Institute of Corporate Directors

Podcast Transcript: Be It Resolved That Ethical Decisions Are the Last Line of Corporate Defence.

Rahul Bhardwaj (00:02): Welcome to Be It Resolved, the podcast where bold ideas meet courageous leadership. I'm Rahul Bhardwaj, President and CEO of the Institute of Corporate Directors in Canada. In each episode, I speak with experts to explore pressing issues affecting directors and decision-making in the boardroom.

My guest today is Dr. José Hernandez, founder and CEO of Ortus Strategies. He's a globally recognized expert in corporate governance, ethics, and crisis management. José has worked with organizations worldwide, helping leaders address fraud, corruption, and reputational risks while fostering long-term trust with stakeholders. Now, today, we're gonna explore why ethical leadership is not just a moral choice, but a strategic imperative for boards, especially when facing complex corporate challenges.

Now, for our listeners, today's resolution: Be it resolved, ethical decisions are the last line of corporate defence. Think about which way will you vote.

José, great to have you here, and we'll get you to vote on the resolution a little later as well. Now, we won't be surprised where listeners will say ethics are really important, I don't think anybody's going to debate that, but I think one of the points that you wanna make is that it's not just a nice-to-have, but it's a need-to-have. Is that right?

José Hernandez (01:27): Yeah, that's correct. In particular moments like today, when businesses are really cornered due to tariffs, businesses are facing different prospects. Pressure goes up, and when pressure does go up, you have leaders that sort of try to take shortcuts. And that is particularly the times when ethics becomes critically important. But also, it sets a compass: a compass for your people, a compass for your suppliers, your customers, that's who you stand for.

So, when you think of ethics, you have to be paralleling it to brand value. So it's critically important, but it's not something that you just aspire to do. You actually have to do it in terms of putting into processes, into your strategy, into your culture. And I'm sure we're gonna get into that as we go through.

Rahul Bhardwaj (02:09): Right. We wanna build that into the concept of a last line of corporate defence as well. So, you've touched a little bit about why ethics are important in the big picture. Can we connect that to value creation for the corporation?

José Hernandez (02:24): Yeah, absolutely. I mean, it's always a challenge academically speaking to saying, our companies that are more ethical generally do they create more shareholder value. But the way the world is focusing on how we manage externalities, how we manage brand value, when we see allegations in the media about child labour out in Bangladesh, you know, what happens to the stock price?

So I think we're very good at measuring on a negative side that customers and companies, financing agents are not willing to be associated with certain parties that have issues but on the flip side of it, and that's where we have some incredible examples of companies that really rehabilitated after a scandal and really brought their shareholder values to multiples of the highs that they used to experience in the past.

Rahul Bhardwaj (03:08): And it seems that people make questionable ethical decisions because there's a short-term win here to be had. And I get the sense that what you're aiming at is to say this is connected with the brand. So the long-term value creation, which is key to boards by the way, and we'll get to that in a second, but it also speaks to trust and lowering the costs of transactions. And can you talk about that a little bit?

José Hernandez (03:33): Yeah, so for example, I used to take for some of my major corruption cases, there was always an issue in Moscow. So, in Moscow and Russia, people don't trust each other.

So you would have, for a particular transaction, 10, 15 signatures that would go into a particular invoice in order for payment to be approved. It's a low trust situation. At the end of the 10, 20 signatures, you would assume that the payments would not constitute bribes or being diverted, but actually you'd had the opposite.

So what you end up with is duplication in more procedures, more processes, because we can't trust the other side. So that just builds in bureaucracy and red tape, which [does] not necessarily help on the efficiency side of things. I also worked in places like Cuba. Again, the same rationale, that we need more procedures, more processes, and we need more validation before we will actually take the other parties at arm's length and take their word for a particular state.

Rahul Bhardwaj (04:29): You know, it's interesting to hear you describe it that way, José, because we've been talking about trust as the lifeblood of corporate governance for a long time, and a lot of people seem to take that for granted. It's just a given. But the way you're framing it around, you know, the friction and the lack of efficiency and business processes and just the day-to-day business, you don't hear that emphasized very often. Why do you think that's the case?

José Hernandez (04:56): I think because we're naturally good people and we wanna associate ourselves with good people, so we just take it for granted. But if you are in business, particularly in business involving with different cultures, with lots of money on the table, you wanna put some safeguards, for your own shareholders and for your own sake of a project.

