

“Comply or explain” – the pragmatic approach to corporate governance

Interview with Dorothee Deuring, non-executive board member and chairs or serves on the audit committees of Axpo Group, Lonza and Elementis (UK).

The pandemic has accelerated many trends that were already emerging before the crisis: the future of work, the importance of sustainability in corporate strategy and, last but not least, the value of transparent crisis communication. In an interview with Florin Krapp and Reto Eberle, Dorothee Deuring explains what these insights mean for the work of the board of directors.

KPMG: *The last 18 months have been a time of dynamic change in many respects – for companies and their people, but also for society as a whole. How did you experience this period? What was your highlight, and greatest challenge?*

Dorothee Deuring: The greatest challenge was certainly the sudden professional distance that came with working from home. For me, the unexpected highlight was the enormous speed at which COVID-19 vaccines were developed. Back in March 2020, nobody believed we’d get there in less than a year. On reflection, we can say that the impossible was made possible thanks to effective cooperation between governments, private and public funding, the pharmaceutical industry, and also the regulatory authorities. This will go down as a milestone in human history.

In this context, it’s important to note that vaccine development and production is not one of the most attractive business areas in the pharmaceutical industry. That’s why it was so important to have upfront financing for vaccine development. It’s absolutely paid off for the public sector, and society as a whole, though. Taking Austria as an example: two days of lockdown were found to cost the national economy more than vaccinating the entire population free of charge.

We’ve faced changes – some of them quite dramatic – almost overnight. These are associated with both risks and opportunities. As we begin to see light at the end of the tunnel, it’s time to draw some conclusions. What will change? What will return? What will remain?

From a medical point of view, it would be nice if the virus would disappear without a trace. What will certainly change is the world of work. But I think this will just be a continuation of what we were already seeing before COVID; the pandemic has massively accelerated flexibility in the way we work, and it’s been a boost for digitalization. We have to take a very differentiated view of the shifts in major economic areas – these vary from industry to industry. The big issues of sustainability



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and climate change were there before the pandemic, and will continue to dominate the economic and political agenda afterwards as well. Certain regions of the world will have a big job to catch up, and we must be careful that the gap between rich and poor does not widen. But again, these problems were already a concern before coronavirus.

You have international board experience. How do you generally perceive corporate governance in Switzerland compared to other countries?

Pragmatic is the word that comes to mind. Like everything, pragmatism has its advantages and disadvantages. The advantage is that it can stop you rushing to implement every confusing new rule or exaggerated regulation. Instead, you try to focus on what really matters. In Germany, the UK and the USA, there has been a frenzy of corporate governance regulation in recent years. Fortunately, we haven’t seen it to the same extent in Switzerland. At the same time, there’s a danger that Switzerland will fail to keep up with the discussion and that the international capital markets will perceive Switzerland as not working wholeheartedly on issues such as sustainability or transparency.

As we understand it, it’s up to the economy, i.e. companies, to align their strategies with pressing issues. You don’t necessarily need the legislator to make boards of directors and companies aware that sustainability is a key issue, do you?

That’s true. However, it is difficult to take on a pioneering role in the absence of generally applicable regulations that enable companies to draw comparisons. Clear regulation or, ultimately, a law could help that process. Currently, we have a jungle of guidelines and benchmarks. This makes international comparison in particular difficult. Often, it is not so much the home market that poses a challenge to companies in terms of their environmental or social issues. It’s more the subsidiaries abroad, where local laws and directives come into play. And I’m not even talking about developing or emerging countries. In Europe alone, and in certain parts of the USA, the difference compared to Switzerland is very significant.

Let’s take a look at the UK, where you also serve as a board member. What are the issues keeping companies busy at the moment, and what can board members working in Switzerland take away from this?

The UK has a very similar governance system to Switzerland. Germany, on the other hand, operates quite differently with its two-tier management and supervisory board system. Current topics like compliance or management structure lean more heavily toward possible conflicts of interest of the board members in Anglo-Saxon countries than in Switzerland. These countries define more precisely what constitutes a conflict of interest, and what is – and is not – acceptable in terms of compliance. However, there’s a perceptible shift in Switzerland toward the North American-UK approach. This is impacting requirements with regard to the much-cited independence of individual board members, as well as the auditors with their regular rotation. The capital market, among others, is demanding this more critical view.



In your experience, how does collaboration and exchange differ between the board of directors, audit committee, and internal and external auditors?

I observe large differences between individual companies rather than national jurisdictions. In other words, differences are based on the industry in which a company operates; on the individual members of the management bodies; and generally on the specific corporate culture. This is true of Switzerland, the UK and other countries.

That would suggest that you can't standardize and regulate everything. Every industry has its own history and its own challenges, and the board of directors must look for appropriate solutions.

That's right. At Axpo, for example, the energy transition – and therefore sustainability – is one of the central topics of every board discussion, whereas for past mandates in Germany, for example, I was confronted more with legal compliance issues. There are also very few fixed legal requirements, just a confusing variety – a veritable flood – of codes. I like the “comply-or-explain” approach, which we see in Germany but also in Switzerland, for example in the SIX Directive on Corporate Governance. It is perfectly possible to deviate from a recommendation if you can justify it well. In other words, the guidelines are strict in terms of transparency but not in terms of exact application. This gives the board of directors sufficient flexibility to establish an independent culture and implementation practice within the company.

The big topic of the day is the sustainability of each company's economic activity. On the one hand, the importance of sustainable business cannot be stressed enough; on the other, doing business sustainably has long been part of the DNA of many companies. How do you see things?

