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# Answers

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**1 (a) Corporate code of ethics.**

**Purposes**

A corporate code of ethics (sometimes contrasted with a professional code) has five general purposes.

The first is communicating the organisation's values into a succinct and sometimes memorable form. This might involve defining the strategic purposes of the organisation and how this might affect ethical attitudes and policies.

Second, the code serves to identify the key stakeholders and the promotion of stakeholder rights and responsibilities. This may involve deciding on the legitimacy of the claims of certain stakeholders and how the company will behave towards them.

Third, a code of ethics is a means of conveying these values to stakeholders. It is important for internal and external stakeholders to understand the ethical positions of a company so they know what to expect in a given situation and to know how the company will behave. This is especially important with powerful stakeholders, perhaps including customers, suppliers and employees.

Fourth, a code of ethics serves to influence and control individuals' behaviour, especially internal stakeholders such as management and employees. The values conveyed by the code are intended to provide for an agreed outcome whenever a given situation arises and to underpin a way of conducting organisational life in accordance with those values.

Fifth, a code of ethics can be an important part of an organisation's strategic positioning. In the same way that an organisation's reputation as an employer, supplier, etc. can be a part of strategic positioning, so can its ethical reputation in society. Its code of ethics is a prominent way of articulating and underpinning that.

**Evaluate Coastal Oil's performance**

In the case of Coastal Oil, the company appears to have failed its own code of ethics in terms of its pledges on full compliance with regulation in all jurisdictions: safety and care of employees, transparency and communication with stakeholders, social contribution and environmental responsibility.

Coastal Oil stated its aim to achieve full compliance with regulation in all jurisdictions. The contract with Well Services was clearly contestable in terms of who was liable, partly due to the complexity of the documentation. There is no evidence from the case that the company was criminally negligent but health and safety or environmental controls, relevant to companies operating in Eftland waters, may have been breached.

In terms of the safety and care of employees, the company also did not perform well against its own standards. The deaths of eight employees on the Eftland Coastal Oil Rig resulted from health and safety failures because of a number of internal control failures. If Coastal Oil saw the protection of employees as an ethical issue, it might have adopted, or ensured that its JV partners adopted, the 'highest standards' of performance in ensuring their safety.

The company gave the appearance of a lack of transparency and communication failure. Because of the internal arguments between Coastal Oil and Well Services, it took seven days to make a public statement about the event. Clearly, there would be many stakeholders eager to hear Coastal Oil's view on what had happened, including the families of those killed and injured, and the delay caused by the internal arguments was a breach of its own code of ethics on this issue.

In terms of social contribution, the oil spill had a number of negative social consequences. The oil spill caused a number of problems to the communities along the Eftland coast. Business was damaged during the important tourist season meaning that communities were less supported, in terms of income, over those important months.

The valve failure caused an oil leak on the sea floor which took several months to stop. This is an environmental failure and, given that Coastal Oil stated that environmental responsibility was a key heading in its code of ethics, stakeholders will be reasonably entitled to conclude that it has failed against its own ethical standards. Given that the company operates in such an environmentally sensitive industry, it would clearly require a high level of commitment to internal controls to maintain this, whether directly by Coastal Oil employees or through the partners in the JV such as Well Services.

**(b) Voluntary disclosure and environmental risk**

**Difference between**

Company reporting, usually in annual reports, interim reports or on websites, contains both mandatory and voluntary disclosures. Mandatory disclosures are those statements that are compulsory under relevant company laws or stock market listing rules. In most jurisdictions, mandatory items are the main financial statements such as income statement, statement of financial position and statement of cash flows. Listing rules in many jurisdictions, such as in the UK, also mandate some corporate governance disclosures such as directors' shareholdings and emoluments, and details of directors' contracts.

Voluntary disclosures are not required by any mandate but are provided, usually in narrative rather than quantitative form. There is a belief that some information of interest or relevance to shareholders or other stakeholders cannot be conveyed numerically and so additional information is needed. The chairman's statement, chief executive's review, social and environmental disclosure, intellectual capital reporting and risk reporting are all examples of voluntary disclosure in most jurisdictions.