So, what I've seen a lot in the past is [that] ethics and trust are not something that you just aspire to, but you put a process around it. For example, if I'm gonna do business in a particularly difficult geography and I need business partners, I do some due diligence; not just, is this a good person, a good guy, you know, you hear a lot of that, this is a good guy, José, you can really do business with him. But no, you do your work as to who is this person, where did they get their wealth, what are their business practices? And then, you know, you follow that through in terms of what you put in contracts, and then you come back a year or two later, and you do some audit.

So it's something that you actually work at. It's something that, when we know how to do it, is why ethics and compliance programs are important. And it's just about safeguarding and doing it efficiently rather than questioning everything that comes to the table.

But I've found it particularly in Canada, because we have such a trusting culture, some of this is just intuitive and we don't necessarily think that we need any of this complexity, but as we've seen in the scandals that we've had, sometimes our naiveity and our trusting culture get in the way.

Rahul Bhardwaj (06:19): Interesting. So set a couple of words in there that we can unpack here. We're talking about process, framework, now boards, board oversight. So, we know the boards have a duty to act in the best interest of the corporation. Directors have a duty of oversight of culture, strategy, and risk. And it sounds like ethics are built into all aspects of that. A little bit about legal compliance, the law, but when you really get down to it for boards, if they're concerned about ethical decision-making, let's talk about a couple of steps that they can put in place, or where do they even start to look from their due diligence standpoint and building a framework? Where do they start?

José Hernandez (07:00): The first and most important thing is knowing who your CEO and top management team are and what they're doing, how they do business. You hear allegations in the World Economic Forum, they have an investigation because of certain bullying tactics, so the CEO has to step down.

I think the most important thing is that organizations are made up of humans, and humans take their cue from the top. So, if your management team is taking shortcuts, your management team is misappropriating funds or thinking that the corporation's funds are their funds, that's how you start testing what the LITMUS test and where the compass is for the organization. So that's one.

The second part of it is, you know, I'm an accountant, so I tend to look at exceptions. What are the exceptions? The audit reports. What do they say? Not just what do they say in terms of the tone of how organizations put in place internal controls, how do they respond to issues, but also investigations; allegations that individuals are bullying, individuals are perhaps using company's assets in ways that we would not like, or individuals are working with suppliers in a potential conflict situation.

So, I think it's the pros of knowing who your business leaders are, knowing who your key partners are. And the flip side is to test it and make sure by looking at the internal audit reports, investigation reports, and also media reports, to really form a full picture.

Obviously, we're all good people, but one of the things I've found out, I thought, you know, I was born in El Salvador, so I thought a lot of good people do bad things. And that holds for El Salvador as it holds in here in Europe, where I'm today, and in Canada, where I spent a huge amount of time.

Rahul Bhardwaj (08:41): Yeah. So let's dig into that just a touch more, because there's this asymmetry of information that we know about. You're relying on management reports to talk about what they're doing, and on the board, for the most part it's trust and you know, trust but verify. So let's talk a little bit more about the verify.

If you are a director and something, it doesn't pass the smell test or you just wanna inquire further here, where do you start to look to assure yourself that your management team in the company is achieving that ethical standard that you're expecting?

José Hernandez (09:14): Yeah. I think a lot of times, when we had criminal investigations involving companies, and directors would say, well, am I doing enough? Do I need to put more procedures in place, get out there?

And we would say, look, have a one-on-one session with your head of compliance, your head of internal audits, your head of procurement, and go out to the field to speak to CEOs.

Now, the fine balance is, as a director, you do not want to encroach on the functions and duties of management, but it is your job as a director to know what's going on and to listen to people firsthand. And you do not need lots of hours with the head of risk, the head of audit to get a sense. You need half an hour or an hour every quarter just to create also that connection, that personal connection that it says it's okay to come to the board with issues, even if they involve management.

And the fact that a CEO and CFO say, of course it is okay to have those clear channels, send a signal of openness, send a signal of not letting problems fester, and I think is critically important, but finding the way to do it, particularly in the culture of an organization that you may be overseeing, that's a bit of an art.

Rahul Bhardwaj (10:26): And ethical suppliers, or I should say unethical suppliers are often a bit of an Achilles' heel for global companies and those are situations that come back to really harm the brand. What do boards do or directors in particular? I mean, you only get the board package and rely on that information. Is there a level beyond that that they can go or should go?