I would dispute that sustainability is already embedded in the DNA of many companies. We're at the very beginning of a structured, measurable and meaningful sustainability debate. We are still moving through a thicket of guidelines, benchmarks and barely comparable criteria. Many reports are being written, appropriate sustainability topics identified, and goals set. But the authenticity and real-world effectiveness of these efforts are not yet where I'd personally like to see them. This is because the defined sustainability goals and measures cannot be achieved by employees in their day-to-day business without compromising personal performance goals. This throws up dilemmas in those individuals' daily actions. As long as these contradictions exist, we have not yet reached our goal.

In that case, we are still a long way from “integrated thinking”, which should form the basis for the much-discussed “integrated reporting”.

It's always difficult to generalize. There are industries whose CO₂ emissions – the most discussed sustainability issue – only account for a small part of the environmental metrics. Then there are others whose CO₂ footprint is the decisive strategic issue, like the oil and gas industry.

On the subject on integrated reporting: for me, sustainability is not integrated into a company's DNA until the separate report, ESG committees or ESG officers become redundant. Only then has it become part of the strategy, part of the company's purpose. Many boards of directors are now setting up their own ESG committees. This is a good thing and it makes sense to raise employee awareness of sustainability. But it's only the beginning of the story, not the end.



It's probably also about a shift in value systems as well as intrinsic and extrinsic motivation.

Exactly. It's actually a bit easier for the younger generation than for people of my generation, who grew up placing different values on our working lives and, in particular, were also economically socialized. It ultimately boils down to the fact that incentivization systems also need to reward the sustainable actions of each individual. And we're not there yet.

According to that logic, could we also abolish the audit committee or the compensation committee once proper and credible internal processes have been established?

An interesting thought. Of course, there are the non-delegable tasks and duties of the board of directors, including the supervision of the internal and external audit. It means we're unlikely to abolish the audit committee any time soon. But where to place compliance is certainly open to discussion. Does it belong with the audit committee? Does it need its own separate vehicle, and where should this be located? And is compliance fully integrated into the corporate culture and strategy even if we no longer need a separate committee? You also have technology or transformation committees to accompany change at an organization for a brief period. Such board committees often serve as important short-term accelerators or catalysts of a process, but it doesn't mean they have to become permanent institutions.

Let's stay briefly with the topic of compliance. What are your thoughts on the concept of compliance as an important pillar of sustainability?

Compliance risks are highly diverse. They have to be assessed differently, for example, in the construction industry, in the pharmaceutical industry, in the automotive industry or in the financial industry. Some compliance issues are regulated by law, while for others there are only ethical principles to follow. In some cases, an industry self-regulates through mutual supervision. When self-regulation of industry participants does

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not take effect, competition can grow out of control and need trimming back again. In this case, creating clear legal foundations can help. Public pressure can also contribute to the desired behavior. Compliance has a lot to do with reputation management. Much work is needed behind the scenes to ensure that a clear image is presented to the outside world. Let me illustrate this: for a water lily to bloom, it needs deep roots. That's why compliance must be seen as an element of deep-rooted, sustainable corporate management.

Related and/or previously used terms for compliance include business ethics, corporate culture and trust.

Absolutely. It all depends on the "tone from the top". As a board member, I cannot expect employees to behave in a way that I do not exemplify myself. And trust is not enough in the case of compliance; the company management must establish a functioning and clear compliance management system. The Swiss value model in particular cannot be transferred 1:1 to other countries and cultures. Even in Germany or France, the scaling of this model is slightly different, while in the US or China, some aspects are fundamentally different.

As auditors, we are naturally interested in understanding our role in the context of sustainability.

My answer to that is as simple as it is clear: everything a company publishes regarding the achievement of its goals is part of a progress review. That includes sustainability targets, of course. So we need an audit that increasingly examines non-financial reporting in addition to the financial aspects.

And that is not always easy in practice. We do audit sustainability reports, but they are often not well structured, and the audit is not based on a uniform standard.

Currently, we need a statement from the auditors on whether the published report reflects a true and fair view. In the future, auditors will also need new, specialized knowledge about non-financial aspects of reporting. If I want to make a judgment about CO₂ emissions or certain waste management parameters, I need to understand how these parameters are calculated and where they come from.



Finally, let's take a look at what's in store for us in the coming months. How will our working lives change after the pandemic? We will see more flexible working models that are not necessarily tied to a physical workplace. In principle, this development is to be welcomed. But I do have my concerns that in the process we'll lose something we've cultivated so carefully over recent decades, namely corporate identity, or the culture within a company. Flexible working can make integration and training of young or new employees more difficult. As a result, people's loyalty to their employer could also decrease, which in turn would increase staff turnover. This means that companies' HR departments will have to adjust to a faster pace of change, and step up their recruitment activities accordingly. "Standardized onboarding" and good "alumni care" are the keywords here. Another trend I see is growing demand among external

stakeholders for various kinds of information. Corporate communication needs to be professionalized further and made as transparent as possible. This doesn't mean pushing the board of directors to the fore. Communication should remain an operational management task. However, the recent situation has shown me how important it is in the event of a crisis to engage in effective communication with stakeholders, all the way up to government agencies. And that's something I'm taking with me as we emerge from the pandemic.

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Dorothee Deuring is a non-executive board member and independent corporate finance consultant with more than 25 years of experience in industrial manufacturing, pharmaceuticals and banking. She currently serves on the board of directors of several companies, including Axpo, Lonza and Elementis (UK). In 1994, she completed her Master of Science in Chemistry, and received a Master in Business Administration from INSEAD in Fontainebleau (France) in 1996. Since then, the mother of one daughter has worked for companies including McKinsey & Company, F. Hoffmann-La Roche Ltd, the bank Sal. Oppenheim Jr & Cie and UBS Ltd. The Vorarlberg native already demonstrated a steady hand, clear vision and great marksmanship in the small-bore rifle shooting discipline of the 1988 Olympic Games in Seoul.

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