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# Forum

## Compliance programs — the benefits for companies and their stakeholders



The following is an edited version of a speech given by Professor Allan Fels, Commission Chairman, at the launch of Minter Ellison's on-line compliance product, SAFETRAC, on 27 July 1999.

Compliance programs and strategies are becoming increasingly important and common in the Australian corporate landscape. It is not only regulators such as the Australian Competition and Consumer Commission that are promoting their use. Courts and corporations are now also acknowledging the value of compliance programs and strategies. Legislators are even including comprehensive compliance obligations in laws such as the new *Managed Investments Act 1998* (Cth).

In short, legal compliance is becoming a top priority. Many companies now understand that good compliance programs help to reduce corporate risk. However, fewer companies understand how good compliance programs may actually assist them to compete effectively in the marketplace.

### What is a compliance program?

In simple terms, a compliance program is a system designed to reduce an organisation's risk of breaking the law. The *Australian Standard on Compliance* gives a more comprehensive definition, saying that a compliance program aims:

- (a) to prevent, and where necessary, identify and respond to, breaches of laws, regulations, codes or organisational standards occurring in the organisation;
- (b) promote a culture of compliance within the organisation; and
- (c) assist the organisation in remaining or becoming a good corporate citizen.<sup>1</sup>

Compliance programs therefore contain three main elements. They aim to prevent law-breaking, they promote a culture of compliance and they encourage 'good corporate citizenship'.

### Why have a compliance program?

A common perception of compliance is that it is something to be done to keep regulators happy. It has frequently been seen as a burden, rather than as an opportunity to improve corporate performance or a corporation's relationship with its stakeholders.

It is time to dispel this attitude. For reasons that I will shortly outline, this perception of compliance is inaccurate and short-sighted. The benefits of a good compliance program are many and varied. A good compliance program can actually help to give a company a competitive edge.

A good compliance program has two main benefits:

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<sup>1</sup> Australian Standard on Compliance — AS 3806-1998 at para 1.2.

- It will help a company to avoid breaking the law and suffering the consequences, thereby saving the company time, money and heartache.
- A good compliance program can actually enhance a company's business operations and may be used for 'positive' business purposes (other than reactive risk-management).

### Avoidance of harm

Most businesses already understand that a compliance program helps them to avoid harm. As stated in the Commission's recent publication entitled *Corporate trade practices compliance programs*, companies have traditionally instituted trade practices compliance programs because they do not want to be caught breaking the law.<sup>2</sup> This is a reasonable response, as the consequences of law-breaking can be pretty traumatic.

In the trade practices field a major reason to implement a compliance program is to reduce the risk of penalties. Under the Trade Practices Act, financial penalties are substantial, with fines reaching \$10m for companies and half a million for individuals who behave anti-competitively. A good compliance program can reduce the risk that the company will break the law in the first place.

Courts have also taken the view that companies that have *effective* compliance programs should be rewarded by reduced penalties. But companies that have compliance programs that are inadequate or poorly implemented are not so rewarded. For example, French J in *Trade Practices Commission v CSR Ltd* imposed almost the maximum penalty (at that time) on CSR, despite the fact that CSR had a compliance program.<sup>3</sup>

His Honour looked at the substance of the program and found it lacking. He was scathing of the fact that there was 'little convincing evidence of a corporate culture seriously committed to the need to comply with the requirements of the Act'. He also thought that

the compliance program that CSR did have was 'desultory and in need of reinforcement'.

Emmett J in *ACCC v MNB Variety Imports Pty Ltd* took a similar line.<sup>4</sup> His Honour said that businesses should accept that the cost of a compliance program was small compared to the costs of penalties which would be imposed in the absence of a compliance program. He stated that 'the cost of failing to comply should be set at a level which is significantly greater than the cost of ensuring compliance (via a compliance program)'.

It is not merely exposure to penalty that motivates companies to implement solid compliance programs. Potential liability for damages for conduct that contravenes the Trade Practices Act is another strong incentive. Damages claims can cause multi-million dollar dents in corporate offenders' profit margins. Businesses that contravene the Act may also have to create and fund a corrective advertising campaign or even an industry education program. The list of obligations that can be imposed upon the corporate offender is long and imaginative.

Companies often begin to see the benefits of efficient compliance programs when they start counting the flow-on costs of an investigation or legal action by a regulator such as the Commission. Similar costs mount up when a private party (such as a competitor or a consumer) takes legal action. The negative consequences that may flow from investigation or court action include:

- the human resource costs of locating information and collating it in order to answer regulators' inquiries; and
- the staff time that it takes to locate the information required to prove that the company acted with all due diligence, in the event that action is taken against it by a regulator or a private party.

