked the start of an increased focus on the protection of individual's personal data in recent years. And the focus on protection continues to increase: It is estimated that GDPR violations cost companies over two billion Euros in 2023, more than from 2019 to 2021 combined.[11] Also, new legislation, such as the EU AI act, demands additional protective measures of personal rights. Hence, ACs or other board committees will need to consider if their governance over data and personal rights remains appropriate.

8 Readers should note that depending on an audit committee's specific areas of responsibilities, other expertise, such as IT/Cyber, ESG and risk management may be required to ensure effective collaboration.

9 David A. Garvin & Lynne C. Levesque (2006). A note on scenario planning. Harvard Business School, p. 1.

10 David A. Garvin & Lynne C. Levesque (2006). A note on scenario planning. Harvard Business School, p. 1.

11 Vytautas Kazuionis (2024). Five Data Privacy Trends to Watch in 2024. Forbes. Delivered from: https://www.forbes.com/sites/forbestechcouncil/2024/01/29/five-data-privacy-trends-to-watch-in-2024/?sh=3e13498e4225, accessed May 2024.

Similarly, increased demands from consumers, policy makers, and other stakeholders require companies to address sustainability topics, which include climate and social aspects, but also an effective system of governance controls. The «top of mind» areas to be addressed by boards according to the Deloitte Best Practices study are: (1) sustainability objectives in management remuneration systems; (2) formulating and communicating a sustainability strategy; (3) defining and measuring sustainability-related key performance indicators; and (4) assigning the duties to appropriate committees within the board. Data from the US shows that approximately 60% of the oversight duty lies with Nominating and Governance committees.[12]

However, regardless of where the responsibility within boards lies, ACs need to develop a solid understanding to assess at a minimum the implications of sustainability topics on a company's financial risks and reporting.

Amidst the challenges in labor markets – finding the right talent – and the expected shifts of the workforce towards more difficult and judgmental tasks, talent attraction, development and retention becomes key for the success of many businesses. According to a global Deloitte boardroom study[13], more than 60% of senior leaders don't believe their board conversations are currently sufficient to explore the full talent agenda – including aligning strategic priorities with its investments in the workforce, building a talent pipeline, and nurturing a sense of belonging within the organization. And ACs do play – at a minimum – a critical role in overseeing finance talent topics.

2.3 How does our company effectively sustain value generation in the future?

Many of the challenges discussed previously – the digitalization of our society, or the increased environmental consciousness as well as workforce shortages and supply chain disruptions – call for ACs to oversee how a company's business model generates profits – today and in the future.

Ensuring a company achieves desired short-term results and has sufficient capital to make necessary long-term investment is one key aspect. Similarly, moving away from the traditional approach of purely managing risks, but also discussing with management existing and emerging opportunities they see within the business, is also helpful to develop a sustained business. Additionally, ACs are instrumental in supporting management build a resilient organization which can cope with unforeseen events and uncertainties in the markets – we discussed a possible technique, scenario planning, before.

Close to three quarters of respondents of a recent Financial Times study agree «that board members require a much deeper knowledge of company operations and competitors than ever before.»[14] This ultimately calls for an entrepreneurial approach to governance for ACs to stay close to management and the organization – an approach e.g. followed by private equity.[15]

An entrepreneurial approach goes further than challenging management. It requires ACs to bring in an outside perspective, provide new impulses based on what AC members see elsewhere in the market, and draw upon their own leadership experience.

Actively understanding how a business creates value also requires AC members to spend time with front-line managers to gain intelligence about the business, understand how management is dealing with challenges and pressure – and potentially also identify the next rising star within the organization.

12 Maureen Bujno & Kristen Sullivan (2023). On the audit committee's agenda: Emerging trends in ESG governance for 2023. Deloitte Center for Board Effectiveness. Delivered from: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/center-for-board-effectiveness/us-otaca_jan2023_vf_1-31.pdf, accessed May 2024.

13 Jo Iwasaki et al. (2024). Time to rethink talent in the boardroom. Delivered from: https://www2.deloitte.com/us/en/insights/topics/leadership/prioritizing-workforce-issues-in-the-boardroom.html, accessed May 2024.

14 THE GREAT BOARD REBOOT: Board members open up on changing roles and expectations (2021). Financial Times. Delivered from: https://professional.ft.com/_/view_pdf/file/1973/bec947c4c9c/-, accessed May 2024.

15 Refer for example to Jeffrey M. Cohn (2024). What Boards of Public Companies Can Learn from Private Equity. Harvard Business Review.

An active, entrepreneurial approach requires AC members to balance the benefits from insights they can bring based on their other commitments, such as other board or senior management leadership roles, with the need to spend sufficient time with the company's business.

2.4 How should we communicate and report in the future?

Legislation and compliance are one aspect to be considered in a company's approach to communication and reporting. It is obviously important for ACs to focus on the appropriateness and conformity of their financial reporting[16] with applicable reporting standards.

Additionally, with today's phenomenon of information overload, boards and ACs need to find ways to engage in a dialogue with shareholders and other key stakeholders allowing to focus on key topics, and ultimately building trust.

One tool which can help is an integrated approach to the company's reporting. Different terms are used by practitioners these days, and they have similar meanings, such as impact reporting, value reporting, or integrated reporting.

According to the IFRS Foundations' framework, integrated reporting is «a concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation, preservation or erosion of value over the short, medium and long term.»[17] The approach combines financial and non-financial reporting efforts, and ultimately seeks to communicate how a company generates value – a question we discussed before.

Besides integrated reporting, we see an increased focus of users on accessibility of information (e.g. how easily can annual reports be found on a company's website, searchability of documents, machine-readability) as well as clarity, conciseness and comparability of information (e.g. between periods, or different companies).

2.5 How do we, as audit committees, ensure we remain effective?

Ensuring an AC remains effective includes three dimensions: (1) an evaluation of the AC's work; (2) support by internal and external expert resources; and (3) continuous education.

The Swiss Code of Best Practice for Corporate Governance sets out in one of its principles that a self-assessment should be conducted at least once a year, and that a company shall publish such information in its annual report[18] – emphasizing the importance of a regular evaluation of the AC's work. According to the Deloitte Best Practices Study, an evaluation can take many forms – either conducted internally in the form of a self-assessment or with the support of external advisors. Important is that they are conducted on a regular basis to help spot trends, and that the discussion within the AC is open, transparent, and engaging.

Furthermore, ACs can maintain – and increase – their effectiveness by leveraging various resources and functions – both internal and external. This includes a company's risk, internal audit, and compliance function, but also its external auditors. Additionally, ACs may seek expert advice, e.g. when dealing with questions of cyber security, internal controls, or key performance measures.

The last element ACs should consider is around their members' own continued education. While there are no regulatory requirements in Switzerland for boards on specific educational requirements, from a legal perspective AC members need to ensure they bring appropriate education and qualifications to serve on a board with the required duty of care.

16 and also the non-financial reporting, if applicable.