José Hernandez (10:49): I think you ask simple questions. "How many suppliers do we actually have?" And you would be surprised, Rahul, that how many organizations don't have a number to that. Because that gets you to a sense, as somebody puts them on the list, and we know how many there are.

The second thing you do is you ask, "Have we screened them? Have we screened them for issues just on the basic, on the media side and are we focusing on the issues? And if there are issues, how do they make it to management and how do they make it to the board?"

So sometimes it's the simple things that sometimes tend to be the hardest to do. I've had an organization that I worked with, a huge engineering company that had like 600 subsidiaries with all different accounting systems. And the one thing that we had to get hold of was third parties. Third parties, because some of them were, as you know, a vast majority of bribe cases. It used to be done directly with cash and so on. But most of it tends to be outsourced to third parties. Again, to introduce that element of complexity.

So, almost in every case that I've touched in the last 25 years, you're dealing with getting a hold of the suppliers, getting into their books, and figuring out where the money was diverted to. And then, based on criminal statutes in Canada and the US and abroad, you're liable for those actions that those agents, consultants and third parties do on your behalf.

But again, it goes back to the basics. Get down to understanding how is management managing this and the managing the risk. And if they just don't know how many suppliers we have, because we have 600 subsidiaries and 200 accounting systems, you know you have a bigger control issue.

Rahul Bhardwaj (12:25): And you can appreciate for directors, particularly of public companies, those that are global. So, really complex environment out there, and they're being asked to do so much more. There's a big compliance burden and regulatory requirements, and you could go down and explore this area for a long time, almost to the detriment of other things. You gotta prioritize conversations.

But what would you say to a board that says, look, you know, we're satisfied that we're complying with all legal requirements and we're satisfied with that. What would you respond to that and where does ethics fit in? Is ethics an add-on or is that sufficient?

José Hernandez (13:06): It's a great question. So I've had this case, this company's huge organization came to me and said, we know we're doing all the right things. We know who our people are. We do a certain type of activity that lowers our risk profile as an organization. And then they said, so what should we do next? And I said to them, take a second look. Choose a few geographies, do a deep dive on some particular issues, but you as a director don't have the time nor the expertise to do that yourself. So sometimes a periodic deep-dive into a particular geography on issues that you think are most pressing, and especially on areas about ethics and risk and culture. I think that is one way to put it.

As you said, it's very unfortunate today that a lot of the board governance has turned into checklists and long protocols, and there's so little time for discussion. And unfortunately, as I look at the world today, and I look at the pressure on Canadian and global businesses, the last thing they're thinking about is ethics, because they need to survive. However, the first thing they need to think about is how are we gonna innovate and compete in this very challenging world and not take shortcuts that are gonna cause a scandal in the future? And that 'and' part is critical right now because pressure is very high everywhere, particularly with the moves in the United States.

We have disruptive technologies, we have trade wars, we no longer can count on a world order that we had previously. So again, the ethics question is even more relevant. If we need to do some major strategic adjustments. We gotta make sure if it involves a partner, if it involves a takeover, if it involves a subsidiary, we gotta make sure we know what we're doing and that we don't come and regret this five years from now.

Rahul Bhardwaj (14:49): You know, I find this interesting in terms of the perspective of a director that in the pursuit of creating trust, you can't just trust, but you have to trust but verify. You know, it's one of those inquiries that there's a little bit of incoherence, but it's pragmatism at the same time. It's an interesting conversation to be having. At the ICD, we created a trust toolkit for boards, you know, precisely so boards can explore the importance of trust to their strategy, so at a retreat, to get into these deep conversations.

José, I wanna move on a little bit. You've got such a breadth of experience worldwide with your clients, and I know that you've got some insights on some companies that got this right and some that maybe didn't quite get this right. Is there anything you can share with us there?

José Hernandez (15:35): I used to be a partner at PwC till 2008, and then I formed a business with the former director of the FBI and we decided because it was gonna be a European-based business to put it out of Switzerland. So, the bank that we chose to do business with was Credit Suisse. You know, an organization had been around for 150, 160 years and had a series of crisis over the last 10, 15 years. And back in 2008, they were seen as the giant because UBS, and it wasn't so much trouble, credit threes ceased to exist. So there is a clear situation where, not one crisis, but the cumulation of multiple crises over a decade and a culture that came and took over the bank led to failure. That tends to be the exception, not the rule.