[**Tutorial note:** *mandatory and voluntary disclosures vary slightly between jurisdictions.*]

### **Material to shareholders**

Voluntary disclosure is of interest to shareholders because it provides information that cannot be easily conveyed in statutory statements or in numerical form. In the case of environmental risk reporting at Coastal Oil, it is likely that shareholders will welcome the environmental risk measures put in place after the accident as reported in the annual report.

First, in the case of Coastal Oil, the fact that there has been a recent and expensive environmental accident means that environmental risk is clearly material to shareholder value and is likely to remain so while the company continues to extract and process oil. This is a 'structural' risk resulting from the company's core activity. This makes environmental disclosure potentially highly material and capable of affecting the value of the company. The extent of potential exposure (total impacts), and hence the potential losses, would be a key piece of information needed, and also the previous environmental accident statistics.

Second, it will allow the shareholders to understand the extent and nature of the risk which clearly wasn't fully known before the accident. By knowing this, shareholders can assess whether the risk profile of the business matches their own attitudes to or appetite for risk. In a portfolio of shares, some investors will want to blend certain risks and returns, and knowing about a company's risks is important in making these judgements.

Third, the additional environmental risk information will allow the shareholders to judge how the risk might affect company value and hence the potential volatility and attractiveness of the share. The case says that the disclosure would contain 'value relevant' information meaning that the risks described will be capable of affecting returns, costs or both. The materiality of environmental risk reporting is potentially quite high: shareholders were unaware of the poor internal controls on the Efland Coastal Oil Rig and, had they been more aware, may have discounted the share price accordingly.

Fourth, risk reporting can explain the new risk controls put in place. After a confidence-threatening event such as the valve rupture and oil spill on the Efland Coastal Oil Rig, the explanation of these measures could be vital in restoring investor confidence. In particular, they should reassure shareholders that the accident should not re-occur, or that if it were to re-occur, further controls would be in place to offset the worst of the damage. It is likely that more detailed and granulated environmental reporting would be valued by shareholders, especially those specialist institutional shareholders made cautious by the Efland accident.

### **(c) (i) Internal control failures**

In keeping with Coastal Oil's stated commitment in its code of ethics to transparency, I have been authorised by my board to provide a full and frank statement on the internal control failures that led to the accident on the Efland Coastal Oil Rig. I will be happy to explain any particular point in more detail if required, but if you will allow me I will outline where I believe our internal controls were below standard.

I should inform the committee that the ownership and management of the oil rig was complicated by the fact that Coastal Oil was part of a joint venture in which, despite being the major partner, we did not have complete control. This means that other partners had responsibilities, including control of some operations crucial to the safety of staff and the oil supply.

The complexities of ownership may have led to the first of the failures which was a lack of clarity on individual and collective legal responsibilities. Accordingly, liability for the valve failure was ambiguous even though it was another company, Well Services, who directly caused the problem. We work very closely with joint venture partners on projects such as the Efland Coastal Oil Rig and rely on each other's controls. In this case, the situation was made worse for Coastal Oil by a lack of clarity on these agreements and this is salutary for future projects.

It is my understanding that the engineers belonging to Well Services failed in regard to two operational controls. The valve that was the site of the pipeline's rupture was not tested in accordance with their normal procedures. Also, a connecting part was deployed at a depth beyond that at which it was designed to operate (i.e. beyond its safety tolerance). I was troubled by the suggestion that cost may have been a partial explanation for this. In both of these cases, a failure of operational controls contributed to the failure of the valve.

I sadly have no reason to doubt reports suggesting that the culture on the rig was less rigorous than it should have been. It is important that stringent controls are operated throughout Coastal Oil and it is especially important at the sites of operation where hazardous work takes place. There are issues with the reporting of exceptions to the land-side and hence the management style of a rig's individual manager becomes the defining issue on whether a certain internal control problem is reported to us. On reflection, this could have been more robust and it relied more on objective measures and less on human judgement.

Finally, we had no effective contingency plan in place for sealing the well-head or stopping the flow of oil from the well after the valve ruptured. This was the cause of the leakage of oil into the sea over several months. Contingency plans or system backups may have helped in this regard but we were unable to respond with the speed necessary and this resulted in such environmental and economic damage.