17 IFRS Foundation/International Integrated Reporting Council («IIRC») (2021). International <IR> Framework, p. 10.

18 economiesuisse (2023). Swiss Code of Best Practice for Corporate Governance, p. 12.

However, good governance goes beyond legal requirements – which is why e.g. the Swiss Code of Best Practice for Corporate Governance suggests training new board members appropriately. Considering the manifold aspects of the future work of ACs discussed in this article, continued education becomes key. From self-study, compact online trainings, learnings within AC sessions facilitated by external providers, to more extensive board programs as offered by universities or audit firms, education for ACs can take many forms.

More important than the form of education is the topic the AC selects for its learning. An AC's discussion with their auditors on emerging topics may provide additional inputs for learning, given their auditor's broad experience with many companies operating in various industries.

3 What can audit committees do now?

Uncertainty and volatility, megatrends shaping the next decade, and short-term challenges requiring immediate attention – the environment for making business is going to stay complex.

While we have provided a framework with five questions to help ACs maintain and increase their effectiveness in the future, ACs are advised to develop their own answers to these questions. This can happen with or without the support of external advisors. Regardless of how ACs decide to work through these questions, we believe they are going to experience immediate benefits from starting to apply some of the concepts discussed– mainly in the form of improved collaboration and an increased quality of their discussions with internal and external stakeholders.

The Gray Reality with the Green Money

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Photo: Erste Group/Susanne Einzenberger

The introduction of the EU taxonomy and the Green Asset Ratio (GAR) marks a turning point towards sustainable financing. However, a significant gap exists between the EU's aspirations and the reality our economy faces.

Early on, the EU recognized that success in the fight against climate change depends to a critical extent on which specific economic activities are financed in the future. With the introduction of the EU taxonomy, Europe has taken on a pioneering role in an international context. The heart of the EU's green initiative lies in the GAR, which from 2024 onwards requires banks to disclose the share of sustainable financing and investments in their overall business. The goal is clear: create comparability and by doing so provide incentives for more green investments.

The GAR may shine on paper, but it does not always withstand practical tests: its focus is narrow, leaving important market segments such as SMEs on the sidelines. Meeting taxonomy standards is also a struggle in the social housing segment, due to the involved bureaucratic and financial hurdles, even when energy efficiency criteria are met. As a result, the «S» in ESG (Environmental, Social, and Governance) is often left behind. The discrepancy between theory and practice when it comes to sustainability measurement is particularly evident in the case of our bank, Erste Group. To meet our goal of being a leader in the green transformation in CEE, we developed our own standards for «sustainable financing» early on. Applying these, we achieve a sustainable share of around 14 percent in corporate financing and mortgage loans. However, the GAR in our recently published annual report shows only a low rate of 0.5 percent. This discrepancy is due to the fact that many assets, such as loans to SMEs or our engagement in financial social housing, cannot be included due to a lack of necessary data or to the fact that such activities are not covered by the EU taxonomy. The significant difference between the GAR and Erste Group's actual engagement in sustainable financing shows just how imprecise this metric continues to be.

There can be no doubt that the GAR offers a great opportunity for a more sustainable future, but it still does not capture the depth and breadth of banks' actual sustainability efforts. There is an urgent need for politicians to make the necessary adjustments. Doing so demands more clarity in the interpretation of the taxonomy and in identifying sensible exceptions, for example for non-profit housing. It is only if such steps are taken that the GAR will definitely become a serious indicator of banks' green engagement and can actually ensure that financing flows to where we urgently need it for the green transformation of our economy and society.

Navigating the Future: Challenges and Success Factors of Tomorrow's Board Governance

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1 Introduction

The term «Corporate Governance» is not a precise legal term, but rather a guiding principle that attempts to describe issues of organizational and corporate management in the context of regulatory requirements and stakeholder engagement. As Corporate Governance is not only focused on the interests of shareholders but must include all stakeholder groups relevant to the company, it is dynamic and subject to various developments.

The dynamics of the topic is driven by the fact that companies have become part of the public debate and need to address topics that go far beyond their own purpose. Socio-political issues have long since been brought to the agendas of Board and management meetings. Companies are challenged more than ever to deal with current or future issues and provide responses to questions which are also the subject in public and parliamentary debates as well as on social media. The most prominent example is corporate responsibility in climate change.

Board Governance, as an integral part of the overall Corporate Governance, shall refer to the affairs, structures, and processes of and the collaboration within the Board of Directors (BoD, or Boards) and its interaction with internal and external stakeholders. The effectiveness of Board Governance requires an alignment with the social climate and an anticipation of trends that affect the legal and corporate framework of tomorrow. In this context, the article will elaborate on three important trends which are highly impacting the Board Governance today and tomorrow: Sustainability, Artificial Intelligence (AI) and Resilience. How are the developments influencing the work of Boards? Which key challenges need to be addressed and how can a BoD progress its governance to successfully manage such trends and disruptions going forward?

2 Sustainability has become an integral part of the performance framework

Sustainability implies a long-term approach and shows how a company intends to fulfill its social responsibility towards its stakeholders over time. The approach to sustainability becomes a differentiating factor when evaluating a company's performance. The importance of sustainability requires Boards to broaden their oversight responsibilities beyond traditional financial steering, integrating sustainability considerations into various areas of their work, in particular:

Board composition and competencies: To effectively address sustainability issues, Boards are diversifying their composition to include directors with relevant expertise and experience in different topics, including sustainability matters. When executed inclusively, this diversity in skills and perspectives fosters innovative thinking and comprehensive oversight, also regarding sustainability issues.

Strategic alignment: Sustainability considerations have become an integral part of corporate strategy to ensure long-term value creation. Next to the traditional strategic planning and budgeting, Boards are well advised to broaden the performance assessment and holistically review performance on both, financial as well as qualitative performance criteria such as ESG topics. While qualitative performance criteria are often less hard-wired, it is crucial to set tangible and binding targets. Consequently, as executive compensation should be aligned with strategy, ESG performance gets embedded into remuneration systems, setting clear incentives and signals.

Stakeholder engagement: With the transition from a shareholder to a stakeholder value approach, Boards are increasingly expected to engage with a wider range of stakeholders, including employees, customers, suppliers, communities, and regulators. As a result, Boards gain a more comprehensive understanding of stakeholder expectations and concerns. At the same time, Boards need to continuously assess stakeholder's relevance to the company and prioritize them accordingly.

Digitalization: In overseeing the strategic use of new technologies, Boards need to monitor emerging technological developments and assess their applicability to the organization's sustainability objectives. When implemented correctly, digital technologies strongly support sustainability goals such as optimizing resource use, reducing emissions, and increasing supply chain transparency. However, the energy consumption of digital tools must also be considered.

Risk management: Boards must increasingly identify and mitigate sustainability-related risks, such as climate change, supply chain disruptions, regulatory changes, or reputational damage. Integrating sustainability considerations into risk management practices helps Boards to anticipate and address emerging threats and their impact on the company's business model.

