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Information Has Democratized Business Regulation. Adjust Risk and Compliance Thinking Accordingly.

Traditionally businesses have looked to contractual terms, industry groups, legislatures, regulators and other conventional authorities to identify and manage commercial, legal, and compliance requirements and risks. In today's interconnected, information rich, and reputation-conscious business world, this model is outdated and insufficient. It allows for blind spots that can expose businesses to commercial, legal, and compliance risks from sources that traditional models ignore, misunderstand, or underestimate.

Democratization of Business Conduct Standards

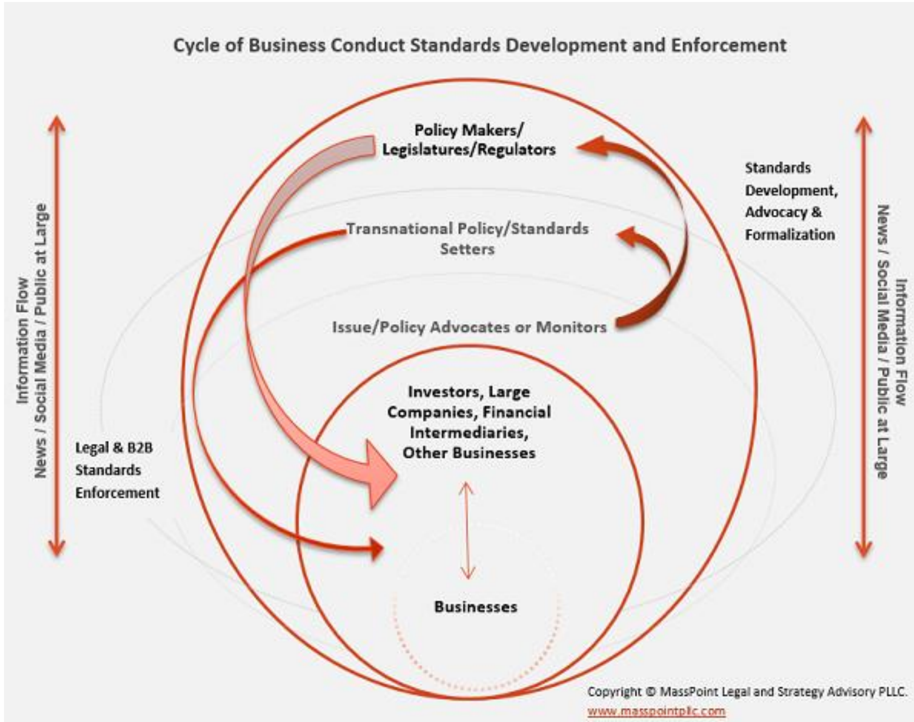
In the same ways that the internet and social media have enabled non- "establishment" actors to communicate and amplify political messages, these and other tools of the information/new media age have enabled non-traditional actors to effectively influence business conduct standards. As a result, constituencies and issues that not so long ago were marginal or viewed as niche or inconsequential are now relevant, and for some businesses and industries they are integral.

Non-Traditional Actors Are Shaping and Enforcing Business Conduct Standards

Now more than ever, non-traditional actors like NGOS/policy advocacy groups, transnational policy setters (*e.g.*, the OECD), and the public at large are playing influential roles in the development and enforcement of business conduct standards, such as those concerning responsible investment, ESG (environmental, social, governance), SCI (supply chain integrity), and general good governance and compliance. Some of these standards become or inspire national laws, or are adopted by countries as benchmarks of corporate conduct.[i] Others materialize as non-legally binding business conduct standards that are privately enforced in two key ways. First, by and through the public at large, and most effectively in the context of consumer-facing business segments. And second, at the business-to-business level—particularly by influential, risk and reputation-conscious firms that are increasingly requiring business partners, counterparties, suppliers, and others in their orbits to adhere to business conduct standards that they have adopted. (*See the below illustration of the business conduct standards development and enforcement cycle*).

Ripped from the Headlines: Non-Traditional Business Regulation and Enforcement in Action

Three recent Financial Times articles illustrate how business conduct standards are shaped by non-traditional actors, enforced at the business-to-business level, and can carry real commercial and reputational risk consequences for non-compliant firms. In March, the Financial Times reported that international banks, "driven to act partly by concerns about their reputation following lobbying by pressure groups such as Greenpeace," were pressing palm oil producers to observe strict, non- legally binding environmental standards as a condition of obtaining finance. A related May article described how institutional investors and large corporations had taken punitive measures against palm oil producers who failed to observe sustainability standards. Nestlé, for example, imposed a "blanket ban" on new business with Malaysia's IOI, a leading palm oil producer, after the



suspension of IOI's sustainability certification by the Roundtable on Sustainable Palm Oil (RSPO), an influential, industry-backed non-profit. Unilever, Kellogg's, and Mars also stopped trading with IOI for the same reason.

In May, Moody's announced that it had placed IOI on review for downgrades of four key credit ratings of IOI entities, because of the "uncertainty regarding IOI's operating performance, particularly on its downstream business, after its entire oil palm production was suspended by the RSPO and the resultant announcement by several of its customers to cease cooperation with the company." Beyond the IOI matter and generally, "many European and US banks," according to FT reporting, "are increasingly careful about dealing with companies which fail to comply with sustainability and environmental rules."

