DOES THE EXISTENCE OF ETHICS AND COMPLIANCE COMMITTEES IMPROVE STOCK MARKET AND FINANCIAL PERFORMANCE?

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Abstract

The major research question, in the title of this paper, was answered positively for stock market performance. The companies with Ethics and Compliance Committees (ECC) outperformed the non-ECC companies on five-year annual averages for both profit margin and net income growth rate, which may mean Wall Street investors are emphasizing non-financial performance indicators, as well as long-term financial performance indicators. Results are somewhat mixed, as investors rewarded ECC companies with superior stock market performance versus other financial measures, like returns on equity and assets, which were better for non-ECC companies. The empirical analysis in this paper relied upon prior research which had conducted content analysis of the 2015 charters of all the board committees of the Fortune top 200 corporations (Holcomb, 2017). This prior research identified 11 companies which had board committees with ethics and compliance duties, versus the Fortune top 20 companies, which delegated such duties to their audit committees. The empirical research in this paper has shown that the Ethics 11 companies outperformed the Fortune top 20 companies over the 2013-2017 period, primarily in the key stock market performance measure of the percentage change of the market capitalization from the end of 2013 until the end of 2017.

Keywords: Ethics, Compliance, Board Committees

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1. INTRODUCTION

A prior research study in Corporate Ownership & Control (Holcomb, 2017) examined the extent to which U.S. corporate boards established ethics and compliance committees and the underlying reasons for the development of such committees. Such reasons included the evolving legal environment of business, the increasing regulatory compliance responsibilities, and the expanding ethical responsibilities. Accordingly, the study found that the skill set of members of ethics and compliance committees have a different profile from members of audit committees.

Such broader skill sets may be needed in today's complex and challenging business environment. While audit committees focus primarily on financial risk management, they may not have the skills or capacity to focus upon these other, emerging risks. Contemporary non-financial risks include political, environmental, climate, governance, litigation, regulatory, product integrity, disaster, cybersecurity and global terror (Holcomb, 2017). By monitoring such non-financial risks, ethics and compliance committees might detect and identify red flags of possible threats or pressures which may fester and evolve into material financial performance risks. Thus, such ethics and compliance committees may be able to provide early warning signals to boards and corporate executives

before such risks become material financial risks and before they have adverse consequences for the firm. Also, top executives need to establish a "tone at the top" that reinforces the importance of such non-financial risks (Stevens, 2008; Strucke, 2014). The involvement of top-level officials as a requirement for an effective ethics and compliance program would be satisfied by having a board committee to monitor and supervise such a program.

Ethics and compliance committees thus play both a reactive role, in ensuring compliance with existing laws and regulations, as well as a proactive role, in anticipating the future direction of laws and regulations. In that way, ethics and compliance committees are a logical companion of issues management programs and futures forecasting, giving such entities an access point to the board of directors. Those managing issues often find that some industries and sectors are targets of public policy, such as emissions regulations, that later impinge on other industries and sectors. It is useful, therefore, for a board committee to monitor the scanning of the broader business environment, not just of one's own industry. Further, laws and regulations that emanate from one state, region, or country, often eventually migrate to a jurisdiction where a company has facilities (Naisbitt & Naisbitt, 2018). Futures forecasting has revealed that certain states or countries are bellwether or precursor jurisdictions that lead the way to public policy innovations in other jurisdictions. An ethics and compliance committee should be able to identify experts who can assist the company in such issues analysis.

To ensure an effective corporate ethics and compliance program, a board committee on ethics and compliance should also supervise and monitor the successful operation of the internal components of such a program. It should first ensure the development and regular updating of a corporate code of conduct. It should ensure that there is employee participation in forming the code and total buy-in from present and new employees. It should also supervise the adaptation of the code to new business developments, whether they are acquisitions of new companies and product lines, penetration of new geographic regions or countries, or investments in new political-economic cultures. Each new development in those areas carries with it new business and ethical risks and demands. Not only must an effective ethics and compliance operation rely on creation and supervision of a code of conduct, but it must also involve continual training of employees on abiding by the code, along with evaluation of employee compliance with the code.