Compliance and reporting: Boards should keep up with evolving sustainability regulations and standards, i.e., understand new requirements but also oversee the development of a robust reporting mechanism for transparent communication. For the first time in the 2024 AGM season, Swiss companies are presenting a sustainability report to shareholders explaining how sustainability is practiced within the company, how the company understands its role as a corporate citizen and assumes its corporate social responsibility, including concrete measures that have been taken.

Sustainability governance is key to embedding sustainability considerations into the long-term composition and capabilities of the company, as well as into strategy, risk management and reporting. Boards play a crucial role in overseeing corporate sustainability strategies, objectives, and progress. This includes acquiring the relevant skills and expertise, setting tangible and binding goals, engaging with stakeholders as well as managing risks and regulatory requirements associated with sustainability issues.

3 AI is reshaping the work of the BoD and bears significant leverage while the risks need to be carefully addressed

AI is not only largely affecting the strategy and transforming the business models of many companies, it is in fact reshaping the work of the BoD itself. The impact of AI on Board Governance is multifaceted, and it provides powerful tools and approaches which can help addressing nowadays as well as future responsibilities such as:

Decision-making and strategic planning: AI algorithms can analyze vast amounts of data to identify trends, opportunities, and threats that may not be immediately apparent to traditional analyses. This enables Boards to use data-driven insights and scenario planning and make more informed decisions regarding the strategic outlook.

Risk management and compliance: AI tools can predict potential risks by analyzing patterns in data, including financial trends, market dynamics, and even cybersecurity threats. By continuously monitoring compliance with regulations, AI systems can flag any deviations in real-time. This is especially valuable in industries with heavy regulatory burdens such as financial services. These approaches allow Boards to address risks and compliance issues before they become critical.

Performance monitoring: Boards can use AI to continuously monitor company performance against strategic goals in real time, providing a more dynamic oversight mechanism than traditional periodic reviews. This enables measures to be taken at an early stage, if necessary.

Stakeholder engagement: AI can help Boards understand and anticipate stakeholder reactions to various decisions or external events by analyzing data from social media, news, and other sources. This can be helpful, for example, in maintaining good investor relations, anticipating shareholder's questions or concerns as well as reputational risks.

Board operations: AI can enhance efficiency of Board meetings, for example by automating the preparation of briefing materials, summarizing discussions, and taking minutes, and even suggesting agenda items based on the company's current situation and market conditions. It can also assist in planning efforts for talent management and succession by identifying skills gaps in the organization and predicting future leadership needs.

Ethical considerations and AI oversight: Boards are increasingly called upon to oversee the ethical use of AI within their organizations, ensuring that AI technologies are used responsibly and in a manner that sustainably aligns with company values and societal norms. The BoD is responsible for ensuring that the company's AI strategy aligns with its overall business objectives and that the risks associated with the use of AI are effectively managed.

To address those impacts, the Board needs to be aware of the challenges and risks, such as technological but also cybersecurity risks, data privacy considerations and others. It should also ensure that the necessary skills are represented at Board level, both by upskilling members (e.g., through educational training) in developing an adequate understanding of AI approaches but also by appointing new members (e.g., through effective onboarding practices) to effectively govern their use and ensure its ethical application. It is crucial that the Board stays aware of the ongoing developments, however, only relevant trends should be anticipated and followed in the sense of thorough decision taking. Further, the regulatory environment surrounding AI is evolving, and Boards must stay informed about new regulations that could impact the use of AI within their organizations.

4 Building up corporate as well as Board resilience is key to ensure long-term success

Corporate resilience means that companies are susceptible to disruption due to their interconnectedness and multidimensional orientation and are confronted with uncontrollable external influences, which can have a negative impact. Classic application examples are cyberattacks and technological progress such as AI. As noted in the context of AI, Boards face an increasing amount of change and dynamics, including the need for transformation and with impacts on their own operations and processes. Resilience, especially as regards the BoD, plays a critical role in steering organizations through turbulent times and ensuring long-term sustainability and success. Therefore, adopting a holistic view of the organization's cultural, political, and economic context is essential. The relevance of Board resilience is key and has extensive implications, especially with respect to the following topics:

Crisis management: Resilient Boards are better equipped to anticipate and respond to crises, whether financial, operational, or reputational. Their proactive response helps in controlling the impact and ensuring quicker recovery. Moreover, they can adapt their strategies to changing circumstances more effectively, ensuring that the organization remains on course even in the face of adversity.

Risk management: Resilience also encourages Boards to take a comprehensive approach to risk management, considering not just financial risks but also operational, reputational, environmental / ESG and other, incl. non-financial risks. Therefore, resilient Boards insist on robust risk management frameworks that include preparedness plans, allowing the organization to navigate through uncertainties more smoothly.

Strategic planning: As resilience promotes a long-term outlook, it encourages Boards to prioritize sustainability and ethical practices that contribute to the organization's longevity. It also brings more flexibility to strategic planning, allowing for adjustments as external or internal conditions change without losing sight of the ultimate goals.

Stakeholder relationships: By demonstrating resilience, Boards can build and maintain trust with its stakeholders, showing that the organization is well-managed and capable of overcoming challenges. For example, the company's responsibility and duty of care towards its employees tends to expand in a demanding social environment and in an increasingly diverse environment which requires new social skills at management level. Important keywords in this context are work-life balance and mental health. In addition, resilient Boards prioritize clear and transparent communication with stakeholders, especially during crises, which is crucial for maintaining stability, confidence, and support.

Leadership and culture: Related to the prior aspects, resilient Boards lead by example, fostering a culture of resilience throughout the organization. This involves promoting adaptability, continuous learning, and an open mindset among employees and management. They recognize the importance of investing in their people, supporting initiatives that enhance the workforce's ability to cope with and adapt to changes and challenges.

Governance and compliance: Finally, resilience is closely related to ethical considerations and governance practices, with Boards ensuring that the organization not only survives but thrives by doing the right thing. They also stay abreast of regulatory changes and ensure the organization remains compliant amidst evolving legal landscapes, protecting it against potential risks and penalties.

While building and maintaining resilience presents challenges, such as the need for ongoing vigilance and the potential for short-term costs, the benefits of resilience are clear. Resilient Boards can help guide their organizations through immediate crises and lay the groundwork for sustainable success, navigating the complexities of today's business environment with agility and foresight.

5 Conclusion

The three trends outlined in this article reflect only part of the dynamics and changes that Boards are facing and they are interlinked. For example, AI is related to resilience as regards to the adaptiveness of strategy and other aspects, but also to sustainability because it requires ethical and data security considerations. It is foreseeable that the dynamics will increase further and with this, Boards will be dealing with an even higher complexity.

Three important steps and measures can be taken to develop and enhance Board Governance in a way to successfully meet the increasing challenges:

- Refine Board composition and diversity: By diversifying its composition, a Board is better equipped to deal with uncertainty and adapt to changing circumstances as it can draw upon a variety of skills, competences, and expertise. This is the right time to assess whether the Board still has the necessary skills to respond adequately to evolving trends in corporate governance, i.e., in line with the spirit of the times and the interests of the stakeholders involved.