Key Takeaways, Steps to Adjust Risk and Compliance Paradigms

The FT articles could be categorized as palm oil industry news, but that would be a glib categorization. In essence, they are general business stories that offer lessons that are relevant across industries and borders, particularly for governance, risk, legal, and compliance functions. The upshot for businesses is that, to succeed in today's environment—or at least escape or mitigate often avoidable commercial and reputational costs—they must not only be good principals, but also desirable partners and counterparties. This requires businesses to adjust governance, risk, and compliance thinking to:

(1) be aware of new and emerging business conduct standards;

(2) understand the participatory processes by which business conduct standards evolve;

(3) acknowledge that non- legally binding or "voluntary" business conduct standards can be just as compelling as laws and regulations; and,

(4) adjust governance, risk, legal, and compliance paradigms to detect and assess the potential impact of business conduct standards and facilitate appropriate action.

More specifically, business should consider the following steps to adjust to and manage the risks and potential rewards of today's participatory business environment.

- **Know Your Audience and Influencers**. Understand the external constituencies that are minding and influencing your business and industry, directly or indirectly through investors, business peers, consumers, lawmakers, or other influential parties.

- **Assess the Nature and Impact of Business Conduct Standards**. Take steps to gauge whether new or evolving business conduct standards will become binding (law), confer business value of adopted, or present commercial or reputational risks if ignored.

- **Expand Scope of Relevancy for Governance, Risk, Legal, and Compliance Purposes**. Legally or commercially binding obligations no longer derive exclusively from traditional sources. As the palm oil industry example above shows, non-legally binding standards that are styled as "voluntary" can, in practical terms, be effectively binding (or costly if flouted). The scope of internal legal, compliance, and risk definitions and functions should be expanded to capture business conduct standards that emanate from non-traditional sources and do not take conventional forms, like legislation or official regulation.

- **Align Internal Resources and Governance Practices to Entire Business Objectives**. Clearly identify and communicate current objectives and enterprise vision to relevant internal functions to more strategically direct governance, risk, and compliance efforts.

- **Encourage Horizontal and Vertical Information Flow Internally**. Facilitate internal information flow between key internal functions—management, business, legal, public relations, CSR (corporate social responsibility) or their equivalents so that information can be contextualized, acted upon, and generally leveraged in service of whole enterprise objectives.

- **See Your Risk Reflection**. Assess how your business and business practices are perceived (fairly or unfairly) and take steps to reduce the likelihood that your business will be excluded from/ made to pay premiums for opportunities or penalized for real or perceived shortcomings in business conduct.

- **Understand That Information Can Work Against Your Business**. Just as businesses use information in service of the bottom line, information can be used against businesses. With this in mind, businesses should take steps to understand how business conduct standards are being marketed and endorsed, particularly when such information directly or indirectly pertains to a specific firm or industry. With this kind of information, businesses make it more likely that they can participate in the standards development process or avoid the risks of unawareness.

- **Learn from Others' Mistakes/Overcome Optimism Bias**. Learn from the experiences or mistakes of other businesses. Do not assume that bad things will not happen to your business or that your business will *naturally* handle commercial or reputation crises more effectively than other firms.

- **Consider Joining the Process**. For strategic or other reasons, some businesses have joined advocacy groups, policy organizations, and standard setters in the process of developing and implementing business conduct standards. For example, the RSPO (discussed above) is an industry-backed non-profit. More than 1,500 investors, asset managers, and related firms are signatories to the United Nations-backed Principles for Responsible Investment. There are other examples of business participation in setting and enforcing standards, and firms should weigh the comparative value of participation in light of their brand, industry, consumer base (particularly important for consumer-facing firms), employee values and demographics (*e.g.*, millennials), the participation (or not) of relevant investors and peers, and other factors.

- **Understand That Litigation is Not Always the Best Solution**. Earlier this month it was reported that IOI had filed a lawsuit against RSPO, apparently challenging RSPO's decision to suspend IOI's certification. Of course, the tactical and substantive merits of a lawsuit are best judged by the relevant parties, and no opinion of the IOI lawsuit is offered or attempted here. But it worth remembering, as a general matter, that litigation is not always the best or only solution. The costs and potential rewards of litigation should be weighed in the broad context of a firm's specific and general strategic objectives, its reputational risk, ability to bear any continuing commercial losses while litigation is pending, and other factors.

- **Capitalize on Business Conduct Standards**. Just as non-compliance with some new or emerging business conduct standards can be costly, compliance with such standards (particularly for early adopters or standards leaders) can be beneficial for firms' bottom lines and brands. With this in mind, business should calculate the potential strategic value of adopting or participating in the process of developing business conduct standards.■

About MassPoint

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[i] For example, the OECD's guidance on conflict minerals due diligence was incorporated as the standard of reference in the U.S. Securities and Exchange Commission's (SEC) final rule implementing the conflict minerals section of the Dodd-Frank Wall Street Reform and Consumer Protection Act. For a discussion of this and related issues, see MassPoint' February 2015 Business Update, FAO-OECD Guidance for Responsible Investment In Agricultural Supply Chains: Considerations for Sovereign and Private Enterprises, Food-Agri Companies, and Finance Providers.