### **(ii) Subjective and objective risk assessment**

I would like to respond directly to Senator Jones's remark in the media that I as the company's CEO 'should have known this was going to happen'. Whilst I understand the senator's anger at the events that have so badly affected his constituency, I owe it to Coastal Oil's shareholders to respond to him for the purposes of clarity.

Risk assessment is an important but complicated process and involves establishing both the probability of a particular risk event happening and also the impact or hazard that would arise if it was realised. A key point is that some of these calculations can be made with some degree of objectivity whilst others rely more on subjective assessment. There is an important distinction, then, between objective and subjective assessments. A risk can be objectively assessed if we can 'scientifically' measure the probability of a given outcome or predict, with some certainty, the impact. I can predict with some confidence, for example, based on past data, the number of working days likely to be lost in a given year through absenteeism of employees. I can predict with much less certainty, the probability that the stockmarket will rise or fall on a given day. In such a situation, I must use more subjective judgement.

Similarly with regard to impact, I might be able to assess the impact of my loss should my car get stolen but I could much less accurately predict the number of people hurt or injured in an accident. Again, I would use a more subjective figure for assessing that risk. The probability of having my car stolen would increase if I were to leave it unlocked and this underlines the importance of controls to help reduce the probabilities of adverse events happening.

#### **Argue against Senator Jones**

This brings me to Senator Jones's remark that I 'should have known' the accident was going to occur. I'm afraid that his remark does not recognise the complexities of risk management and risk assessment. I have outlined the reasons for uncertainty in both assessing the probabilities and impacts of risk events.

Accidents do occur in many industries including in the petrochemicals industry. Given that Coastal Oil operates hundreds of similar deep sea rigs in waters all over the world, I could not, with any degree of certainty, predict the probability of a fatal accident on a given oil rig and much less could I have known about the probability of an accident on the Effland Coastal Oil Rig. Similarly, there is no information that I could have received that could have predicted the scale of death or injury in the event of a given incident.

I concede that there were a number of internal control failures on the rig in question, but would point out to the senator that I was unaware of those failures because of the nature of the information systems linking rigs to our land-side operations. It is the responsibility of each rig's management to enforce safety controls on that rig and no such information would have reached me except by exception. He may be justified in criticising these, and I have explained already that I view these information failures as an internal control issue that we must resolve.

#### **(iii) Health and safety risk**

The board of Coastal Oil was deeply saddened to hear of the loss of life on the Effland Coastal Oil Rig. As a petrochemical company involved in each stage of the extraction, processing and distribution of oil products, we are naturally very aware of the health and safety risks that we face. These are risks to individuals, employees or others, arising from any failure in our operations giving rise to compromised human welfare.

Health and safety risk, and particularly the probability of a given health and safety risk materialising, is generally increased by a number of factors. The first is a lack of a health and safety policy. In some industries, including petrochemicals, large parts of this policy are underpinned by legislation, depending on jurisdiction, but it is also in the interests of a business to ensure that robust policies are in place covering all aspects of health and safety and indeed this was the case on the oil platform in question. The second is a lack of emergency procedures or a failure to deal with hazards that arise. Once identified, a new hazard or impact must be addressed with a policy or a way of dealing with it. Ineffective operational controls, such as was the case on the Effland Coastal Oil Deep Rig, contribute to this failure. Third, a poor health and safety culture can undermine an otherwise good policy if management and staff are lax towards health and safety, or believe it to be unimportant. There is some evidence that this was sadly the case on the rig.

#### **(iv) ALARP**

I understand and share the committee's desire to ensure that an accident of this type does not happen again. However, risk management is partly a trade-off between the cost of control and level of perceived risk. We operate to a principle known as ALARP or that risks should be 'as low as reasonably practicable'. There is an inverse relationship between a risk and the acceptability of that risk or, in other words, a risk is more acceptable when it is low and less acceptable when it is high. Accordingly, risks assessed as 'high' in terms of probability and/or impact, must have credible and affordable strategies put in place for their management. The extent and cost of that risk strategy is a matter of judgement and you will appreciate that as the chief executive of Coastal Oil, I owe it to our shareholders and customers to control costs. This means that risks cannot be completely eliminated, much as I might wish that they could.