Not only are ethics and compliance committees helpful in ensuring effective issues management and ethical conduct, but they might play at least an equally important role in crisis management. The steps in effective crisis management include investigating the facts, evaluating the severity of the crisis, assessing the culpability and responsibility of the various actors involved, responding to critics and stakeholders, adopting new policies and procedures to prevent future crises, promoting any remedial measures internally and externally through publicity and political campaigns, and finally weighing the costs and benefits of alternative preventive or remedial efforts (Holcomb, 1986). A board-level ethics and compliance committee should be involved in supervising and monitoring all of the steps in a crisis management process.

The major research question investigated here is summarized by the title of this paper. Accordingly, the following major sections of this paper are literature and policy review, causality issue, data and methodology, data results, interpretation of results, and conclusions.

2. LITERATURE AND POLICY REVIEW

The literature on corporate governance includes a discussion of board committees, and that discussion emphasizes the roles of the traditional committees – audit, compensation, and nominating or governance committees. Most relevant to this study is the literature on audit committees and the more limited literature on non-traditional committees, like ethics and compliance committees and public responsibility committees. The literature on audit committees discusses the basic roles of the audit committee in auditing corporate financial performance and accounting, monitoring the internal audit function, and supervising the activities of the external audit firm. According to its 1994 *Corporate Director's Guidebook*, the American Bar Association specifies ten functions of the audit committee, all of which relate only to financial performance (Melendy & Huefner, 2007).

Increasingly, however, audit committees are called upon to oversee the evaluation of non-financial performance and regulatory compliance in the areas of both economic regulation and social regulation as well (Buchalter & Yokomoto, 2006). The latter include such areas as employment, environment, health and safety, trade, mergers and acquisitions, product liability, and marketing and advertising. Specific industries like defense, pharmaceuticals, health care, communications, energy, and technology also have compliance with specific industry-related regulations as important concerns. As concerns over privacy and cybersecurity continue to grow, so likewise will regulations in those areas likely proliferate. Knowledge and experience with big data and artificial intelligence will become even more important areas for boards over time (Grove & Clouse, 2017). Even a study of an effective audit committee acknowledges that its responsibilities over risk management and monitoring internal controls require a favorable economic and political environment (Dlamini, Mutatbara & Assensoh-Kodna, 2018). A major question is whether the audit committee generally has the proper skill set to fulfill these functions, and the answer in a recent study is unequivocally in the negative (Holcomb, 2017). The membership of audit committees typically emphasizes financial skills and is heavily populated by accountants, chief financial officers (CFOs), and former CFOs. Ethics and compliance committees, instead, emphasize those with legal skills and backgrounds, along with government agency backgrounds, and those directors actually have higher level corporate positions in the companies where they currently work or previously worked.

With the expanding demands placed on audit committees, they are busier than ever and have become overburdened in many companies. According to one study, audit committees meet twice as often as they did prior to the passage of the

Sarbanes-Oxley law (Melendy & Huefner, 2007), which has in turn imposed further regulations on audit committees. The audit committee must now be composed entirely of independent directors, and the committee must now include at least one financial expert. As required by section 404 of the Sarbanes-Oxley law, a company must also document the existence and effectiveness of internal controls, which has led to the creation of divisions within auditing and accounting firms that specialize entirely on 404 compliance. The board audit committee must, in turn, supervise and monitor the effectiveness of that 404 compliance function (Hill & McDonnell, 2013). The proliferation of economic and social regulations, along with the newly imposed burdens created by the Sarbanes-Oxley law, have overloaded the audit committee and may have led to "cursory oversight" of new areas of compliance (Melendy & Huefner, 2007). Business has responded in some instances by creating compliance committees, or ethics and compliance committees.

Beyond the literature on audit committees, there is some legal literature that creates a strong rationale for ethics and compliance committees. The U.S. Sentencing Guidelines and government agency charging guidelines, for instance, create incentives for companies to form board committees on ethics and compliance. In the 2004 revisions of the Sentencing Guidelines, they specify that corporate "governing authorities" must play a central role in supervising ethics and compliance, in order to mitigate a sentence meted out to a corporation. That conveys a strong signal that having a board committee on ethics and compliance could pay legal dividends, and agency charging guidelines provide almost exactly the same incentives (Holcomb, 2017; Melendy & Huefner, 2007). Further, the watershed case of *In re Caremark International Inc. Derivative Litigation, 698 A.2d 959 (Del. Ch. 1996)* includes a mandate for corporate boards, as part of their duty of care, to establish and supervise internal controls, with language encouraging the formation of a compliance committee. Boards must also monitor the effectiveness of internal controls (Elson & Gyves, 2004). That duty falls on all directors but up to now, more so on audit committee members, where legal liability may be greater than for other directors under a concept of differential liability (Buchalter & Yokomoto, 2006; Brochet & Srinivasan, 2014; Hogan, Schmidt & Thompson, 2014; Licker & Sherman, 2014; Linck, Netter & Yang, 2008).

