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ETHICAL BUSINESS PRACTICE AND REGULATION:

A NEW PARADIGM
FOR BUSINESS
AND REGULATION



CE markings are no guarantee of safety

Transparent supply chains – is it all about blockchain?

FSA advisors to review new evidence on VP and MAP foods

Food waste prevention remains a priority for SOFHT members

Ethical business practice and regulation: a new paradigm for business and regulation



There is a growing consensus among businesses and regulatory organisations that operating ethically makes good commercial sense. **Professor Christopher Hodges** and **Ruth Steinholtz** explain the reasoning behind this.

Ethical Business Practice (**EBP**) is a new paradigm by which businesses can achieve outstanding success. The core idea is that the people involved in the business focus on creating a values-based culture that enables them to consistently do the right thing, and produce evidence that they – and the business – can be trusted.

EBP involves all stakeholders; including directors, managers, workers at every level, customers, suppliers, external communities, investors and regulators in a way that recognises and supports their various interests.

SUSTAINABLE CORPORATIONS

Culture eats strategy for breakfast, so EBP is sound commercial strategy. It responds to multiple issues that concern businesses today, such as sustainability, community, environment and human rights, as required by the UN Global Compact, the OECD Guidelines for Multinational Enterprises, the ISO 26000 Guidance Standard on Social Responsibility, and the UN Guiding

Principles on Business and Human Rights. Institutional investors are increasingly seeking evidence of long-term sustainability.

The themes of social purpose, values, culture and trust are all now appearing in corporate governance requirements such as the G20/OECD Principles of Corporate Governance and the 2018 UK Corporate Governance Code. The UK's **OFWAT** (the Water Services Regulation Authority) has inserted similar requirements on purpose, strategy, values and culture into its licence conditions.

An effective ethical culture is the result of genuine positive values put into practice by the organisation, beginning with leadership. The foundation is a clear **social purpose** and it is created where managers lead by example and all staff consistently strive to put their ethical values into effect. This requires conscious alignment of purpose, values, structure and processes, including incentives.

Leadership's role is to consistently reinforce and apply the values. They must encourage constructive inquiry and challenge through conversations at all levels to determine what is the right thing to do, especially in grey areas. A learning culture, where fair, honest and open feedback is given and received, focusing on accountability rather than blame is key. This approach delivers continuous improvement, as people become more comfortable speaking up.

EBP involves two frameworks: a focus on leadership and culture as well as on values-based ethics and compliance that together produce the desired behaviours and therefore evidence that the organisation can be trusted.

The components of these two frameworks develop and support EBP; however each organisation must consciously adapt them, depending on their particular values, situation and risks. There is no one culture or set of values that will guarantee compliance and business improvement in every organisation. The very process of developing the elements of the frameworks itself is an important contributor to the outcome. Relevant evidence of an effective ethical culture should be holistic, coming from staff, suppliers, customers, investors, society and regulators.

"The food sector is ripe for EBP and EBR, as a response to globalisation and chains of digital evidence"

An illustration of one type of EBP is the idea of 'conscious capitalism' – pioneered by Whole Foods Market – that considers all stakeholders: staff, suppliers, customers, regulators, communities, investors – and takes their needs and interests into account.

The paradigm developed in *Ethical Business Practice and Regulation* is based on **evidence from many sources**, especially behavioural science, i.e. scientific research on how people actually **behave**. It shows that people are not the 'rational actors' in making decisions portrayed by pure economic theory. Instead, humans are subject to many cognitive and other biases and needs that influence behaviour. For example, we often make decisions quickly based on shortcuts, and follow others in our group, whether or not their behaviour is in line with our values. We must therefore create cultures where individuals are not able to rationalise unethical behaviour. In addition, the ethical elements of decisions should be recognised, and not forgotten through pure cost-benefit thinking.

SUMMARY OF ASPECTS OF THE CULTURE AND LEADERSHIP FRAMEWORK OF EBP

THE FOUNDATION

- Belief that ethics is everyone's responsibility
- Clearly articulated social purpose and core values, arrived at through internal consultation
- Commitment to fairness "just" culture and continuous improvement

PEOPLE AND ETHOS

- Leadership committed to all aspects of EBP
- Employee involvement, i.e. as ethics ambassadors
- Collaborative, cross-organisational working, where dissent is encouraged

ALIGNED SYSTEMS AND PROCESSES

- Performance management and incentives aligned with values
- All other policies, systems and processes supporting doing the right thing, directly in the business where possible
- Cultural measuring and monitoring to enable continuous improvement and basis for trust

BUSINESS SUCCESS

There is clear evidence that values-based business leads to sustainability and success. Both profit and compliance are **outcomes** of ethical practice, rather than driving goals. Research has shown evidence of a positive relation between employee satisfaction, corporate cultures of integrity, and stock returns, in long-term business success.

A 2017 McKinsey **study** of 600 firms showed an elite of 27% that focused on the long-term performed better than the 73% that were short-termist. A **Gallup** study found that organisations with highly engaged employees have 3.9 times the earnings per share growth rate compared with organisations with low engagement in the same industry. **Data** from 5,000 German establishments demonstrated that firms that adopt trust-based work contracts tend to be between 11 to 14% more likely to improve products.