Accordingly, then, each risk is managed so as to be as low as is reasonably practicable because we can never say that a risk has a zero value. It would be financially and operationally impracticable to completely eliminate health and safety risks, and so we must live with the ever-present possibility that they can happen. This does not mean we would ever become complacent, of course, but merely that I should be honest in saying that the probability of occurrence cannot be zero. Because of this, we maintain a number of controls that should reduce the probability of the risks materialising, such as by having a policy in place and enforcing it. We also have protections in place, such as the compulsory wearing of safety equipment, to reduce the impact of an event should it occur.

Thank you for listening to this statement. I am now happy to take questions.

## 2 (a) Rules and principles

### Distinguish between

There are two broad approaches to the regulation of corporate governance provisions: rules-based and principles-based. In a rules-based country (jurisdiction), all provisions are legal rules, underpinned by law, transgression against which is punishable in law. Often characterised as a 'box ticking' approach, full compliance is required by all companies at all times (excepting where dispensations are granted, again, under the provisions of the law).

In a principles-based jurisdiction, legal force applies to the provisions of company laws but additional listing rules are enforced on a 'comply or explain' basis. It is important to note that compliance is not voluntary in that the provisions can be ignored, but that provisions may not be complied with in full, usually for a limited period if the full reason for non-compliance is explained to the shareholders. This allows for the market to judge the seriousness of the non-compliance and to potentially re-appraise or revalue the company as a result.

### Critical evaluation of remark

The remark in the Geeland Code strongly argues in favour of a principles-based approach to corporate governance. In particular, it is critical of rules-based codes that would, for example, place a blanket ban on combining the roles of chairman and chief executive. In order to allow for differences between circumstances, it is arguing for flexibility and 'common sense'.

### The arguments in favour of the remark.

In most cases, compliance with general principles is cheaper than compliance with a detailed 'box ticking' regime. A common criticism of rules-based approaches is the expense of compliance including the establishment of information systems to meet reporting requirements (for example on internal controls), consultancy costs, increased management costs and reporting costs. Where some flexibility is possible, the principles-based approach allows some 'common sense' to be employed in the extent of detailed compliance.

A principles-based approach is flexible and allows companies to develop their own approach, perhaps with regard to the demands of their own industry or shareholder preferences. This places the emphasis on investor needs rather than legal demands. There may be no reason, for example, why companies in lower risk industries should be constrained by the same internal control reporting requirements as companies in higher risk industries. As long as shareholders recognise and are satisfied with this, the cost advantages can be enjoyed.

An example of the flexibility afforded by a principles-based approach is that it allows for transitional arrangements and unusual circumstances. Details such as the contract terms of directors may need to be varied to meet individual needs or the notice periods might similarly be varied. In the event of a sudden, unexpected change such as a death in service, a company can enter a phase of technical non-compliance but, with suitable explanation of the reason for non-compliance, most shareholders will nevertheless be satisfied.

It avoids the need for expensive and inconvenient monitoring and support structures, the costs of which are ultimately borne by the companies themselves (through stock market or regulatory bodies) or by the taxpayer. The costs and inconvenience of policing compliance with rules has been shown to be material in some situations, especially in smaller companies. Similarly, the costs of a large national 'watchdog' to monitor and enforce detailed compliance is considerable.

### Arguments against

There may be confusion over what is compulsory under law and what is principles-driven under listing rules. A lack of clarity might be present, especially where compliance expertise is not available to management (such as in some smaller companies) between legally-required compliance and listing rules which are subject to comply or explain. This may confuse some management teams and cause non-compliance borne of lack of advice and information.

A principles-based approach assumes that markets are capable of understanding the seriousness of any temporary or more lengthy periods of non-compliance and of revaluing the shares as a result. Non-specialist shareholders may not understand why a given provision is not complied with nor appreciate the potential consequences of the non-compliance. Cleverly-worded comply or explain statements might mislead shareholders.

A 'box ticking' approach offers the advantage of gaining full compliance at all times (i.e. all boxes are actually ticked) whereas a principles-based approach allows some bad practice to continue. A full compliance regime is likely to provide a greater overall confidence in regulation and this, in turn, will further support long-term shareholder value.

A rules-based approach provides standardisation and prevents any individual companies gaining competitive or cost advantages with lower levels of compliance. This creates a 'level playing field' in which all competitors in an industry understand what is required.

