Business Ethics and Corporate Ethics Programs

Before or After a Scandal?

In recent years, the large number of corporate scandals around the world involving global companies that used to enjoy spotless reputations, like Enron, Worldcom, Siemens, ABB, Parmalat, and many pharmaceutical firms, have brought about many harsh outcomes. This article offers leading academic stances on business ethics and describes the key traits of suitable ethic systems.

This issue has made newspaper headlines over and over again: scandals involving multinationals like Enron, Worldcom, Siemens, ABB, Alstom, Parmalat and many pharmaceutical companies, among others, have often been in the news in recent years. Consequences for companies, officials, employees and shareholders have been devastating. And this explosive risk does not only endanger multinational corporations but also threatens many companies ñ even if they do not make the headlines. Businesses in emerging countries are no exception, and organizational exposure is growing. Failing to recognize the importance of business ethics or, as many firms have done so far, turning a blind eye to these concerns is no longer a viable strategy. The question facing CEOs, board members and shareholders is whether they want to deal with this issue before or after a crippling scandal?

The purpose of this article is to offer a brief introduction of this topic, putting forth leading academic and business stances as well as describing the key traits of suitable ethics systems.

Business Ethics

While everyone talks about business ethics, its contents and boundaries are not easy to determine. It may be safe to assume that ethics involves some hard features, like duties and rights (most of them legal), that are mandatory for all, and soft components, like values, aspirations or best practices, that are desirable but not compulsory and can vary from one organization and person to the next. Generally speaking, laws and regulations just set a minimal ethical standard required for the orderly working of societies. The distinction between what is ethically compelling ñ and not mandatory by law ñ and what is just desirable does not only seem blurry and hard to pinpoint but also changing ñ it often depends on cultural settings and specific scenarios.

It should be noted that business ethics is not limited to refusing to pay bribes. Clearly, corruption is part of the package ñ indeed, one of the most significant and harmful hazards of unethical behavior. However, business ethics includes environmental care, fairness, health and safety, reliability, respect for everyoneís dignity, transparency, and, of course, abiding by all current laws, including tax, labor, market and fair competition regulations. Making ethical decisions in one of the many gray areas challenging businesses today which requires an analysis that is hard to conduct ex ante ñ with tomorrowís newspaper it would be a lot easier, but too late. It is both important and difficult to remain detached and levelheaded when direct and indirect pressures to meet short-term objectives constantly hamper a clear view of companiesí and individualsí genuine interests ...and complicate the issue further: There are no universal rules.

Nonetheless, some tools prove effective to assess the ethical implications of an action. True, these business and personal practices are just crutches, but they have become widely accepted and used:

- **The Mother Test:** Would you be able to tell your mother or your children about this action without being embarrassed?
- **The Newspaper Test:** Would you like to see your decision on a newspaper headline?
- **The Audience Test:** Would you like anyone in a similar situation to do the same?

The answers to these questions are more compelling than any long, philosophical ponderings on what is and is not ethically acceptable.

Compliance Strategy versus Integrity Strategy

At organizations, ethically relevant decisions are made on a daily basis ñ sometimes unawarely and often with ad hoc and instinctive criteria. A realization of this fact leads to a harsh question: How much ethics is convenient? And this question, in turn, brings a host of others, such as, why should an organization go beyond current laws or what its competitors are doing? Would this impair the organizationís competitiveness and compromise its continuity? Can ethics provide anything but peace of mind?

Essentially, organizations can follow two paths: a **compliance strategy**, based on stringent law abidance, or an **integrity strategy** (as formulated by Harvard Business Schoolís Prof. Lynn Sharp Paine) that hinges on committed ñ and, thus, value driven ñ compliance with more demanding values than those set by current regulations. Most companies pursue a compliance strategy ñ they abide by the law. This means, they do what is required in order to end the day not in jail, but it does not entail an ethical behavior. Lawfulness is not necessarily ethical ñ for instance, when companies outsource their operations with contractors in countries with questionable labor conditions or less transparency than expected in the market, they are not breaking any (local) laws.

Barely abiding by the law is obviously not a goal that could make anybody happy, but: Is it perhaps the most profitable way to do business?

At the end of the day, nobody has the right to ask companies to do more than abiding by current laws. And the pressures to achieve higher revenues and better short-term profitability are huge.