- Streamline Board structure and processes: Clearly allocating roles and responsibilities in committees enables a thorough oversight of organizational functions, ensures an efficient decision-making and enhances accountability among Board members. This may require the set-up of a new committee (e.g., sustainability, or technology committee) and a restructuring of the Board itself. Additionally, well-defined, and robust governance and risk management processes, such as crisis-manuals or a roadmap for navigating unexpected challenges, can support swift and coordinated responses when a crisis arises.

- Conduct a thorough self-assessment: By engaging in periodic evaluations of its performance, composition, and processes, a BoD can identify strengths, weaknesses, and areas for improvement. This introspective approach enables Boards to reflect upon their established management practices, ensuring continuous improvement and aligning with organizational goals and stakeholders' expectations. A guided self-assessment supported by an independent external party ensures high quality of output and valuable insights.

Board Assessment: Going beyond the «Tick-the-Box» Exercise

Prof. Dr. Peter Fankhauser
Peter Fankhauser's career is an inspiring journey. He restructured the International Business Unit in Kuoni AG; moved on to LTU Group Holding and successfully restructured this company as well. As CEO of the Thomas Cook Group from 2014 to 2019, he played a key role in shaping the transformation of the tourism industry. He prioritized customer service, put customer at the heart of everything and made Thomas Cook the most profitable travel provider in Germany and Scandinavia. Despite ups and downs, including the insolvency of Thomas Cook Group Ltd. in 2019, he demonstrated exceptional resilience. Today, Peter Fankhauser is CEO and owner of the consulting firm Manres AG, which advises executive and non-executive boards on assessments, cultural change, corporate development and leadership. Since 2017, Peter is an honorary professor at the University of St.Gallen.

1 Vision and Leadership

Effective board leadership transcends mere administrative tasks, combining both logical and psychological skills. As the chairperson, it's imperative to articulate a clear and compelling vision for the board that aligns with the organization's purpose. This vision should not be the exclusive domain of the CEO but a collaborative effort involving all board members, fostering a deep, shared commitment.

The development of this vision involves delineating governance structures and processes. This includes selecting board members with appropriate skills, defining information architecture, and establishing robust governance protocols.[1] Such logical structuring provides clear direction and is fundamental to effective board operations.

However, the psychological aspects of board leadership are equally critical. This includes fostering psychological safety, nurturing healthy relationships among board members, and encouraging open communication. Excelling in these areas not only clarifies the board's objectives but also magnifies its influence and impact.
Values are the cornerstone of this framework. Board members should exemplify the core values of the organization, acting as role models within and beyond the boardroom.

2 The Three Dimensions of Leadership

Leadership should address three pivotal dimensions[2]: the Logical («IT»), the Team («WE»), and the Individual («I»).

- The Logical Dimension («IT») focuses on strategy, processes, structures, and organization, striving for clarity and excellence.
- The Team Dimension («WE») encompasses trust, communication, psychological safety, collaboration, and empowerment.
- The Individual Dimension («I») relates to personal attitude, self-leadership, resilience, and authenticity.

1 Four pillars of board effectiveness and performance (IMD, Prof. Dr. Didier Cassin).
2 The leadership Concept of Manres AG.

Effective leadership requires a holistic approach to these dimensions, enhancing the capability of any unit or board to achieve high performance and implement robust strategies.

2.1 Perception Among Executives

My experience working closely with both executive and supervisory boards reveals that supervisory boards often lack a favorable reputation among executives, perceived as a necessary burden rather than a supportive element. This perception stems from the dynamics of needing to justify actions and decisions to a body that holds significant sway over their professional fates.

This unfortunate view highlights a disconnect that could be bridged by adopting the leadership principles outlined above. Establishing a high-performing supervisory board that fosters trust and mutual respect with executives is crucial for effective governance and organizational success.

2.2 Some insights from recent data[3]

The effectiveness ratings for large company supervisory boards are disappointingly low: only 33% of executives rated their boards as good or excellent, while 52% deemed them fair, and 16% poor. Furthermore, a significant 60% of executives expressed distrust in their boards' ability to self-assess their performance effectively. When asked whether their boards overstepped their roles, 82% of executives felt that their boards respected boundaries, suggesting a preference for minimal board interference in day-to-day operations. However, deeper issues emerged concerning board functionality: only 33% of executives believed their boards asked probing questions, just 26% felt the boards possessed the right mix of skills and expertise, a mere 21% thought their boards dedicated enough time to their roles, and only 20% saw their boards as having sufficient diversity in terms of gender, race, and ethnicity. This paints a bleak picture, with the trend from 2021 to 2022 showing a negative shift, indicating worsening perceptions of board performance.

In my view, the primary issue is the lack of emphasis on developing a dynamic, high-performance board that effectively serves all stakeholders. How can we address this? It begins with a comprehensive assessment of board activities across all dimensions. This approach extends beyond traditional board evaluations that merely measure effectiveness. It includes a thorough examination of what I previously discussed regarding the three dimensions of leadership: the 'IT' (the tasks), the 'WE' (the team), and the 'I' (the individual). This should be treated as a genuine, holistic assessment, rather than a perfunctory review.

3 Elements of an Integral Board Assessment

In the standard board evaluation process, the initial focus typically centers on areas that are readily quantifiable, such as 'risk and audit'. The assessment then expands to cover critical board functions like leadership succession planning and compensation—commonly referred to as Nomination and Compensation—viewed as pivotal roles of a board. Additional aspects evaluated include strategy and innovation, stakeholder engagement, compliance, internal and external reporting, and sustainability. Increasingly, leadership and organizational culture also come under scrutiny.
To obtain a comprehensive understanding and create an effective board effectiveness feedback report, various methods are utilized: board surveys, document inspections, and interviews with the Chairperson, board members, and the CEO, supplemented by observations of board meetings. If boards take these feedback reports seriously and commit to actionable improvements, these assessments become potent tools for enhancing board performance. Otherwise, they risk becoming mere checkbox exercises.

However, often missing from these evaluations is the crucial 'individual' dimension of leadership, noted as the 'I'.

3 PWC and The Conference Board, Board Effectiveness: a survey of the C-Suite, May 2023 and November 2021, 601 participants.

3.1 Challenges of a Chairperson

Unlike operational teams that work closely on a daily basis, boards convene on a scheduled basis, and the interaction time is limited. This dynamic is akin to a national football team, with the Chairperson playing the role of the coach. Board members, like star athletes from various clubs, bring their significant decision-making power and influence from their primary roles into the boardroom. The Chairperson's challenge is to maximize the output of these high-caliber individuals in the limited time available, similar to a CEO nurturing an executive team.