[Tutorial note: allow individual arguments to be used for or against as appropriate]

## (b) Separation of roles

The strongest and most common reason for the separation of these roles is to avoid the dangers of unfettered power that may arise when power is concentrated in a single, powerful individual. The original proposition for the separation of roles was in the UK's Cadbury Report in 1992 which was itself a response to a number of corporate 'scandals', similar to those in Geeland, involving unfettered power and the abuse of shareholder wealth as a result.

Accountability is better served by the separation of roles because the chief executive has a named person, in addition to the non-executive directors, to whom he or she must account for the company's performance and his or her own behaviour. This serves to protect against conflicts of interest where chief executives may be tempted to act in their own self-interest rather than to serve the best interests of the shareholders.

Third, both roles are complex and demanding. In large companies, it is likely that the two roles cannot be carried out effectively by one person. By gaining the advantages of a separation of duties (and hence a division of labour), the performance of the company's management in total will be enhanced. The two roles are materially different in terms of their skills, and it enhances organisational effectiveness for one to chair the board (chairman) and another, with different skills, to manage the strategy of the company. It is usual for the chairman role to be undertaken by a non-executive director, whilst the chief executive is an executive director. Having this distinction at the top of the company allows the chief executive to be hands on and directly involved in the management of the company, whilst the chairman can adopt a more supervisory position.

Finally, it is considered best practice because it provides a reassurance to investors and ensures compliance with relevant codes. Investor confidence in company management is very important and this is enhanced by having a transparent and clear separation of roles. Where codes specify separation and this can be demonstrated, unlike at Anson Company, unqualified comply or explain statements can be issued thereby promoting investor confidence.

**(c) Comply or explain**

The statement clearly identifies the one area of non-compliance and represents a full discharge of the company's reporting obligation to comply or explain. In a principles-based jurisdiction, this statement is required under listing rules and involves informing shareholders of the level of compliance and also specifying any areas of non-compliance, which the company has done in this case.

It is clear and free of ambiguity in what it says. Clearly though, one area of non-compliance is explained. The area of non-compliance is identified and the individual is named. The naming of William Klunker may be material because if he is known and trusted by shareholders, the breach may be less important than if he were less known and less trusted.

It does not provide a good reason for the non-compliance other than saying that it was 'benefiting from having Mr Klunker in control' which might be seen as weak by some investors. The reasons for combining the roles in July 2009 are not given and so it could probably be argued that this is not a full explanation.

It does, however, provide a date for returning to full compliance against which management can be held accountable for failure. This will reassure investors that its period of non-compliance is temporary and the default position of the company is to remain in full compliance with the relevant code.

**3 (a) CEO's reward package**

**Purposes**

Reward packages are generally considered to have three purposes: to attract, retain and motivate. To attract means that they must be set at a level adequate to ensure that people with suitable skills will find the post attractive. If the salary is too high, a number of people with the wrong skill levels will be attracted and if it is too low, too few suitable applicants will be attracted. Retention means ensuring that the level is adequate to prevent a good chief executive from seeking employment elsewhere in order to find a level of reward more suited to his or her skills and experience. Finally, rewards serve to motivate. This means that there must be enough reward to provide loyalty and a desire to achieve in the role. This is often done by providing a part of the reward in the form of a variable payment linked to corporate performance.

**Influencing factors**

The market rate is the first factor that influences the reward level. This is what the case meant when it said 'commensurate with the importance of the job and in line with other public companies of similar size'. The market rate is the transfer value of Mrs Evans if she were to move to a comparable position in another company. In the case, it is evident that the remuneration committee believes this to be double the previous salary she was paid when the gas supplier was owned by the state.

Legal, fiscal or regulatory constraints are relevant in many situations. Public servants, including those employed by state monopolies, are sometimes constrained in their earnings by legislation or maximum differentials (i.e. a compulsory multiple between the highest and lowest paid in an organisation). Mrs Evans's salary had previously been limited because of 'government constraints on the salaries of public servants', but the privatisation meant she was now free of this limitation.

The third influencing factors are previous performance in the job (if relevant) and the outcomes of performance reviews. The recommendation of the remuneration committee has clearly based its value of Mrs Evans on her past performance. Based on this, it has not only decided to recommend her retention in post but also the substantial pay increase. The knowledge of her strategic and communications skills is based upon observing her in post when she worked for the nationalised company and, based on these, there is a belief she will perform well in future.