Finally, as a key component of legal settlements and deferred prosecution agreements, judges and prosecutors will sometimes include a requirement that a corporate board include an ethics and compliance committee, in order for an accused corporation to escape prosecution and punishment. Given current trends, that may become a statutory requirement in the future, or a requirement imposed by listing standards such as the New York Stock Exchange.

As part of the purpose of this study, in weighing the reactions of investors to those companies that have or lack an ethics and compliance committee, it is reasonable to suppose that effective ethics and compliance efforts and mechanisms would attract more investors concerned about legal, ethical, and public policy risks. Likewise, shareholder advisory services, such as Institutional Shareholder Services (ISS) that rate the governance standards of corporations, could conceivably reward companies in the future with higher ratings, should they have an ethics and compliance committee. Existing scholarly research has found that companies with positive governance ratings are rewarded with higher stock market performance (Kostyuk, Mozghovi & Govorun, 2018). Finally, both employees and consumers who are increasingly concerned about ethical and legal performance could be drawn to companies with ethics and compliance committees at the board level (Melendy & Huefner, 2007).

While investors are increasingly rewarding companies that have ethics and compliance committees, both investors and shareholder advisory firms are punishing corporate boards and directors that fail to do an adequate job of legal and ethical risk management. For example, shareholders and advisory firms Glass Lewis and Institutional Shareholder Services (ISS) brought pressure against JPMorgan Chase directors for their failure to monitor and control high-risk trading in the London Whale scandal. The Advisory firms advised shareholders to vote against retention of the three members of the risk committee and also to vote against audit committee members (Craig & Silver-Greenberg, 2013; Johnson, 2013; Morgenson, 2013; Silver-Greenberg, 2013). Likewise, shareholders have challenged the Wal-Mart board for failing to monitor and control the wave of bribes by its Mexican officials (Barstow, 2012; Bastillo, 2012; Clifford, 2012; Clifford & Greenberg, 2012; Martin, 2012; Morgenson, 2012). In 2012, one-third of non-family shareholders voted against four directors, including the chairman of the audit committee (Clifford, 2013). Under pressure, the company and its board have improved its global compliance program (Harris, 2014b). ISS also advised shareholders to vote against seven of the ten members of Target's board in 2014 for failing to insure and monitor cyber-security that might have prevented an identity theft scandal (Harris, 2014a).

Beyond legal and business incentives to create ethics and compliance committees, there is also a limited literature on the non-traditional board committees, including ethics and compliance committees and public responsibility committees. We use those as generic labels, since the actual names of those committees can vary considerably. The generic labels refer to two categories of committees, with ethics and compliance committees referring to committees with an internal corporate focus, while public responsibility committees have basically an external focus. Ethics and compliance committees focus on more immediate responsibilities to internal stakeholders, including employees, customers, suppliers, and shareholders. The committees most often carry titles such as compliance, ethics and compliance, regulatory compliance, regulatory compliance and public policy, and risk. Meanwhile, public responsibility committees focus on longer-term responsibilities to external stakeholders, including the government, the physical environment, and communities in which companies operate, with some combining a focus on internal stakeholders as well. Such committees carry a wider variety of titles, such as public responsibility, public issues, corporate

responsibility, corporate social responsibility, sustainability and governance, safety, and ethics, sustainability, and governance.

The first recorded study of such non-traditional board committees actually focused on the public responsibility category and was published in 1977 (Lovdal, Bauer & Treverton, 1977). Since that was during the first flowering of corporate social responsibility, following the social movements and pressures of the late 1960s and 1970s, corporations first moved to respond to those pressures, partially by forming such committees. It was only after the strong push from regulation and litigation that companies focused later on ethics and compliance responsibilities. Audit committees first expanded the range of their activities, followed by the current wave of ethics and compliance committees.