3.2 What Constitutes a High-Performance Team?

A high-performance board begins with an inspiring vision. It requires clear and efficient communication both internally among members and externally, providing clear direction and ensuring a unified voice. Diversity of opinion is vital; members must feel secure in expressing dissenting views within a framework of clear guidelines and responsibilities. The underlying attitude should be proactive, supportive, and inclusive. Achieving this is ambitious but can be highly rewarding. In the pursuit of such a team, the three dimensions of leadership are critical: 'IT' (structural and strategic elements), 'WE' (team dynamics), and 'I' (individual contributions). While the selection of CEOs often involves rigorous personality assessments to ensure cultural and leadership fit, such diligence is less common in board member selection, where the focus is usually on skillset and professional background. However, to build a truly high-performance team, soft factors must also be evaluated, as they significantly influence the team's culture.

3.3 Three Aspects of Resilience

From my perspective, the board bears the ultimate responsibility for ensuring that the company is resilient on multiple levels:

- Corporate Resilience: This involves the board's functionality, the effectiveness of checks and balances, and the integration of risk management and compliance into the organizational culture. The board must exemplify leadership in these areas.
- Team Resilience: This entails selecting the best candidates who fit the organizational culture and fostering them into a high-performance team across all management levels.
- Individual Resilience: Board members should maintain personal resilience through a holistic approach encompassing physical health, mental agility, emotional stability, and spiritual fulfillment.

4 My Recommendations

- Define Desired Outcomes: Clearly articulate the desired skillset, working methods, team dynamics, personalities, and cultural attributes for your board.
- Conduct Thorough Diagnostics: Implement a board evaluation process that encompasses all discussed aspects. Encourage board members to participate in development assessments for personal growth, supplemented by external support if necessary.
- Set Rigorous Selection Criteria: For new board members, include comprehensive assessment centers that evaluate both hard skills and soft factors.
- Invest in Team Development: Allocate time and resources for board team development training, focusing not just on the costs but on the potential for significantly enhanced performance.

A Global Tour d'Horizon of Conduct Risk Methodologies

Barbara R. Siegenthaler

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Barbara R. Siegenthaler is an expert in fast-paced, dynamic cultural and conduct risk assessments. She developed the Organizational Personality Framework, also known as Finance without Numbers, to benchmark company behavior preferences. Currently, her work centers on conduct risk within the Social and Governance components of ESG for boards. Barbara is the Founder and Managing Director of the consulting boutique Savanteon and an active member of Women for the Board.

For this article, she leveraged her global network of conduct risk experts for insights on global trends.

Conduct risk methodologies are evolving at top speed to match the need for better controls across all sectors. For example, earlier this year, Nicolai Tangen, CEO at Norges Bank Investment Management (NBIM) posted on LinkedIn:

«One year ago we invited an anthropologist into the fund to have an inside look. The thinking was: if it's good, then it is good. If it's bad, then it is good, because then we know what to improve! Here is the report, we are already working on the improvement points.»[1] Attached was the report 'Anthropological gaze, stories, and reflections on NBIM culture'.[2]

Tangen manages Norway's oil fund with a market value of 1.633 billion dollar as of March 31, 2024, yet he turns to anthropology to gain better insight into the organizational culture of the fund. Intriguing, is it not?

However, I will leave it to the reader to delve into the findings of the report as this article focuses on examining the applied methodology itself.

1 What is conduct risk?

It may come as a surprise that there is no rigorous definition as would be typical for academic studies.[3] In fact, the answer to the above question varies depending on which people, professions, organizations, and industries you ask. The same applies to related terms such as 'behavior risk' and 'corporate culture'.
Moreover, in high-stakes industries such as aviation and railways, where human factors – or ergonomics – are crucial, the term 'conduct risk' is not even commonly used.[4]

1 See, Norges Bank Investment Management and Nicolai Tangen's LinkedIn post on January 2024.
2 See, Danielsen, T., «Anthropological gaze, stories, and reflections on NBIM culture», 2023.
3 See, Reader, T., & Scott, S., «What is Conduct Risk?», 2023.
4 This scientific discipline is concerned with the understanding of interactions among humans and other elements of a system, see, e.g., Ergonomics Knowledge Areas, and Shorrock, S., «Four kinds of 'human factors'», 2017.

2 Conduct risk in terms of practice

Instead of offering a definition of conduct risk, this article explores different practical applications. Similar to a library, it includes multiple links for deeper exploration to promote cross-industry dialogue.

Why is managing conduct risk crucial? Take, for example, the case of Credit Suisse. Finma's recent post-mortem report revealed that poor risk management culture was among the main reasons for the bank's collapse.[5]

Structured in three parts, the article first introduces practical applications of conduct risk methodologies as reported by practitioners. Second, it discusses key observations, and finally it presents pivotal questions essential for boards to consider when selecting their conduct risk strategy.

3 Conduct risk methodologies from A to Z

This article includes feedback from 25 practitioners across diverse professions, industries, and continents gathered through written forms and interviews.[6] By deliberately leaving out a 'conduct risk' definition, contributors were encouraged to provide insights based on their personal interpretations of the term.

The results indicate a spectrum of methodologies used in practice, ranging from simple, straightforward approaches to AI-powered data insights and sophisticated organizational maturity models and safety concepts.

For ease of reference, the approaches are listed alphabetically and numbered accordingly. The methodologies are not categorized, recognizing that many can be grouped across multiple categories.

1. Anthropology. Anthropologists work qualitatively, holistically, and bottom-up to describe and discuss social structures, signs, rituals, artefacts, and patterns. The NBIM report is based on several months of anthropological fieldwork, i.e., 'participant observation'.[7] New compliance approaches shift focus from traditional paperwork and surveys to insightful anthropological observation.[8]

2. AI-guided mixed methods approach to measure culture. London School of Economics Professors Alex Gillespie and Tom Reader utilize the latest advances in natural language processing to scale and score textual data on dimensions of risk culture. The approach allows for both overall benchmarking of the company or unit and the identification of high-scoring text segments, which are then analyzed qualitatively. It draws on over a decade of research and multiple peer-reviewed articles on corporate culture and risk.[9]

3. Assessing subcultures that may drive risk. To assess social, group and cultural influences (e.g., social norms, group dynamics, shared beliefs), NatWest Group's Internal Audit Behavioral Risk team utilizes a mixed methods approach. The approach involves qualitative data (e.g. interviews, observations, leadership communications, policy and procedures, targets etc.) and quantitative data (e.g. surveys, re-analysis of secondary data e.g. conduct, commercial or HR data). Conclusions are triangulated from across the different data sources. The approach is designed to assess the behaviors and mindsets characterizing a particular team or function (not one-off behaviors); identify what drives those behaviors and pre-empt future outcomes they might lead to (e.g., conduct risk or strategic risk).

5 See, «FINMA Report, Lessons Learned from the CS Crisis», 2023, p. 7.

6 I would like to thank Philippe Ammann (CH, aviation methodologies), Elizabeth Arzadon (US), Kai Karin Baum (DE, learning methodologies), Raffaela Cannizzo (CH), Vera Cherepanova (IT), Alexandra Chesterfield (UK), Alex Gillespie (UK), Muel Kaptein (NL), Jürgen Neff (DE), Magda Osman (UK), Kelly Paxton (US), Katja Rieger (SA), Shane Rogers (US), Stephen J. Scott (US), Geert Vermeulen, (NL), Christian Wilhelm (UK), and Stuart Woollard (UK), among others, for their valuable contributions to this research.