Having a poor compliance regime can expose companies to many other problems.

Negative publicity flowing from investigation or legal action can substantially reduce stock prices and thereby upset shareholders (not to

<sup>2</sup> ACCC, *Corporate trade practices compliance programs* at 1 (Canberra: ACCC, 1999).

<sup>3</sup> (1991) ATPR ¶41-076 at 52,155.

<sup>4</sup> (1998) ATPR ¶41-617 at 40,758.

mention corporate management). It can also dissuade customers from dealing with that business, thereby reducing profit. Substantial sums of money may also have to be spent to counteract negative publicity.

The company subject to investigation or legal action must necessarily divert resources away from its core business activities to focus instead upon the investigation or legal action. This may impair the company's profit-making capacities and hamper its ability to generate new business. It may also provide competitors with a golden opportunity to steal market share.

Where a company is subject to investigation or legal action, many employees will be distracted from their core tasks. They may also undergo considerable stress. Those who were not associated with the law-breaking activity but who nevertheless were forced to face its aftermath may leave the company. The company is then faced with a knowledge gap and must pay to re-advertise and fill the job.

The legal costs of gaining advice during the investigation and legal action can be very substantial.

By implementing an effective compliance program, companies are less likely to have to face these drastic consequences. A compliance program will help a company to meet its obligations under relevant laws and may also help it to identify breaches of the law by third parties (such as competitors or suppliers). Compliance programs can therefore protect a company against illegal conduct by increasing its knowledge of the legal parameters in which it operates.

In addition to reducing risk and avoiding harm, there are also positive reasons to implement compliance programs. These reasons might collectively be called 'the positive business case for compliance'.

### **The positive business case for compliance**

Instituting a good compliance program and generating a 'culture of compliance' has many pay-offs. I wish to stress the fact that companies can have good compliance programs *and* a strong bottom line. The two are not diametrically opposed.

Compliance can improve profitability in many ways. For example, legal compliance can result in improved safety and quality of products and services, as well as innovation. This in turn can give a company a competitive edge.

This concept is probably best expressed by Harvard academic, Professor Michael Porter, who said:

Stringent standards for product performance, product safety and environmental impact contribute to creating and upgrading competitive advantage. They pressure firms to improve quality, upgrade technology, and provide features in areas of important customer (and social) concern ...

Firms, like governments, are often prone to see the short-term cost of dealing with tough standards and not their longer-term benefits in terms of innovation. Firms point to foreign rivals without such standards as having a cost advantage. Such thinking is based on an incomplete view of how competitive advantage is created and sustained. Selling poorly-performing, unsafe or environmentally damaging products is not a route to real competitive advantage in sophisticated industries and industry segments, especially in a world where environmental sensitivity and concern for social welfare are rising in all advanced nations. Sophisticated buyers will usually appreciate safer, cleaner, quieter products before governments do. Firms with the skills to produce such products will have an important lever to enter foreign markets, and can often accelerate the process by which foreign regulations are toughened.<sup>5</sup>

The following scenarios illustrate Professor Porter's theory.

A company that overhauls the packaging of its products in order to ensure compliance with environmental laws might reduce the amount of packaging that it uses. It might also swap to environmentally-sustainable packaging materials. By reducing its packaging to achieve compliance, the company might simultaneously lower its packaging costs. By switching to 'ethical' packaging materials, the company may also attract customers who previously would not have bought that product. In this example, compliance promotes profitability.

Consider too the car manufacturer that works hard at product safety compliance. If it markets its product cleverly, the manufacturer may be

5 Porter M, *The Competitive Advantage of Nations* (London: Macmillan 1990).

able to sell those safe cars at a premium. Again, the bottom line is actually improved by the presence of an effective compliance strategy.

Another benefit of an effective compliance program is that it can foster customer goodwill. This is most likely to occur if a company has a sound complaints handling system. Such a system is a crucial feature of an effective compliance program. If properly used, a complaints handling system can help a company to improve its customer service standards and retain customers who encounter problems.

A recent Australian study confirms this finding. The Australian Society of Consumer Affairs Professionals commissioned a study of Australian consumer complaints handling systems and found that consumers were far more likely to re-purchase if their consumer complaints were satisfactorily handled.<sup>6</sup>

Another benefit of good complaints handling systems is that they 'pick up patterns in customer complaints and allow the company to identify problem business units, production processes or products before regulators or consumer groups do so'.<sup>7</sup> This benefit was identified by compliance expert Dr Christine Parker, who supports the argument that strategic management of regulatory issues can improve institutional integrity and ultimately strengthen the strategic position of a company.