In examining both public responsibility committees and ethics and compliance committees, there are three avenues to pursue. Corporations do post their committee charters on their corporate websites, and occasionally the membership in each committee. They also post the frequency of committee meetings. From that information, one can infer some important baseline information regarding the importance of each committee. First, if a committee meets more frequently, one can infer that the committee is more important. Second, the length of a committee's charter provides a rough indication of its importance and the level of its responsibility. Third, the content of the committee's charter provides an even better indication of the issues within its jurisdiction.

From the charters of public responsibility committees, it is clear that the agenda of such committees focus mainly on external issues and external relations. Philanthropy, stakeholder engagement, and formulation of public policy positions and strategy often find a home in such a committee, it is also clear from examining the posted frequency of meetings that the public responsibility committees, while important, are less crucial than audit committees and even ethics and compliance committees. In the Fortune top 20 companies, whose financial performance is analyzed in this paper, audit committees meet at least four to eight times a year and usually in the higher end of that range. Meanwhile, public responsibility committees meet only zero to four times a year, and often only twice a year. Given the external focus of such committees and the infrequency of their meetings, there is a danger that such committees could wind up being window dressing, especially those committees that are rarely active at all.

Public responsibility committees, even when initially formed in the 1970s, were a common response by corporations to the social pressures of that era. By 2014, they had grown to be very popular. While twelve of the top 200 companies have a board committee with some ethics and compliance oversight responsibilities, 89 of the top 200 companies have board committees on public responsibility, with 46 of the top 100 having such a committee and 43 of the next 100 having such a committee. By way of contrast, a study of compliance committees found that their growth only started in the 1990s. In S&P 500 companies, there has been a steady growth of 13 such committees in 1993 to 103 in 2007, or roughly one-fifth of S&P 500 companies (Melendy & Huefner, 2011).

Regarding the twelve ethics and compliance committees examined in this study, and beyond the content analysis of committee charters, analysis of frequency of meetings of the ethics and compliance committees confirms the crucial nature of those committees. Taking the pharmaceutical companies as examples, the Pfizer audit committee meets six times a year, and its charter is three pages long, while its regulatory and compliance committee meets four times a year, and its charter is even longer, at 5 ½ pages, denoting the serious range of its responsibilities. Pfizer may be the model for good corporate governance regarding oversight responsibilities. It has received awards for its corporate governance, has a senior-level corporate governance officer, and yet has nevertheless experienced two CEO crises during the reigns of past CEOs Henry McKinnell and Jeffrey Kindler (Elkind & Reingold, 2011).

The regulatory, compliance, and government affairs committee of Johnson & Johnson meets four times a year, as does the audit committee, even though its charter is two pages long, while the audit committee's is four pages long. Amgen's corporate responsibility and compliance committee meets four times a year, as does its audit committee, while its charter is somewhat shorter at three pages, versus the audit committee's five-page charter. The Abbott Labs public policy committee meets four times a year, as does the audit committee, and even though its charter is shorter than the audit committee's, the charter heavily emphasizes regulatory and compliance responsibilities. The committee also requires the ethics and compliance director to report three times a year to the committee.

Of the four financial companies with an ethics and compliance committee, the regulatory, compliance and public policy committee of AIG's board meets four times a year, as does the audit committee, even though its charter is shorter, at two and a half pages, versus seven pages for the audit committee's charter. Similar findings emerged for the other three financial companies and for the four energy companies with ethics and compliance committees.

There is also a body of literature that examines various other board characteristics and their links to financial performance. A study of U.S. commercial banks after the financial crisis of 2008 found that CEO duality, where CEOs also hold the position of board chair, was negatively associated with the banks' financial performance, but executive incentive pay was positively associated with the banks' financial performance. Board size and director age also impacted the banks' financial performance (Grove et al., 2011). Board independence was also examined in studies about the impacts of social ties and the Dodd-Frank legislation for banks (Fink, 2006; Grant, 2014). Various studies investigated the link between board diversity and financial performance and found either positive, mixed, or no correlations (Adams & Ferreira, 2009; Ahern & Dittmar, 2012; Campbell & Minguez-Vera, 2008; Dale-Olsen et al., 2014; Erhardt et al., 2003). Also, one study investigated the benefits of having lawyer-directors on committee boards to monitor non-financial risks and found an