7 See, Danielsen, T., «Anthropological gaze, stories, and reflections on NBIM culture», 2023, p. 4-8.

8 See, Studio Etica.

9 See, e.g., Gillespie, A., & Reader, T. W., «Online patient feedback as a safety valve: An automated language analysis of unnoticed and unresolved safety incidents», 2022, and Suss et al., Bank of England, Staff Working Paper No. 912, Organisational culture and bank risk, 2021.

4. Assessing the impact of customer choice architecture on customer behavior. To examine customer choice architecture, NatWest Group's Internal Audit Behavioral Risk team uses sophisticated econometric approaches or randomized controlled trials, and some qualitative data. The goal is to assess the unique impact of a particular activity, event, product, or service (e.g., customer communications) on customer behaviors and, ultimately, an outcome of interest (e.g., customers getting into financial difficulty or risk events).

5. Aviation. At the level of pilots and cockpit crews: Crew Resource Management (CRM, methodology no. 6) and Threat and Error Management (TEM, methodology no. 32). At the level of the airline: Line Operations Safety Audit (LOSA, methodology no. 11), Safety Culture Assessments (methodology no. 18), and Safety 1 and 2 (methodologies no. 19 and 20).

6. Crew Resource Management (CRM). CRM focuses on utilizing all available resources (equipment, information, personnel) to enhance safety and efficiency in flight operations. It involves training in communication, situational awareness, decision-making, teamwork, and conflict management. This method helps reduce human errors that contribute to most aviation accidents.[10]

7. Data approaches. Next to conducting behavioral risk reviews, assessments, and deep dives, banks such as ING and Citi are working on sound large data approaches, to use AI in analyzing communication data, e.g., emails and chats, to get further insights.

8. Just Culture. A Just Culture approach is defined as a culture in which front line operators and others are not punished for actions, omissions and decisions taken by them that are commensurate with their experience and training, but where gross negligence, willful violations and destructive act are not tolerated.[11]

9. Leadership. (i) Fair and Caring LeadershipTM is a toolbox to become a fair and caring leader.[12] (ii) Visible Felt Leadership is a key component of Anglo American's Safety Leadership methodology which has been shown to drive tangible improvements in safety outcomes.[13] (iii) Enhance transparency within management teams by fostering openness and receptivity to feedback and diverse perspectives. (iv) To successfully manage non-financial risks like reputational and operational risks, risk managers need to be leaders, not just managers.[14]

10. Learning analytics. (i) Utilize data analysis and behavioral modelling for predicting and managing behavioral risks within learning and development programs. (ii) To minimize behavioral risks associated with the adoption of new technologies and enhance culture-oriented personnel development, companies are identifying patterns and trends in their employees' learning behaviors. This enables the creation of personalized learning pathways and the early identification and addressing of potential risks, such as lack of engagement or ineffective learnings strategies.

11. Learning platforms. Integrate gamification elements in digital learning platforms to boost employee engagement and motivation, and mitigate the risk of disinterest and the consequent loss of productivity and innovation.

12. Line Operations Safety Audit (LOSA). LOSA is a proactive safety monitoring program aimed at assessing operational risks and the effectiveness of Threat and Error Management (TEM) through observation of normal flight operations. It provides an objective analysis and promotes a safety culture within an airline.[15]

10 See, e.g., SKYbrary, Crew Resource Management (CRM), and EASA Pro, CRM Training Implementation, 2017.

11 See, e.g., SKYbrary, «Just Culture Repository», and, in German only, «Just Culture».

12 See, «Fair and Caring Leadership».

13 See, «Visible Felt Leadership – An interactive learning guide», sponsored by the Anglo American Safety Academy.

14 See, e.g., Rieger, K., «What does leadership have to do with risk management», 2021.

15 See, e.g., SKYbrary, «Line Operations Safety Audit (LOSA)».

13. Management responsiveness to risk. (i) Assess managing directors semi-annually or annually on key behaviors, such sharing of information with audit, risk, and compliance teams, their demonstration of risk awareness, issue ownership, and punctuality for meetings. Results are reported to the board and can influence bonuses and promotions. (ii) In audits, evaluate management's responsiveness to risk by examining their ownership of risks, proactive self-reporting of issues, and implementation of corrective actions.

14. NatWest Group's Internal Audit Behavioral Risk team. Post-financial crisis, NatWest Group pioneered a behavioral risk capability within its internal audit function. The core principle of the team is forward-looking, pre-emptive, and data-driven.[16] The team assesses behavioral risk factors using insights and methods from across the behavioral and social sciences. This includes examining (i) organizational choice architecture (e.g., incentives, decision processes, targets, policies, and procedures), (ii) customer choice architecture (e.g., customer communications and interfaces), (iii) social, group, and cultural influences (e.g., social norms, group dynamics, and shared beliefs), and (iv) decision-making heuristics and biases (e.g., overconfidence). More insights about the team's approach can be found in methodologies no. 3 and 4.

15. Obtaining an understanding of soft controls related to an audit of financial statements. NBA Practice Note 1148 of the Royal Netherlands Institute of Chartered Accountants offers the auditor concrete guidelines for obtaining an understanding of the culture, behavior and soft controls within entities.[17]

16. Psychological Safety. 'The Fearless Organization Scan' measures psychological safety.[18]

17. Railways. Human and Organizational Factors (HOF) are essential components of the Safety Management System (SMS) in the rail transport cluster. HOF aspects are naturally embedded in SMS standard audits (mainly in the second line of defense) in the sector. Since 2019, this topic has been a focus of regulatory oversight.[19]

18. Risk Type Compass™. A peer-reviewed psychometric tool evaluates an individual's subjective interpretation of risk, while also offering a team or organizational perspective to highlight vulnerabilities within the organization.[20]

19. Safety Culture Assessments. Assessing the safety culture within an airline aims to understand and improve the awareness, attitudes, beliefs, and behaviors of all employees regarding safety. A strong safety culture is fundamental for minimizing behavioral risks and promoting a safe operating environment. The safety culture is closely linked to a practiced Just Culture; without it, there is little or insufficient reflection on errors.[21]

20. Safety 1. Safety 1 focuses on preventing accidents and incidents through the identification and management of hazards. It is based on the assumption that safety is achieved by preventing errors and deviations from standard procedures. In practice, this includes conducting safety audits, incident analysis, and strict adherence to safety regulations and procedures. Safety 1 emphasizes the importance of compliance and the minimization of risks through preventive measures.

16 See, e.g., Eccles, R. G., in Forbes, «How The Behavioral Risk Team Is Innovating The Internal Audit Function at NatWest», 2022, and Engler, H., & Wood, A., in Harvard Business Review, «How Banks Are Using Behavioral Science to Prevent Scandals», 2020.