There are other significant advantages that flow from a good compliance program. An effective compliance program:

- encourages identification of previously unidentified risks;
- may improve communication and reporting to upper management, particularly where the compliance manager is independent of the core business;
- promotes ethical behaviour by encouraging a 'culture of compliance', which in turn can

be used to promote an organisation as a 'good corporate citizen'; and

- allows a business to enhance its saleability by demonstrating that it trades profitably in a legally satisfactory way.<sup>8</sup>

There are obviously multiple reasons for businesses to take compliance seriously. In the final analysis, companies that make comprehensive efforts to comply are more likely to analyse their own procedures than corporations that do not. Self-analysis is a useful process as it can ultimately result in more efficient business processes. These in turn can boost the bottom line.

### Who else can benefit from a good compliance program?

Companies should at all times remember that their activities affect a wide variety of stakeholders and that they have positive duties to behave responsibly towards these stakeholders. These obligations are embodied in laws that protect diverse stakeholder interests, such as:

- its customers (for example, through consumer protection and product safety laws);
- its competitors (for example, through restrictive trade practices laws);
- its employees (for example, through occupational health and safety laws and industrial relations laws);
- its shareholders (for example, through securities laws); and
- the environment (for example, through pollution laws).

Compliance programs obviously help corporations to keep within these legal limits. A good compliance program may therefore benefit all of the stakeholders who have an interest in, and are affected by, that company's activities.

6 American Express, Society of Consumer Affairs Professionals in Australia Inc., *Study of Complaints Handling in Australia, Report 1, Consumer Complaint Behaviour in Australia*, 1995.

7 Parker C. 'The Emergence of the Australian Compliance Industry: Trends and Accomplishment' (1999) 27 *ABLR* 178 at 187.

8 These advantages were identified by Mills K in 'Implementing Compliance Programs: Training and Persuading', *University of New South Wales — Faculty of Law — Continuing Legal Education Conference* (1 July 1998).

For all of the reasons outlined, compliance is becoming more and more important. Compliance programs help companies to avoid harm but can also help to improve business performance. Successful compliance programs can even benefit the community beyond the company itself, in that they ensure observance of laws designed to protect a variety of third-party interests.

Corporate compliance is not easy, but it is both necessary and worthwhile. Keely J acknowledged this in 1980 when he said:

Sheer size of operations may result in problems in ensuring compliance with the Act or any other law, but the likelihood of those problems has to be recognised by management and the problems have to be solved.<sup>9</sup>

Almost 20 years on, this statement still rings true. I therefore commend any initiative that strives to meet the challenges of achieving compliance.

## The regulatory safeguards provided by product liability and consumer protection laws



*The following is an edited version of a speech given by Commission Deputy Chairman Allan Asher to the APEC Seminar on Good Regulatory Practices at Rotorua, New Zealand on 6 August 1999.*

I think we would all agree that in today's global environment good regulatory practice cannot be regarded as domestically confined. There has to be development or continued development of

relationships with other countries that facilitate and support as far as possible regulatory practices in the areas of product liability and consumer protection law. While the challenge is to **get it right** in your own backyard, the greater challenge is to achieve good regulatory practice on an international scale where there are many participant jurisdictions willing to be involved and stay involved.

Accordingly, when formulating product liability and consumer protection laws, careful attention must be given to ensuring that the consequent regulatory safeguards to consumers are realised without unduly disadvantaging suppliers, industry and international markets.

I will return to this theme of what I call homogeneous or universal good practice later in the presentation.

### The Trade Practices Act and the role of the Commission

The Commission is an independent statutory authority that administers the *Trade Practices Act 1974* and the *Prices Surveillance Act 1983*. It also has additional responsibilities under other legislation. The Trade Practices Act covers anti-competitive and unfair market practices, mergers or acquisitions of companies, product safety/liability and third party access to facilities of national significance.

Section 2 of the Act in setting out its objectives states that the aim of the Trade Practices Act is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection. These goals are in part achieved through consumer protection provisions dealing with misleading/deceptive conduct, false representations, product safety and information standards and product liability.

The Commission has a wide range of administrative and enforcement options available to it to secure compliance with the Trade Practices Act. I will consider these later in my presentation but note at this point that the Commission uses these options creatively.

### Product liability provisions of the Act

Good regulatory practice aims to strike a balance between the interests of consumers and suppliers. It must cut both ways. The laws must

<sup>9</sup> Trade Practices Commission v Dunlop Australia Ltd & Anor (1980) ATPR ¶40-167 at 42.320