average 9.5% increase in firm value or market capitalization with a lawyer present on the board (Litov et al., 2014). Since this article analyzes the comparative impact of ethics and compliance committees with that of audit committees on corporate financial performance, it is particularly important to note a comprehensive review of studies on the impact of audit committees. That study found that while audit committee quality had a positive impact on financial reporting, and less so on the quality of both internal and external audits, the impact on overall corporate governance and firm performance was unsubstantiated (Velte, 2017). Another study has found a negative relationship between the quality of corporate governance and the existence of financial fraud (Magnanell, Pirolo & Nasta, 2017).

3. CAUSALITY ISSUE

On the causality issue, there may be a multiplicity of causes for a company to create an ethics and compliance committee. For example, a company's record of legal charges and violations might lead it to form an ECC in the first place. Further, the size, regulatory exposure, and public visibility of the corporation might also cause it to form an ECC of the board. Further, the culture of the firm or the convictions and leadership of top management might lead it to form such a committee. For purposes of this study, however, we are not focused on the causes giving rise to the formation of such committees but are instead focused on the financial results of adopting such a committee. It is interesting that in a recent and comprehensive study of legal violations and charges, along with deferred prosecution agreements, against all U.S. public companies, that not one of the ECC companies in this study has any recent record of such charges, violations, or legal settlements (Public Citizen, 2018). One might, therefore, argue that having such a committee not only leads to positive financial performance, but might also lead to prevention of legal charges and violations. Given the expertise of ECC members in areas of law, regulation, and public policy, as found in a previous recent study (Holcomb, 2017), it is reassuring that the expertise on such committees is positively correlated with such a positive impact.

We cannot infer from this study that having an ECC committee is the primary cause of positive financial performance, since there are a host of factors, both nonfinancial and financial, to consider. In this study, we do not control for all other possible factors. Regarding other social and ethical performance initiatives, such as positive records on sustainability, recent studies demonstrate that they also have a positive correlation with corporate financial performance (Eccles, Ioannou & Serafeim, 2014). Meanwhile, other recent studies and a ranking of corporations on political accountability and disclosure do not show any strong correlation between better records on political accountability and corporate financial performance (Center for Political Accountability, 2017; Werner, 2017). Hence, investors are likely less interested in that factor than they are in having a positive record of sustainability and also having a board committee on ethics and compliance. It is thus reasonable to conclude that a combination of those kinds of programs and decision-making processes are markers of a well-managed corporation, and one which enjoys positive financial performance.

One could maintain that positive financial performance provides the resources for companies to promote social performance and initiatives, and therefore reverses the causality loop, but that assumes that those initiatives cost money. Having an ECC of the board which already has a developed committee structure, however, is not a costly development, and may be virtually cost-free. Given the findings and arguments in this study, therefore, it is more reasonable to conclude that the creation of an ECC committee of the board leads to better financial performance, rather than vice versa. This study, though, does not totally resolve the problem of causality analyzed by an article that reviews the literature on causality (Saravia & Saravia-Matus, 2017). It reviews the studies on the correlation between governance indexes and firm valuation, and finds there is no consensus on either the positive correlation or on the direction of causality. "While some papers find that causality likely runs from governance to firm valuation, others find that it runs in the opposite direction" (Saravia & Saravia-Matus, 2017).

4. DATA AND METHODOLOGY

In the previous article (Holcomb, 2017), the author and his research assistants performed content analysis of the charters of all the board committees of the Fortune top 200 corporations to determine ethics and compliance duties. They identified twelve companies that had major ethics and compliance responsibilities under various board committee names. These twelve companies were Abbott Labs, Johnson & Johnson, Pfizer, Amgen, AIG, Morgan Stanley, Hartford Financial Services, Travelers Companies, Baker Hughes GE, Duke Energy, Exelon, and Occidental Petroleum. In the following data analysis of market and financial performance for these companies, Baker Hughes GE had to be excluded since it was a new company created by a 2017 merger of Baker Hughes and the oil and gas segment of General Electric. Since the identification of these ethics and compliance committees and companies occurred in 2015, this new study here considered both pre and post impacts of such committees by analyzing the five-year time period 2013-2017 around this 2015 identification midpoint.