The second example is that I was just with the former CEO of Siemens about a couple months ago, back in 2006, we were there then in my hat at PwC, helping them sort of survive an earthquake, which were these allegations of bribery around the world. Clearly there's a path that you need to take, you gotta investigate, you need to get to the facts, you need to clean it up, make sure it doesn't happen again. But the one thing that's so critical about Siemens is they were at that time looking, you know, how can we be as good as General Electric? Because General Electric was the model. Well, what they did is a strategic shift, right? A total strategy shift. They decided to bet on digitization, they decided to bet on green, and over a course of about five, eight years, they made that pivot.

So just to see a company that was almost bankrupt in 2006, 2008, because of their issues as of 2003, they had generated more shareholder wealth than all of German public companies together. And obviously, you know, the issues that they had, it was, obviously people made mistakes there. Maybe there were some bad habits. They were listed in the US market in 2001, so they should have known better. But sometimes there's a loss of confidence that maybe we can't do this without cheating or taking shortcuts.

But actually organizations with great brands and great people, they can innovate and become competitive, but not just by being nostalgic. And it's just a lot of hard work. And again, if you look at that process over 20 years, that to me is, again, a great example from a shareholder wealth creation and also from a near-catastrophic experience.

Rahul Bhardwaj (18:02): And considering the reordering that's going on in the world right now, particularly around the tariff wars, you know, this is really gonna put some pressure on companies and individuals on this heightened competition to make ethical decisions. And as you've said, this is going to have consequences. So let's talk about one in particular, and that is that you've said that there is a cost of lowering ethical standards, and I think maybe Credit Suisse could be an example, but maybe you wanna expand on that a bit.

José Hernandez (18:33): Yeah, so, a lot of times in major organizations and investigations, something in the media, I mean, it phases them and at the end it doesn't really destroy them. I think what happens in an organization as individuals take their cues from the CEO and from the top management team, if a culture of taking shortcuts of 'move fast and break things' goes too far, it becomes almost impossible to bring it right back without changing the leadership team.

So a lot of times, this different way of doing things. You know, I was working with a, an organization in Scandinavia that was a merger similar to SNC and Lavalin way back, a certain culture takes over, but this was TeliaSonera and a certain culture of entrepreneurialism takes over. But entrepreneurialism, you know, that sometimes then leads to choosing partners and choosing geographies to do business that you may not necessarily be geared up to take on from a risk or a compliance perspective, but they can be highly lucrative.

So I think, in general, that is just the challenging situations that you sometimes have. And if you take a wrong turn, it becomes quite difficult because once you enter into a joint venture to extract certain minerals out of Congo and you have a minority share, you basically are stuck because you control nothing.

Things could be happening and the only thing that you can do is to pull out and lose a lot of money and also, you know, the market will respond pretty negatively. So there are things that are easy to turn, for example, with people cheating on their expense reports. And there are things that are really hard to turn, such as you making a strategic pivot in a position that puts undue risk on yourselves and on your reputation.

Rahul Bhardwaj (20:15): That's great. And that goes right down to director's duties, do, you know, act in the best interest of the corporation. But you know, rule of thumb, don't break the company. And if ethics are your last defense to doing that, you'd be wise to have a framework and consider it deliberately.

So thanks José, today, it's been a great conversation, but I wanna remind you what our resolution is, and that is be it resolved ethical decisions are the last line of corporate defense. Which way would you vote today?

José Hernandez (20:43): I fully agree because if you get to ask this question, probably you've said that we can't take us a particular decision because it doesn't break any corporate rule. We probably have a legal opinion that says it doesn't break any legal rules. So then at the end you really have your compass, your ethical compass that says, is this gonna really explode in our hands in the future? Is this gonna really affect the long-term sustainability of our business? And I think that's what it comes down. You'd hope that it's ethics first, but people are in organizations work under pressure.

So yes, I agree that ethics is the last and it should be the first, but that's not really how an organization, particularly large organization should support.

Rahul Bhardwaj (21:25): Got it. Ethics first. If you really got an eye on the long term, that's great. It's been great speaking with you today, José. And to our listeners, I hope you enjoyed today's episode of Be It Resolved and that you've deepened your boardroom insights to stay ahead of emerging trends.

If you enjoyed the episode, please subscribe, rate and leave a review on your favorite streaming platform. From the Institute of Corporate Directors in Canada, I'm Rahul Bhardwaj. Until next time.

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