The legal approach uses fear of exposure and punishment as deterrents to guide organizations towards compliance. This approach is supported by an organizational model built on the Agency Theory and the power of intimidation, which view individuals as trying to maximize their own interests, making decisions based on their own costs and benefits and impervious to moral concerns about their behavior.

The question seems to narrow down to something like Machiavelli vs. Aristotle: Govern by the rule of fear vs. the rule of virtue.

Indeed, people can be ìmotivatedî by fear. Fear may produce short-term results, but it eventually becomes ineffective, bringing more problems than solutions. A job can only be satisfactory and meaningful if it contributes to an individualís spiritual fulfillment. Therefore, the most powerful driver comes from being convinced to make the right choices, from doing things the right way. This is how people safeguard and promote the things that they hold dearest: their families, their communities, their self-esteem, and their pride in what they do. Itís not only about doing things right, but about doing the right things.

Integrity Strategies try to establish a companyís values, aspirations, ways of thinking and behaviors. These strategies seek to address ethical issues by leveraging human beingsí natural disposition for moral thoughts and actions. The underlying rationale argues that employees who adopt organizational values as their own willingly comply with company standards ñ even if they are less monitored. Research has shown that culture is more influential than compliance programs and values influence behavior more than potential exposure. Thus, an ethical system is no longer viewed as a burden and an external imposition. Rather, it stands as a guideline steering an organization. While compliance strategies focus on avoiding sanctions, an integrity approach zeroes in on a behavioral notion that hinges on self-defined principles and values that go beyond current laws and regulations, securing employee buy-in. An integ-

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rity strategy requires the definition of and commitment to company values, building an environment that supports ethically robust behavior and promotes a sense of shared responsibility among employees.

The success of ethical systems depends on what is usually known as an organizationís ëethical climateí, which reflects employeesí faith in management morality and stems from the companyís values, shared by everybody in the organization. For employees, the proof of a morally sound management is fairness ñ both in procedures and in results and punishments.

If ethics is not embedded in the organization, it dies quickly. There lies the value of an integrity strategy: it is the driver that enables the organization to live the external values (standards and legal constraints) and internal values (aspirations, culture, etc.) as their own and not imposed by somebody outside the organization.

Organizations that implant ethical programs with a view to merely securing legal compliance are not embracing ethics. In fact, their behavior is perceived as quite contrary to true ethics: while abiding by legal regulations, the organization is expected to do ìwhatever it takesî to achieve business objectives. It is tantamount to telling employees to leave their morals at the entrance, because they do not count in company life. Consequences are dire. People cannot be asked to separate their private and professional morality; if they are, the resulting working environment drives individuals to act accordingly, i.e., unethically. The strong influence of organizational settings on human behavior is well-known, with famous experiments ñ like the one conducted at Stanford ñ and research revealing their power.

Yet, rather than clashing, both strategies ultimately complement and support each other. Current research has found that a strictly legal, controlling approach that only conveys the need to abide by laws and regulations across the organization proves unsuccessful, for it reveals that management does not believe employees will behave adequately if unmonitored. This is a self-fulfilling prophecy: intrinsic motivation fades, and voluntary cooperation is replaced by mandatory ìcooperationî. Largely viewed as dishonest, this approach is often perceived as managementís attempt at self-protection ñ a way of saying, ìdo what it takes, but donít tell me and donít get caught.î This message, compounded by performance evaluations and incentive schemes exclusively based on financial targets, tends to lead employees to illegal behaviors in order to acomplish company (and incentive) objectives. Conversely, an integrity strategy solely based on convictions and devoid of formal preemptive controls and deterrents does not suffice either. It does provide a strong foundation, but it needs the rigor of adequate control systems. Even as a precaution, the entire organization should realize that unethical behaviors will never be tolerated, that a control system is in place to ensure exposure across its ranks, with a fair, suitable response for everyone.

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Ethics Does Pay!

Unethical behavior causes massive costs. Several studies have shown that companies with illegal records have not only been forced to pay for investigations and fines but have also suffered significant stock price decline and report, on average, lower profitability rates than their law-abiding counterparts. In fact, many have experienced sharp sales drops, higher equity costs and severe damage to their reputation among customers and other stakeholders.

The world has changed. Business constituencies ñ customers, prospects, employees, recruits, investors and opinion leaders ñ prefer ìwell-behavingî companies for their purchases, career choices, investments and endorsements. There is no choice between sound financial results and good ethical outcomes; indeed, sound financial results require good ethical outcomes. In a world where many companies can produce superior products and services, the differentiating power that creates competitive advantages increasingly lies in their reputation. And a sound reputation is built on ethical behavior!