Fourth, stakeholder opinion and ethical considerations are also relevant factors in some situations. Where a CEO is highly visible or in charge of a politically-sensitive organisation, the opinions of stakeholders is sometimes a constraint on what can be paid. This might apply to charities, for example, non-governmental organisations (NGOs) and similar organisations. In the case, Dale Gas appears to be seeking to pay Mrs Evans the increased salary despite the concerns of some in society.

**(b) Market risk and retaining Mrs Evans**

**Market risk**

Market risk concerns potential losses on capital markets from changes in the value or volatility of a share price or other security. A number of factors give rise to market risk, sometimes referred to as 'market or price sensitive' factors including a

range of external opportunities and threats. In the case of Dale Gas, an internal factor, the potential loss of a trusted CEO, is thought, by Tom Nwede, to be a source of market risk because her loss would cause a devaluation of Dale Gas shares.

#### **Justify the remark**

In the context of the case, Mr Nwede was referring to the increased market risk and loss of shareholder value that may arise were the experienced Mrs Evans to be replaced because of the public concern. Increased volatility or a reduction in share price could result in a lower company value and a lower return on investment for the clients of XY Investments and other shareholders in Dale Gas.

Mr Nwede is clearly of the view that Mrs Evans is important for the stability of Dale Gas after its privatisation and for the mitigation of market risk. He is saying that it was important that the protestors and opposing small shareholders did not win in opposing the salary increase as that increase was, he felt, important in retaining and motivating Mrs Evans in the important period ahead.

Shareholders greatly value competent leadership in the companies they invest in, and Mrs Evans was clearly held in high regard by XY Investments and other institutional shareholders. The case highlights her excellent strategic and communication skills, both of which are valued by shareholders. The company will be strategically repositioned because of the privatisation and her communication skills will be necessary in managing the business and in conveying information to shareholders and others.

There were several board changes resulting from the privatisation. This would have meant that some new members were unfamiliar with the gas industry and would need to learn their new roles at a strategically important time for the company. Market uncertainty and hence market risk will be reduced by the continuing presence of an experienced and trustworthy CEO. This would, accordingly, be valued by shareholders in that she would be a source of valuable experience, continuity and stability.

She was respected by, and had the trust of, employees meaning that necessary internal changes could be made. These would be more difficult were a new and less trusted CEO to be brought in (although in other cases, a new CEO can have a positive effect). These changes are deemed necessary and so future shareholder value is likely to depend upon them being competently and fully implemented.

### **(c) Proxy voting**

#### **Proxy voting**

A proxy is a substitute or 'other person' that can be nominated to attend a company meeting to exercise the votes of shareholders unable or unwilling to attend in person. The proxy can be the company chairman (where the shareholder agrees with the directors' recommendation on a particular vote) or another person so nominated. It requires the completion of a 'proxy form' transferring the shareholder's voting right to the proxy person. A proxy other than the chairman will almost always have highly specific instructions of how to vote on each motion in the meeting. The validity and the number of votes for each proxy is essential in calculating the outcome of each vote.

#### **Advantages**

The advantages of the appointment of a proxy include a lower agency cost if fund managers do not need to attend each AGM in person. This becomes more important as the number of individual stocks in a fund increases. Where votes are routine and uncontested, there is no need for fund managers to attend in person and proxy voting (where the proxy is a company officer, e.g. chairman) facilitates this absence. In addition, the use of proxies in the case means that fund managers would not need to face the added pressure of being confronted by the smaller shareholders' protest. These are likely to be seen as an irritation by Mr Nwede with no possibility of them changing his voting were he to attend in person.

## **4 (a) Rights and responsibilities**

### **Rights and responsibilities**

The comment by Albert Doo identifies rights and responsibilities as being two essential characteristics of citizenship, be it human or organisational in nature. In the same way that individuals have rights and responsibilities in society, so do business organisations such as Biggo. The question asks about rights and responsibilities in the context of Biggo.