The Ethics 11 companies' stock market and financial performances were compared to the Fortune top 20 companies which had only audit committees dealing with ethics and compliance duties. As identified with content analysis in the prior research, these 20 companies were Wal-Mart, Exxon Mobil, Chevron, Berkshire Hathaway, Apple, General Motors, Phillips 66, General Electric, Ford Motor, CVS Healthcare, McKesson, AT&T, Valero Energy, United Health Group, Verizon, AmerisourceBergen, Fannie Mae, Costco, Hewlett Packard, and Kroger (Holcomb, 2017).

For each firm in this study, the following variables were calculated. A key stock market performance measure was the percentage change in the market capitalization (common shares

multiplied by stock price) from the end of 2013 until the end of 2017. Also, six financial operating performance variables were used here: 5-year annual averages for profit margin, net income growth rate, and sales growth rate, and 5-year averages for return on equity, return on assets, and return on capital. All these 5-year averages were for the 2013-2017 time period.

5. DATA RESULTS

Both median and mean values were calculated for these stock market and financial performance measures in Table 1. The Ethics 11 companies only had one negative stock market performance result (and outlier) over the 2013-2017 time period. Occidental Petroleum's value of -19.1% reduced the mean market performance variable to 37.8% versus the median of 47.9%. Conversely, the Fortune 20 companies had three outliers of large positive market performance. United Health Group at 192.7%, Apple at 111.1%, and Valero Energy at 82.2% increased the mean market performance variable to 32.3% versus the median of 18.9%. The Ethics 11 companies outperformed the Fortune 20 companies on both the median and the mean percentage results for this key market performance variable over the 2013 to 2017 period: 47.9% versus 18.9%, which is 153.4% better for the median and 37.8% versus 32.2%, which is 17% better for the mean, as shown in Table 1. The S&P 500 Index increased from 1848 at the end of 2013 to 2674 at the end of 2017, an increase of 44.7%, similar to the 47.9% increase by the Ethics 11 companies, and in line with Warren Buffett's stock investment strategy recommendation of just investing in an S&P 500 Index Fund.

Wall Street investors reward superior profit performance, according to a CFO who dealt with Wall Street during 40 conference calls over 10 years at two different public companies (Coburn, 2018). Thus, Wall Street may have considered the 5-year annual average profit margin superior performance for these Ethics 11 companies versus the Fortune 20 companies, as reflected in the superior market value performance of these ethics companies. The Ethics 11 companies outperformed the Fortune 20 companies on both the median and mean percentages for this profit metric: 10.6% versus 3.4%, which is 211.8% better for the median and 10.9% versus 5.0%, which is 118% better for the mean.

However, the 5-year annual average for growth rate results for both net income and sales were mixed. Concerning the net income growth rate, the median results were better for the Fortune 20 companies at 3.7% versus 0%, but the mean results were better for the Ethics 11 companies at 5.7% versus 2.4%, which is 137.5% better. The sales growth rates were better for the Fortune 20 companies. Concerning the 5-year averages for the three return measures, on equity, assets, and capital, the Fortune 20 outperformed the Ethics 11 on all the median and mean measures. However, none of those percentage changes (36.5% to 59.4%) were anywhere near as large as the Ethics 11 companies' superior performances on the median percentage changes for stock market performance (153.4%) and profit margin (211.8%).

6. INTERPRETATION OF RESULTS

Apparently, Wall Street investors were paying more attention to the financial measures of profit margins and net income growth rates than to the financial returns on equity, assets, and capital, since the Ethics 11 recorded superior stock market performance as measured by the percentage change in market capitalization over the 2013-2017 period. Another interesting explanation may be that Wall Street is rewarding the non-financial types of risk management that were previously discussed. Various rationales for these emerging ethics and compliance committees included a focus on internal controls, ethical concerns, legal concerns, and the disclosures of corporate wrongdoings. Such disclosures helped destroy market capitalization at Enron, WorldCom, BP, Hewlett Packard, JPMorgan Chase, and Toyota (Holcomb, 2017).

