5.3.1

ETHICS

Ethics is about doing what is right, not only what is required. The law and the corporate governance code set the minimum standards; ethics is the standard the company sets for itself, and the one by which its Board, management and people are judged when the rules are silent or inconvenient. Every company has an ethical standard in practice, whether or not it is written down. The question for the Board is whether that standard is chosen deliberately and upheld consistently, or left to emerge from habit and pressure.

This sub-chapter deals with the ethical standard itself and the Board's responsibility for it. Corporate culture and tone at the top are covered in sub-chapter 5.1.2; compliance, whistleblowing, conflicts of interest and related party transactions in sub-chapters 5.3.2 to 5.3.5; and the duty of loyalty of each Board member in sub-chapter 4.1.

Most corporate scandals begin not with an illegal act but with a series of lawful decisions that no one was willing to call wrong. Ethical failures destroy trust faster than financial ones. In the Baltic states, where markets are small and business and political networks overlap, the cost of an ethical lapse is high, and for state-owned and municipally owned enterprises public trust in the company is also public trust in its owner.

The role of the Board

The Board is the guardian of the company's ethical standard. It cannot delegate this role to a compliance function or a lawyer, because ethics is ultimately a matter of judgement, and the Board's judgement sets the ceiling for everyone else's. The Board's contribution has four parts. It defines the standard, by approving the code of ethics and the company's position on the dilemmas that matter in its business. It embodies the standard, by applying the same rules to itself and by the way it takes decisions. It tests the standard, by asking about the ethical dimension of what it approves and by refusing lawful but improper proposals. And it protects the standard, by ensuring that systems are in place to detect and correct breaches, and that consequences apply regardless of seniority.

Management runs the ethics programme: it drafts the code, designs training, handles day-to-day questions and investigates most incidents. The Board does not do this work, but it approves the framework, receives the evidence and holds management to account for the results. Where a Board committee exists, the audit committee or a dedicated ethics and compliance committee will usually prepare the

materials and proposals for the Board; the responsibility, however, remains with the full Board.

What the Board should do

1. **Own the ethical standard.** Approve a code of ethics (or code of conduct) that expresses the company's values in concrete terms, states what is expected of everyone from the Board down, and explains how to raise concerns. Keep it short and specific to the company; review it at least every three years and whenever the business changes materially.
2. **Apply the standard to the Board first.** Adopt Board-level rules on gifts and hospitality, outside interests, use of company information and dealings with shareholders, and record in the minutes that they are observed. A Board that exempts itself from the code cannot demand that management follows it.
3. **Make ethics a criterion in decisions, not an afterthought.** Require that major proposals to the Board (transactions, market entries, restructurings, incentive schemes and similar) address the ethical and reputational dimension explicitly: who is affected, what could go wrong, and how the decision would look if made public. Where a decision is lawful but questionable, the Board should be prepared to say no.
4. **Assign clear ownership.** Designate who is responsible for the ethics programme (an ethics or compliance officer, the company secretary or a committee) with direct access to the Board or its audit committee, adequate resources and the authority to investigate. In smaller companies the role can be combined with another function, provided the reporting line to the Board is preserved.
5. **Insist on training that is practical.** Ensure that all employees, and the Board itself, receive training built around real dilemmas the company faces, in the languages people actually speak, rather than a generic annual e-learning module. Ask to see the dilemmas used, not only the completion rates.
6. **Review ethical performance at least annually.** Receive a report covering incidents and how they were handled, questions raised with the ethics function, results of employee surveys on trust and pressure, and the disciplinary consequences applied at all levels. Treat this review with the same seriousness as the review of financial results.
7. **Verify consistency across the company, its group and the value chain.** Ensure that subsidiaries, agents, distributors and major suppliers are bound by equivalent standards, particularly where the company operates in markets or sectors with a higher risk of corruption, sanctions breaches or human rights violations.

Warning signs

- The code of ethics has not been revised for years and nobody on the Board can recall its main provisions.
- Ethical questions are referred to the legal department, and the answer is always “it is legal”.
- Board papers on major transactions or incentive schemes contain no reference to reputational or ethical risk.
- Reported incidents are few and always minor, while the company operates in a high-risk sector or market.
- Senior managers accept invitations, gifts or side engagements that would not be tolerated at lower levels.
- Employees describe the values as “what we say to customers” rather than “how we work”.
- Pressure from a shareholder, including a public owner, to take a decision the Board considers improper is accepted without a recorded discussion.