A **2014 analysis** of 57 US public and private companies, and 15 companies from other parts of the world, identified as operating as 'firms of endearment' that adopt a comprehensive approach of delivering the needs of all stakeholders, showed cumulative shareholder returns for these firms over 15 years were 1,681% and 1,180% respectively, as against Standard & Poor 500 companies' rate of 117%. They called culture the 'secret ingredient', and society the ultimate stakeholder.

Ernst & Young's 2016 **survey** of 100 Board members of FTSE 350 companies found that 92% said that investing in culture had improved their financial performance, 55% believed that investing in culture had increased operating profits by 10% or more, and 86% said that culture is fundamental or very important to strategy.

An outstanding example of the establishment of a cultural approach by organisations throughout a sector is that of civil aviation safety. The key concepts are an 'open culture', in which everyone engages constantly by feeding back data, asking questions of themselves and others, and challenging assumptions, and a '**just culture**' in which people are accountable for the open culture and for the tasks for which they are responsible, and action will be taken for breaches of trust.

The focus has shifted from 'that person did something blameworthy' to 'why would any human behave like that in those circumstances so how can we reduce the risk of recurrence?' It is critical that blame is removed from the general culture. Both an open and a just culture have to apply consistently throughout all parts of the system. The outcome of this approach is that commercial air travel is extremely safe.

Conversely, there are many examples where corporate failure can be attributed to the absence of an ethical culture, such as Volkswagen and Wells Fargo.



WHAT IS ETHICAL BUSINESS REGULATION?

Ethical Business Regulation (EBR) is a relationship between a business, or a group of businesses, and a regulator, or group of regulators, in which the business produces evidence of its on-going commitment to EBP and the regulator recognises and encourages that commitment.

A surprising number of UK regulatory authorities aim to distinguish between businesses that aim to do the right thing and those whose intent is criminal. They have amended their enforcement policies and practices, using deterrent penalties only on the criminal group rather than on everyone. The regulators that are effective are those that have – and use – a ‘front end’ regulatory structure, which they use to develop an adult-to-adult ongoing regulatory relationship with businesses.

They have changed the regulatory relationship and aim to support businesses that have demonstrated they wish to improve. They retain a wide toolbox of enforcement powers, and select appropriate tools for use depending on the behaviour of the organisation and people in question. Firm enforcement remains required as a response to deliberate (criminal) wrongdoing. But imposing massive fines on banks over a decade from 2008 failed to stop corporate wrongdoing and led the **Financial Conduct Authority** to ask: ‘Why? What have we not learned?’

Elements of EBR can be identified in the approach of a wide range of regulators, such as pharmaceuticals, medical devices, health and safety, environment, energy, food and the UK’s Primary Authority scheme. The food sector is ripe for EBP and EBR, as a response to globalisation and chains of digital evidence.

REGULATING BY PURPOSE, ALIGNED VALUES AND CULTURE

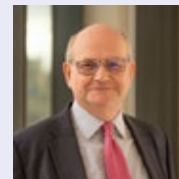
Regulating by culture is the next breakthrough. But it is not possible for regulators to impose or ‘regulate’ the culture of another organisation. Culture is indeed created within an organisation. This realisation is the essence of the EBP and EBR models.

Organisations should decide if they wish to base their activities on ethical values, and then work on demonstrating that they do so, building up evidence of this over time. Cultural measuring tools such as the Barrett Values Centre’s Cultural Values Assessment enable leaders to understand and where needed transform their cultures and provide the evidence. All their stakeholders – staff, customers, suppliers, investors, regulators, communities – can then evaluate relevant evidence and treat the organisation accordingly.

About the authors

Christopher Hodges

is Professor of Justice Systems and a Fellow of Wolfson College, Oxford; head of the Swiss Re Research Programme on Civil Justice Systems at the Centre for Socio-Legal Studies, Oxford; and a Fellow of the European Law Institute.



He is a leading expert in regulatory, enforcement and dispute resolution systems and advises many governments and businesses. He is a founding member of the Executive of the International Network for Delivery of Regulation (INDR), created at the request of UK Government, that includes experts from across the globe.

Recent books include [Ethical Business Practice and Regulation](#) (with Ruth Steinholtz); [Law and Corporate Behaviour; Redress Schemes for Personal Injuries](#) (with Sonia Macleod); [Delivering Collective Redress: New Technologies](#) (with Stefan Voet); [Consumer ADR in Europe](#) (with Iris Benöhr & Naomi Creutzfeldt), [The Costs and Funding of Litigation](#) (with Stefan Vogenauer and Magdalena Tulibacka).

Ruth Steinholtz’s mission

is to make a difference in the world by changing attitudes and practices relating to ethics and compliance. Following a varied international legal career, she founded AretéWork in 2011. Areté is the Greek concept of excellence and virtue ethics – being the best one can be.



Previously, as General Counsel, Group Security Coordinator and Head of Ethics at Borealis AG, Steinholtz developed a values-based approach to ethics and compliance – employing ethics ambassadors throughout the company. Organisations around the world have since adopted this approach.

She is a member of the UNODC E4J panel of experts on Ethics & Integrity and is a fully certified Barrett Values Centre’s Cultural Transformation Tools (CTT) consultant. She co-authored with Professor Christopher Hodges [Ethical Business Practice and Regulation: A Behavioural and Values-Based Approach to Compliance and Enforcement](#).

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