17 Koninklijke Nederlandse Beroepsorganisatie van Accountants, Unofficial Translation, NBA Practice Note 1148, «Obtaining an understanding of soft controls related to an audit of financial statements», 2022.

18 See, «The Fearless Organization Scan».

19 See, e.g., European Union Agency for Railways, «Human and Organisational Factors (HOF)» and «Safety Management Systems (SMS)», and RailHOF, a collaborative project between the European Union Agency for Railways (ERA) and the International Union of Railways (UIC).

20 See, Risk Type Compass.

21 See, e.g., SKYbrary, «Industry Safety Culture Evaluation Tool and Guidance», SKYbrary, «Assessing Safety Culture in ATM», and Hollnagel, E., in SKYbrary, Hindsight 18, «Is justice really important for safety?», 2013.

21. Safety 2. Contrary to Safety 1, which focuses on preventing errors, Safety 2 explores how organizations can operate successfully and remain safe across a wide range of conditions. This approach acknowledges that in the complex world of aviation, not all uncertainties can be anticipated or covered by rules. Safety 2 promotes the flexibility, adaptability, and resilience of the systems and personnel by focusing on how everyday operations can proceed safely and effectively. It involves understanding what works well and building upon it, rather than solely focusing on what could go wrong. This is also referred to as «Learning from the Positive».[22]

22. Simple, straightforward approaches. (i) Ask Five Times Why.[23] (ii) 'Can We? Should We? Test', a simple yet powerful tool to support ethical decision making. (iii) Influence behavior with micro-actions. [24] (iv) Perform post-mortems.[25] (v) Surprise & Delight Your Employees, an approach aimed at those with 'access to money'.[26] (vi) The Newspaper Check, taught to business as a preliminary control before engagement, asks: 'If my family and friends saw this piece of news on the front-page tomorrow, how would they feel and react?'.

23. Social Governance. Diverse perspectives support better risk and decision taking, and a diverse and collaborative workforce is better at innovation.[27]

24. Supervisory bodies. (i) De Nederlandsche Bank supervises behavior and culture by examining the board's decision-making, leadership, communications, group dynamics, behavior patterns, and mindset.[28] (ii) The Federal Reserve Bank of New York recently hosted a panel discussing error admission methods with speakers from high-stakes industries such as nuclear and medicine.[29] (iii) The Australian Prudential Regulation Authority (APRA) has documented their evolving approach to supervising risk culture.[30] (iv) The Financial Conduct Authority (FCA) defines culture as the habitual behaviors and mindsets of an organization, focusing on the four key drivers: Purpose, Leadership, Reward Systems, and Governance.[31]

25. System-Theoretic Process Analysis (STPA). Systems Thinking applied to safety, including workplace safety and organizational and social analysis.[32]

26. Terrorist threat management. How is it done, and what are the best threat management approaches to do this effectively? Scenario-based or situation-based management models consider the emergent conditions for a terrorist attack and the vulnerabilities that could be exploited, to determine available resources needed to prevent catastrophic outcomes from occurring.[33] The limits of this approach have been highlighted by many, where instead proposals have been made for driver-based or causal-effect based threat management models.[34]

22 See, e.g., SKYbrary, Eurocontrol «From Safety-I to Safety-II: A White Paper», 2013, and Federal Aviation Administration, «Safety Culture Assessment and Continuous Improvement in Aviation: A Literature Review», 2023.

23 See, e.g., American Society for Quality (ASQ), «Five Whys and Five Hows».

24 See, e.g., Unbossers, «An alternative approach to sustainable behavioural change in the workplace».

25 See, e.g., PMI.org, «The use of project post-mortems».

26 To maintain the appearance that 'nothing is set in stone', mix things up to keep employees on their toes. If you only look at checks over $5 000 pull one for $500. If the audit is done in June have the auditors come in October.

27 See, e.g., Rieger, K., «Social Governance: What can we learn from the world around us?», 2021.

28 See, De Nederlandsche Bank, «Supervision of governance, behavior and culture».

29 The 2023 and 2024 conference recordings are available for online viewing.

30 See, e.g., APRA, «APRA's evolving approach to supervising risk culture».

31 See, e.g., FCA, «Culture and Governance».

32 See, e.g., Leveson, N. G., & Thomas, J. P., «STPA Handbook», 2018, and Nancy Leveson's webpage.

33 See, Lagner, R., & Singer, B., «SCADA Threat Modeling Using Attack Scenarios», in Proceedings of the SCADA Security Scientific Symposium, 2008.

34 See, Wright, G., & Goodwin, P., «Decision making and planning under low levels of predictability: Enhancing the scenario method», in International Journal of Forecasting, 2009.

Of the many reasons proposed, compared to a driver-based approach that examines mechanisms that apply to different possible outcomes that lends itself to a systems-based approach that is general purpose, focusing on threats in scenarios constrains the generalizability of responses to new threats, and crucially limits the applicability of ever-expanding advances in the mining of data[35] to improve identification and mitigation of threats.[36]

27. The Corporate Ethical Virtues Model. Team ethical culture as a coupling mechanism between a well-implemented organizational ethics program and the prevention of unethical behavior in teams.[37]

28. The Hudson Safety Ladder. A model which describes the development of an organization's safety culture. Take a look at Figure 1 for more information.

29. The Organizational Maturity Index (OMINDEX®). The Organizational Maturity Index (OMINDEX®)[38] measures causal links between the management of a company's human capital and material value and risk across all stakeholders. OMINDEX® is a holistic, human measure of organizational health. It integrates purpose, strategy, systems, and key cultural factors that compare directly with financial 'AAA' ratings.[39] Research findings link higher OMINDEX® scores to improved business value and lower risk; including financial, human, and environmental outcomes. This is what the Maturity Institute measures as Total Stakeholder Value.[40]

Figure 1: Types of Safety Cultures

Credit: Professor Patrick Hudson

35 See, Shenvi, A., Bunnin, F. O., & Smith, J. Q., «A Bayesian decision support system for counteracting activities of terrorist groups», in Journal of the Royal Statistical Society Series A: Statistics in Society, 2023.

36 Received from Magda Osman, Principal Research Associate in Basic and Applied Decision Making, Cambridge Judge Business School, University of Cambridge.

37 See, Cabana, G.C., & Kaptein, M., «Team Ethical Cultures Within an Organization: A Differentiation Perspective on Their Existence and Relevance», 2019, and «Team ethical culture as a coupling mechanism between a well-implemented organizational ethics program and the prevention of unethical behavior in teams», 2024.

38 See, Maturity Institute, «OMINDEX®».

39 See, Bonds&Loans, July / August 2019 edition, «Capturing Human Risk's Influence on Credit Risk Remains Elusive – But That Might Be About to Change», p. 6.