A right is an expectation of the benefits that Biggo can receive, by virtue of citizenship, from society. Biggo can expect the right to have the freedom to conduct business by engaging in resource and product markets, to enjoy the protection of the law and the goodwill of other members of society in supporting the right of the organisation to exist, to innovate and grow. Biggo had the right, for example, to expect fair treatment under law in respect of its planning application (and in fact received this permission).

A responsibility is a duty owed, by the citizen (in this case, Biggo), back to society as a quid pro quo for the extension of rights. These are owed by virtue of the citizen's membership of society. In most societies, responsibilities extend to compliance with all relevant laws and regulations, including the payment of taxes, and compliance with the behavioural norms of that society. Biggo, along with all other businesses, has a number of legal and ethical responsibilities but it is the extent to which the ethical responsibilities are recognised that is the subject of dispute along the Gray, Owen & Adams continuum.

### **Gray, Owen & Adams's perspectives**

Gray, Owen & Adams described seven possible positions that can be adopted on a company's relations with its stakeholders. These concern the ethical assumptions of the roles of a business in society and are as follows: the pristine capitalist, the expedient, the social contractarian, the socialist, the social ecologist, the radical feminist and the deep green. The range of

views along this continuum are primarily characterised by the ways in which they interpret the rights and responsibilities of business.

Broadly speaking, the nearer to the pristine capitalist end of the continuum, the greater the rights of shareholders and the fewer their responsibilities to a wider constituency. Conversely, the nearer the 'deep green' end of the continuum, the fewer the perceived rights and the greater the responsibilities of the company and its agents to a more widely defined group of stakeholders.

At the 'pristine capitalist' end of the continuum, rights and responsibilities are understood principally in terms of economic measures. The company has the right to pursue its legal business activity and to develop that business with the support of society and the governing authorities. In return, its responsibilities are limited to the profitable production of goods and services and, accordingly, the generation of profits that are entirely attributable to shareholders. It is not the responsibility of businesses to pursue any other social, environmental or benevolent end. In this context, it is clearly not the company's responsibility to use shareholders' money to contribute to the new children's play area.

At the socialist-to-green end of the continuum, it is argued that businesses like Biggo have fewer (and contestable) rights and much greater responsibilities. According to positions at the deep green end, Biggo, does not, for example, have the right to consume non-sustainable resources 'simply' for the purposes of wealth creation. They may not have the moral right, even if they have a legal right, to build on the community's play area. At the same time, Biggo has a wide responsibility to society and to the environment that might seriously constrain their behaviour and activities.

#### **(b) The two comments**

Robert Tens is closest to the expedient position. The expedient position is one in which social responsibility is seen in terms of what return can be gained from social responsibility policies and actions. In other words, it may be expedient to adopt social responsibility actions but only if by doing so, it furthers its strategic interests. The expedient position does not recognise any implicit social responsibility as such and social policies are therefore only pursued if a clear strategic rationale can be identified for them.

His comment considers the actions towards the community in terms of cultivating current and future employees: it is an exercise of specific stakeholder management with the key stakeholder being the local community. By engaging in activities that give the appearance of being socially responsible, i.e. making the requested donation, other economically advantageous ends can be achieved. He highlighted three strategic benefits that might arise: it might 'cultivate the company's reputation' specifically in order 'help in future recruitment'. Third, it might 'help to reduce resistance to any future expansion the company might need to make.' He clearly sees the donation in instrumental terms.

Margaret Heggs's comment is closest to the pristine capitalist position. Her comment suggests that she believes that the social responsibilities of Biggo do not extend beyond the social benefits it already provides through employment and the provision of 'excellent products'. The purpose of Biggo is not to engage in costly social responsibility measures such as community donations, even if they can be shown to have a positive strategic benefit. That is not the purpose of a business. In accepting that the company had 'no further contractual or ethical duties to the local government nor to the local community', she was demonstrating a pristine capitalist perspective.

#### **(c) SR and short/long term**

##### **Social responsibility**

This phrase refers to the belief that companies such as Biggo must act in the general public interest as well as in the specific interest of their shareholders. This can apply to the company's strategy and the way in which the company is governed, but Mr Doo is referring to the specific social footprint that the company has locally. It can also apply to the environmental footprint that a company has, i.e. the effect of company activities on resource consumption or the effect that emissions from operations have. It is possible to interpret this phrase narrowly, as Margaret Heggs has done, or more widely, as Albert Doo has.