When it became public that famous sportswear brands subcontracted the production of their sports shoes to workshops with unacceptable labor conditions that included child labor, misery wages, and dungeon-like factories, they suffered significant sales losses. The argument that these outsourced production sites belonged to foreign contractors based in developing countries proved not helpful. Examples abound, and they all point to the fact that losses resulting from disrespect for values people expect companies to live up to are not only financially substantial but also hard to remedy. Reputation is lost in seconds, while great efforts, consistency and time are required to build it up again. The message comes across quite clearly: ethical values play an increasingly important role for business. They can account for true competitive advantages, and their absence can threaten organizational growth and impair its survival ñ whether a company is facing criminal charges or it is ëjustí its customers or employees that question its behavior. No ethical system can succeed without values.

Times have indeed changed ñ no secrets can be kept anymore. With instant and transparent information and communications, blogs, email traceability (including deleted messages), and phone tabs, whistleblowers eventually save the day. Ethical issues at organizations cannot be swept under the rug, covered up or contained for long. They are immediately and globally known, their ripples multiplying damages manyfold. In short, business ethics pay twice, as they safeguard organizations against huge threats to their survival and creating strong competitive advantages.

Ethical Systems

How can organizations pursue a value-based ethical strategy? Ad hoc, case-by-case decisions will not do; it is necessary to build a system with seamless standards and processes. Ethical issues are far too complex, and stakes are too high for anything short of a complete ethical system to work. In the light of the risks involved, the entire organization needs to fully commit itself to the values embedded in its Code of Ethics, and this commitment should be supported by means of a formal training, control and punishment system. The key to successful execution lies in striking an adequate balance between these two core system components: value buy-in by both employees and management as well as a formal control system based on those values. It is not an easy task, for control systems may jeopardize the sense of shared values.

Ethical systems revolve around three key purposes: prevention, detection and response.

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➲ *Prevention*

Code of Conduct

The code of conduct is the cornerstone of all ethics systems, clearly defining an organizationís values, thinking and behavior patterns, as well as its commitment to those values. Simply copying one of the many existing codes would be a mistake. Similar as they may seem, their specific contents should be adjusted to the organizationís industry setting, its history and its typical risks. As building an ethical climate becomes critical, an organizationís code of conduct must reflect its individual values, shared by all its constituencies.

Tone From the Top

Clearly, it does not suffice to disseminate the organizationís code of conduct and its guidelines via email. Management should prove its commitment to organizational values on a daily basis ñ and not just with words but with deeds. Company officials should become actively involved, participating in relevant meetings and refraining from delegating these tasks. Codes come to life in organizations when they are embraced by the top down. This is a crucial requirement for codes to be effective, as it proves that management has not endorsed a code merely for self-preservation. It is particularly challenging to convey consistent messages, avoiding contradictions or misunderstandings. Incentive systems provide an illustrative example, for their design should carefully reflect the companyís values rather than just rewarding financial success ñ regardless of its costs. However, nowadays, annual bonuses tend to rise, as pressures to seize greater short-term returns and to meet stock marketsí expectations mount and quantitative results are easier to measure than qualitative outcomes.

Unethical behavior often embodies the result of current performance evaluation methods, encouraging employees to contemplate wrongdoing as a shortcut to a larger bonus. Nonetheless, finding qualitative yet measurable objectives is not an easy task. Setting goals that reward ethical behavior (recently rolled out by several multinationals) does not seem to solve the problem either. Ethical goals in incentive systems seem to assume that employees behave ethically only when rewarded with a sizable bonus ñ a message that brings the Agency Theory to mind. This kind of solutions go against the true spirit of any code of conduct: a financial prize should not be used to reward ethical behavior, which, by nature, does not derive from financial gain and must not be viewed as an extraordinary achievement deserving additional pay. It would be more convenient to incorporate long-term objectives and reduce annual bonuses. Perhaps, the time has come for companies to revise their performance evaluation systems and to revisit the notion of reward bonuses for both employees and top management.