Accordingly, investors are now more focused on risk management beyond just financial risk, such as political, environmental, climate, governance, litigation, regulatory, product integrity, disaster, cybersecurity and global terror risks (Holcomb, 2017). Such initial non-financial risks may subsequently lead to bankruptcies and/or market capitalization destruction, such as Enron's $78 billion and WorldCom's $186 billion along with their bankruptcies. Recent examples of market capitalization reduction from initial non-financial risks include:

- Volkswagen ($30 billion) where the board of directors was just an "echo chamber" for top management decisions, i.e. the emissions cheating (Ewing, 2018);
- Wells Fargo ($13 billion) where each customer was supposed to have eight separate (and unneeded) accounts as "8 is great" was the customer department slogan (Goldstein, 2018; Henning, 2018);
- Equifax ($6 billion) where the data hack was not disclosed until after top executives had sold their Equifax stock, i.e., illegal insider trading (Court, 2017);
- Tesla ($11 billion) where the CEO, Elon Musk, refused to answer Wall Street investors' questions in a quarterly conference call about the $1.4 billion debt coming due by yearend 2018 or the cash burn rate of $7,430 per minute. Also, a whistleblower filed a tip with the SEC about falsified production data for the Model 3 vehicle which Tesla called "false claims to the media" (Poletti, 2018; Harwell, 2018).

Additional non-financial risk management issues with market capitalization reductions relate to three of the Fortune 20 companies included in this study as follows:

- Wal-Mart ($30 billion) did not respond on a timely basis to the threat of online shopping and competitors like Amazon and Alibaba;
- Exxon Mobil ($29 billion) refused to acknowledge the environmental risks of vehicle emissions for many years and since 1998 has funded $33 million of "junk science" reports denying global warming;
- General Motors ($9 billion) went into bankruptcy in 2009 and still has operating problems even though a female CEO was named to replace the prior male CEO, i.e., the glass cliff phenomena.

To the extent that some investors are rewarding companies that create board-level ethics

and compliance committees, that reinforces their tendency to promote ethics through shareholder proposals as well. That is not a new phenomenon but started in the 1970s, with a proliferation of social cause-oriented shareholder resolutions, largely sponsored by religious institutional investors affiliated with the Interfaith Center on Corporate Responsibility (Rehbein, Logsdon & Van Buren, 2013; Rehbein, Waddock & Graves, 2004). Following was a second wave of more mainstream governance-related shareholder proposals in the 1990s and thereafter, which generally have received a much higher percentage of favorable votes cast by investors. In 2018, more than 400 shareholder resolutions were filed on a wide range of social, environmental, and governance issues.

Shareholders might now see proposals favoring the formation of ethics and compliance committees as opportunities to combine a substantive focus on ethics with a process-oriented focus on corporate governance. Based on the success of the Ethics 11 companies, this could provide an impetus for an organized effort by shareholders to promote the creation of such committees in other corporations. There is some historical precedent for that type of development. In 1971, when Ralph Nader was still sponsoring shareholder proposals through his Project on Corporate Responsibility and Campaign GM, he introduced a resolution at the General Motors annual meeting that the company forms a public responsibility committee of the board (Schwartz, 2012; Vogel, 1979). Avoiding the need for a shareholder vote, GM voluntarily adopted Nader's process reform, setting off a wave of now over one hundred of the Fortune top 200 companies having such a committee, focused on external concerns (Holcomb, 2017). It would be fitting if companies would now create a second wave of ethics and compliance committees, focused on crucial internal concerns, should shareholders appreciate their need and value, and exert demands for such committees.

7. CONCLUSIONS

The major research question is the title of this paper which was answered positively for stock market performance. However, the financial performance results were somewhat mixed, but the companies with Ethics and Compliance Committees (ECC) outperformed the non-ECC companies on five-year annual averages for both profit margin and net income growth rate. That may mean that Wall Street investors are emphasizing long-term financial performance indicators as well as the non-financial factor of an ECC, by rewarding such ECC companies with superior stock market performance, while other financial measures like returns on equity and assets, which were better for non-ECC companies.