40 See, Maturity Institute, «Total Stakeholder Value (TSV)».

30. The Organizational Personality (TOP) Framework / Finance without Numbers. TOP is a theoretically based methodology for analyzing and benchmarking a company's behavior preferences. Textual data is scaled on dimensions of behavior patterns, allowing reliable forward-looking insights into non-financial risk governance. The approach allows for assessing compliance with external standards at the level of behavior patterns. When aggregated in terms of an organizational personality profile, TOP enables corporate culture to be assessed from the 'outside'.[41]

31. The Starling Compendium on Culture and Conduct Risk in the Banking Sector. Since its 2018 launch, The Starling Compendium has become a key resource for culture and conduct risk in banking, with over 40 experts contributing to the 2023 edition.[42]

32. The 7-S Framework. A framework introduced to address the critical role of coordination, rather than structure, in organizational effectiveness.[43]

33. Threat and Error Management (TEM). TEM is a comprehensive approach to understanding and managing threats and errors in the aviation industry. It involves identifying threats, managing errors, and avoiding undesired states. TEM integrates concepts from Crew Resource Management (CRM) and is utilized in training and flight operations to enhance safety and mitigate occurring and perceived risks before an incident or accident occurs.[44]

34. Training: Low-Fidelity-Trainings for non-technical skills. Involves sessions with a greater content divergence from technical-operational everyday life. Participants are intentionally removed from their familiar work environments and placed into different contexts (e.g., outdoor settings, Lego games) where their technical skills, routines, and experience do not directly apply. The advantage of this approach is that mental processes, intra- and interpersonal competencies, and non-technical skills such as communication, leadership, team cooperation, and resilience become much more visible. They can be deliberately reflected upon and developed without being overshadowed by technical aspects.[45]

35. Training. (i) Use real-life examples, scenarios, and moral dilemmas in ethics training to assess individual's moral reactions and understanding. (ii) Use collective training and reflection on case studies and big failures, i.e., 'could it happen in our organization?' (iii) Use scenario analysis, i.e., constant open reflection on what could go wrong and how to react. (iv) Conduct on-site orientations, safety trainings, and install signage at construction sites.

36. Unobtrusive Corporate Culture Analysis Tool (UCCAT). UCCAT is a theoretically based and scientifically tested methodology for analyzing and benchmarking corporate culture. It measures 108 «unobtrusive indicators of organizational culture» (UIC). Each UIC represents an observable and measurable aspect of organizational activity indicative of culture. When aggregated in terms of cultural dimensions, UICs allow corporate culture to be assessed from the 'outside'.[46]

41 See, e.g., Siegenthaler, B.R., «Evaluating The Organization's Innovation Capability: A New Guiding Methodology», 2021, and Siegenthaler, B.R., «CEO vs CFO vs CPO (Chief HUMAN PATTERNS Officer», 2023.

42 See, Starling Trust, «The Starling Compendium».

43 See, e.g., McKinsey Quarterly, «Enduring Ideas: The 7-S Framework», 2008.

44 See, e.g., SKYbrary, Threat and Error Management (TEM); Merritt. A., & Klinect. J., Defensive Flying for Pilots: An Introduction to Threat and Error Management, 2006; Helmreich, R. L., On error management: lessons from aviation, 2000; and Decker, S.W.A., From threat and error management (TEM) to resilience, 2006.

45 See, e.g., Nicolaides et al. «Team performance training for medical students: Low vs high fidelity simulation», 2020; Scott, A., & Gartner, A., «Low fidelity simulation in a high fidelity world», in Postgraduate Medical Journal, 2019, and Human Factors Hamburg, «Low-Fidelity-Training».

46 See, Reader, T. W., & Gillespie, A., «Developing a battery of measures for unobtrusive indicators of organisational culture: a research note», in Journal of Risk Research, 2022, and LSE Blogs, Reader, T., & Gillespie, A., «Developing a tool to understand corporate culture from the outside», 2017.

37. Use nudges to complement traditional methods of risk management. This alternative approach rooted in behavioral psychology involves understanding the contextual drivers of human behaviors and introducing small changes, or «nudges,» to eliminate misconduct at the source.[47]

38. Zero tolerance. Human misconduct can result in immediate construction site bans and, in cases where it endangers others, could escalate to legal action.

4 Conduct Risk Methodology Observations

Given the number and variety of approaches, there are, in my opinion, five conclusions and trends that should be taken into account:

First, the importance of discussing the theoretical underpinnings of conduct risk methodologies. Conduct risk methodologies are built on diverse theoretical foundations, including Anthropology, Behavioral Science[48], Ergonomics[49], Psychology, Psychotherapy[50], Sociology[51], and Systems Science[52]. While interconnected in various ways, each of these fields focuses on different aspects of human behavior, societies, and systems. Informed methodological choices require a comprehensive understanding of the characteristics and underlying premises of these foundational theories.

Second, the advantages of mixed-methods approaches. Given the diverse theoretical bases and the methodologies they inspire, adopting a mixed-method approach is highly recommended.

Third, the need to identify transferable methodological parts. In the past years, cross-sector conduct risk knowledge sharing has been accelerating.[53] Fostering a multidisciplinary mindset is beneficial for identifying which methodological aspects can be applied to other professions, organizations, and industries.

Fourth, the importance of defining the strategic ambition level related to conduct risk. Any chosen conduct risk methodologies will be closely linked to a company's strategic ambition level, whether consciously decided or inadvertently shaped. The spectrum ranges from reactive, rigid, and binary approaches to an integrated, proactive mindset aimed at engraining conduct risk into all operational processes of an organization.

Fifth and last, the acknowledgement that theory-based approaches remain essential. There is a prevailing consensus that conduct risk methodologies will continue to evolve alongside the emergence of unstructured data and powerful algorithms extracting insights. Theory-based approaches remain essential for guiding the search within data, generating predictive insights, and identifying patterns to uncover root causes and potential solutions.

5 Conclusion

As the importance of conduct risk continues to evolve, boards must address a number of critical questions such as:

- What is our strategic ambition regarding culture and conduct risk?
- Which conduct risk methodologies do we currently employ? Are we aware of the advantages and disadvantages of these approaches?
- Are there specific methodologies that we choose not to adopt?
- What insights can we draw from other industries regarding best practices?
- Do we incorporate data-driven approaches in our conduct risk efforts?
- Are we acknowledging the impact of human behavior on our financial results?

All of the above questions should feature prominently on the board agenda and need to be discussed regularly, using effective measures to track progress.

47 See, Scholten et al., «A Better Approach to Avoiding Misconduct», in Harvard Business Review, May-June 2022.
48 See, e.g., «Behavioral Scientist», a nonprofit digital and print magazine offering expert commentary from the front lines of behavioral science.
49 See, e.g., International Ergonomics & Human Factors Association IEA.
50 See, e.g., in German only, Milton-Erickson-Institut Heidelberg and Simon Weber Friends swf.
51 See, e.g., Metaplan.
52 See, e.g., MIT Management Sloan School's systems dynamics and systems thinking courses, and the Centre for Systems Studies at the University of Hull, UK.
53 For example, experts from high-stakes industries such as shipping and aviation are sharing their methodologies with other sectors, see, e.g., Pilot Impuls, and, in German only, Human Factors Hamburg.

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