Compliance Officers

An ìidealî compliance officer manages to convey the belief that ethical behavior is good for both organizations and individuals, securing significant competitive advantages rather than just preventing trouble. To this end, compliance officers need to be both pro-active and pro-business in their organizations, tirelessly participating in projects and meetings, with strong business knowledge and character to successfully communicate an ethical culture and its convenience for the company. Indeed, compliance officers should be the walking proof that the organization and its management take ethics seriously and are willing to openly discuss conflictive issues. They should demonstrate that the organizationís trust-based and transparent environment supports each individualís ethical decision-making process.

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Training
Organizations should engage all employees, from the CEO down, in initial and periodical update Code of Conduct training sessions that review internal and external guidelines and standards. Training efforts should encompass several formats, including classes delivered by compliance officers or outside consultants, Intranet-based tutorials with compulsory tests, interactive games involving real-world case studies, etc. Additionally, companies will be well advised to include these training contents as part of their regular ex ecutive education programs.

Ethics Helpdesk
Employees may need assistance to clarify issues in their decision-making processes. Specific support may be provided by compliance officers, their collaborators, a dedicated Help Desk, and, eventually, the companyís CEO or an external ombudsman. Some companies have several channels in place to provide assistance and support, while others have established the role of ombudsman, who, as an outsider, can inspire greater trust among employees facing specific dilemmas. In general, inquiries can be made anonymously.

➲ *Detection*

For an ethical program to be effective and reliable, steps must be taken to ensure the detection of standard infringement. The more transparent processes are, the more detectable potential violations will be ñ and the more detectable infringements are, the less probable they will become. As a result, perception turns into a powerful tool: knowing that detection is very likely serves as a primary deterrent for any wrongdoing.

The significance of ethical issues for the organization as well as the potential damage of non-compliance for both individuals and the organization itself call for a control system that ensures early detection. For an ethical culture to become deeply rooted in an organization, its members need to rely on the fact that code violations will be detected and punished timely and adequately.

Hotline
At present, most large companies have a hotline for employees (and often outsiders as well) to anonymously report alleged cases of wrongdoing. Reported claims are sorted by area and severity and usually looked into by forensic audits. It should be assured that no report, even if found to be unsubstantiated or wrong, will bear any negative consequences for whistleblowers.

Audits
Routine audits should include a companyís code of conduct and its associated policies and procedures. It may be convenient to conduct additional ñ both scheduled and unexpected ñ compliance audits. These audits should be carried out by compliance office personnel, company auditors or external consultants.

➲ *Response*

Showing that the organization adequately responds to Code of Conduct violations bolsters its credibility and conveys its commitment to its values. This message is instrumental for widespread engagement, as it prevents employees from viewing the code as a meaningless endeavor or ñ worse and more frequent yet ñ as a self-protective precaution taken by top management. An appropriate response to infringements of the code helps employees to believe in the organizationís set of values and does not only require fair punishments for wrongdoers, regardless of their rank. It also entails taking corrective steps to eradicate that sort of behavior from the organization.

Ethical systems pursue the same rationale as quality and security systems. At first, companies controlled only results, focusing on fixing flawed outputs. Later, they moved forward, building total quality into each step in their value creating process. Ethical systems are unfolding in a similar fashion, leaving behind compliance-oriented efforts to embrace overall programs based on values and expanding throughout the organization to prevent unethical behaviors ñ a much more cost-effective approach than remediation actions.

Closing Comments

In recent years, the large number of corporate scandals around the world involving global companies that used to enjoy spotless reputations, like Enron, Worldcom, Siemens, ABB, Parmalat, and many pharmaceutical firms, have brought about many harsh outcomes, including

- Increased external controls from local Judiciary and Stock Exchange agencies;
- Greater exposure to personal criminal charges;
- Widespread social punishment for unethical behavior;
- Weakening competitiveness that can lead to organizational demise.

Directly or indirectly, these dire consequences are faced by organizations in emerging countries as well, as a result of several factors, including public opinion shifts, more efficient judicial systems, increasingly stringent legal standards, and the fact that subsidiaries of MNEs operating in those markets have fully enforced their corporate codes of conduct, compliance policies and procedures across their value chains. Thus, local suppliers, joint venture partners, agents, representatives and distributors are increasingly engaged in world-class compliance efforts.

This certainly hopeful setting makes a compelling case for the implementation of an adequate ethical system that suits organizational size and environment. The underlying reasons are no longer just ethical and personal, but also practical and business smart. The only question that CEOs and Boards need to ponder is whether to embrace ethical behavior before or after a scandal hits their organizations.

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