This analysis has shown that the Ethics 11 companies outperformed the Fortune 20 companies over the 2013-2017 period, primarily in the key stock market performance measure of the percentage change of the market capitalization from the end of 2013 to the end of 2017. The median percentages were 47.9% versus 18.9%, which is 153.4% better and the mean percentages were 37.8% versus 32.3%, which is 17% better, even with the inclusion of the Fortune 20 outliers of Apple (+111.1%), United Health Group (+192.7%), and Valero Energy (+82.2%). The Ethics 11 companies also outperformed the Fortune 20 companies on the 5 Year Annual Average of profit margin: 10.6% versus 3.4%, which is 211.8% better for the median and 10.9% versus 5.0%, which is 118% better for the mean. Such superior profit performance helped impress Wall Street investors who rewarded the Ethics 11 companies with higher growth in stock market capitalization.

However, concerning the other five financial performance measures for both the medians and the means or ten possibilities, the Ethics 11 companies outperformed the Fortune 20 companies on both the 5 Year Annual Averages of the profit margin and the net income growth rate for the means: 10.9% versus 5.0% which was 218% better and 5.7% versus 2.4%, which was 138% better, respectively, versus the other financial performance factors. Since Wall Street investors still rewarded the Ethics 11 companies with higher percentage changes in their market capitalization, they may also be analyzing and rewarding non-financial factors which could be addressed by Ethics and Compliance committees. Thus, these empirical results agree with the previous research hypothesis (Holcomb, 2017) that Wall Street investors may be more focused on risk management and other non-financial factors beyond just financial risk, such as political, environmental, climate, governance, litigation, regulatory, product integrity, disaster, cybersecurity and global terror risks. Also, seven company examples were cited here where their total market capitalization destruction of $128 billion occurred primarily in the 2013-2017 period studied in this research. Such market capitalization destruction was caused, or at least initiated by, non-financial factors: Volkswagen ($30 billion), Wal-Mart ($30 billion), Exxon Mobil ($29 billion), Wells Fargo ($13 billion), Tesla ($11 billion), General Motors ($9 billion), and Equifax ($6 billion).

The stock market and financial performance issues investigated in this paper are important with respect to the impact of non-financial measures on such performances. Is it worthwhile for companies to implement ECC and other non-financial sustainability factors? A limitation of this research is the limited exploration of this causality issue: does an ECC cause improve stock market and financial accounting performances or is the causal link the other way around? This study suggests it is reasonable to conclude that the innovation of an ECC committee produces positive financial results. Current academic research has found both direct and indirect links of non-financial factors to improved stock market and financial accounting performances. Future research can explore this important causality issue in more depth.

There are several future research directions suggested by this study. There could be more scholarly and rigorous analysis of the connection between prior criminal charges and civil lawsuits and the formation of ethics and compliance committees. Such research could focus on the forces giving rise to the recent formation of such committees. Research might also focus on the records of ECC companies on criminal and civil charges, and on regulatory violations, after the formation of such committees and over time. Research might also focus on the correlation between the presence of ethics and compliance

committees and corporate reputation ratings, e.g., whether companies with such committees rank among the Fortune most admired companies. The connection between having a board ECC committee and performance on other good governance criteria would be important to explore. For instance, do the firms with ECC committees also perform well on the Dodd-Frank pay gap rankings, indicating they have a reasonable executive compensation structure? Do they separate the roles of CEO and board chair, as an indication of good governance, and do they avoid a dual-class stock structure that deprives most investors of voting rights?

Table 1. Market and financial performance: 2013-2017

	Median %'s		*% Change:*	*Mean %'s*		*% Change:*
	Ethics 11	*Fortune 20*	*Difference*	*Ethics 11*	*Fortune 20*	*Difference*
			Market Performance			
Market Cap % Change from 2013 to 2017	47.9	18.9	153.4	37.8	32.3	17.0
			Financial Performance			
			5 Year Annual Averages:			
Profit Margin	10.6	3.4	211.8	10.9	5.0	118.0
NI Growth Rate	0	3.7	n/a	5.7	2.4	137.5
Sales Growth Rate	2.3	3.2	-28.1	-0.6	1.3	-146.2
			5 Year Averages:			
Return on Equity	8.5	16.9	-49.7	9.4	17.9	-47.5
Return on Assets	2.2	5.4	-59.3	3.3	5.2	-36.5
Return on Capital	4.3	10.6	-59.4	5.2	8.9	-41.6

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