Common pitfalls and drawbacks

The first pitfall is confusing ethics with compliance: assuming that because the lawyers have cleared a decision, the ethical question has been answered. It has not; the law is the floor, and many of the decisions that later prove most damaging were perfectly lawful. The second is the aspirational code: a document full of fine words that gives no guidance on the three or four dilemmas that actually arise in the company’s business, such as gifts from suppliers, pressure from a large customer or shareholder, or cutting corners to meet a deadline. The third is the exception for the important: tolerating behaviour from a founder, a star salesperson or a politically connected manager that would end the career of a junior employee. Nothing tells the organisation more clearly what the real standard is. The fourth is treating ethics as a reporting line rather than a Board responsibility, so that the Board hears about it once a year in a slide on training completion. Boards should also be aware of the opposite risk: an ethics programme so heavy with policies, declarations and campaigns that people stop reading and start ticking boxes. A short code, honest examples and visible consequences work better than volume.

Guidance for other governance professionals

The company secretary should ensure that the code of ethics is formally approved and periodically reviewed by the Board, that ethics appears on the Board’s annual calendar, that Board members’ own declarations are collected and minuted, and that new directors are inducted into the company’s ethical standards and the

dilemmas specific to its business. The ethics or compliance officer should keep the code short and usable, build training around real cases, maintain a record of the questions and incidents raised, and report to the Board on patterns and root causes rather than on activity. Internal audit should test whether the standard is applied in practice, for example by reviewing gifts and hospitality registers, procurement decisions and the handling of past incidents, and should state in its findings where a control was bypassed for reasons of culture rather than capability. Human resources should ensure that ethical conduct is assessed in performance reviews and promotion decisions, and that disciplinary outcomes are consistent across levels. General counsel should advise on what the law requires, but should also be willing to tell the Board when a lawful course of action is nonetheless unwise.

KEY TAKEAWAYS

A. Ethics is about doing what is right beyond what the law requires. Compliance sets the floor; ethics sets the standard by which the company, its Board and its people are judged.

B. The Board is the guardian of the ethical standard. It approves and reviews the code of ethics, applies the code to itself first, and treats ethical and reputational considerations as a criterion in every major decision.

C. An ethical standard needs an infrastructure: clear ownership with a reporting line to the Board, practical training built on the company's real dilemmas, a safe channel for raising concerns (sub-chapter 5.3.3), and consistent consequences at all levels.

D. Ethics must be reviewed at least annually on the basis of evidence – incidents, questions raised, survey results and disciplinary outcomes – with the same rigour as financial performance

E. In the Baltic context, small markets, close personal networks and, in SOEs and MOEs, political pressure create specific ethical risks. The Board should name them openly and set rules for them, rather than assume goodwill.

F. Ethics extends beyond the company's own staff to subsidiaries, agents, distributors and suppliers, particularly in higher-risk markets and sectors.

QUESTIONS FOR THE BOARD

1. *Do we have a code of ethics that is specific to our company, approved and reviewed by the Board, and would it tell a new employee what to do in the three situations most likely to arise in our business?*
2. *Does the Board apply to itself the rules on gifts, hospitality, outside interests and confidential information that it expects management to follow, and have we, as directors, declared our own?*
3. *Is ethical and reputational risk assessed explicitly in the papers for major decisions, and which decision in the last year did we take, or refuse, mainly on ethical grounds?*
4. *Who owns the ethics programme, do they have the resources and authority to investigate, and do they report directly to the Board or its audit committee?*
5. *Who in this company would tell the Board that management has crossed an ethical line, and would they feel safe doing so?*
6. *Do our remuneration and promotion decisions reward the way results are achieved, or only the results, and are consequences for misconduct applied consistently regardless of seniority or performance?*
7. *What evidence did the Board review in the last year on ethical performance – incidents, questions raised, survey results, disciplinary outcomes – and what did it decide as a result?*
8. *What do our subsidiaries, agents, distributors and key suppliers know about our ethical standards, and how would we find out if they breached them?*
9. *For SOEs and MOEs: how does the Board handle requests from the owner that it considers improper, and is that handling recorded?*