##### **Short and long-term perspectives**

This question recognises that the attitude that a company may take towards a particular stakeholder claim can vary when a time perspective is introduced.

A short-term perspective is likely to consider a time period of days, months or perhaps up to a given financial year in terms of an action affecting short-term performance. A longer-term perspective, typically looking to years rather than months ahead, is likely to consider the legitimacy of a claim in terms of its effect on long-term shareholder value.

In the short term, Biggo may see the claim from Mr Doo, on behalf of the community, as a cost because a 'sizeable' contribution would have an effect on the profit for the year and hence the return to the shareholders. The case mentions that profits are likely to be low in the current year and so all costs should be carefully scrutinized for value for money and reduced or eliminated if possible. As Biggo is a public listed company, a short-term reduced profit can erode shareholder value because of reduced dividends and a potential reduction in share price.

In the longer term, Biggo can be seen to be cultivating two potentially key stakeholders (Mr Doo and the local community) and hence may create longer term value in terms of the advantages identified by Robert Tens (such as local employees and lower resistance to future factory enlargements). The case mentions the resistance from the local community and, given that the company will have to 'live with' the community for many years to come, it may be in Biggo's long-term strategic interest to do what it reasonably can to reduce any friction with this key stakeholder. There may, therefore, be a strategic case for making the contribution as requested.

- 1 (a)** 1 mark for each purpose of a code of ethics to a maximum of 5 marks.  
1 mark for evaluation of each point. (10 marks)
- (b)** 2 marks for distinguishing between voluntary and mandatory disclosure.  
Half a mark for each example of mandatory and voluntary to a maximum of 2 marks.  
2 marks for each benefit to shareholders identified and assessed to a maximum of 8 marks. Half a mark for identification only. (Maximum 10 marks)
- (c) (i)** 2 marks for each internal control failure identified and explained. Half a mark for identification only. (10 marks)
- (ii)** 2 marks for distinguishing between objective and subjective risk.  
Half a mark for explanation of each and/or evidence of understanding to a maximum of 2 marks.  
2 marks for each argument developed against the senator's statement to a maximum of 4 marks. (8 marks)
- (iii)** 1 mark for explanation of health and safety risk.  
1 mark for explanation of each factor to a maximum of 3.  
Half a mark for identification only. (4 marks)
- (iv)** 2 marks for evidence of understanding of ALARP.  
2 marks for explanation of why health and safety risks cannot be completely eliminated under the ALARP principle. (4 marks)
- Professional marks for logical flow, persuasiveness, format and tone of the answers. (4 marks)
- 2 (a)** 4 marks for distinguishing between rules and principles based approaches.  
Up to 2 marks for each argument for or against, to a maximum of 10 marks. (Maximum 12 marks)
- (b)** 2 marks for each point of explanation. Half a mark for identification only. (8 marks)
- (c)** 1½ marks for each relevant point of assessment. Half a mark for identification only. (Maximum 5 marks)
- 3 (a)** 1 mark for each purpose to a maximum of 3 marks.  
2 marks for each influencing factor reviewed in context to a maximum of 8 marks. Half a mark for identification only. (Maximum 10 marks)
- (b)** 2 marks for definition of market risk.  
2 marks for each relevant point of justification made to a maximum of 8 marks. (10 marks)
- (c)** 2 marks for definition.  
1 mark for each advantage to a maximum of 3 marks. (5 marks)

- 4 (a)** 1 mark each for an explanation of rights and responsibilities, and up to 3 marks each for explaining these in the context of Biggo, to a maximum of 6 marks.  
Half a mark each for identification of the two ends of the continuum.  
Half a mark each for explanation of terms (pristine capitalist and deep green).  
Up to 2 marks each for descriptions of the pristine capital and deep green ends of the continuum. (Maximum 10 marks)
- (b)** 1 mark for correct identification of the position of each person to a maximum of 2 marks.  
2 marks for justification for selecting the position of each person from the case information to a maximum of 4 marks. (6 marks)
- (c)** 1 mark per relevant point on social responsibility to a maximum of 3 marks.  
2 marks for recognition of short and long-term perspectives.  
2 marks for discussion of short-term effects.  
2 marks for discussion of long-term effects. (9 marks)