



Ethics and Integrity in business

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Why Should Companies be concerned with Ethics and Good Governance?

Increasing pressure from governments to ensure fair practice

International pressures to ensure transparent business dealings

Listing requirements from some stock exchanges

International conventions-

OECD Convention on fraud & corruption

Impact of Sarbanes-Oxley

NGOs Transparency International; Caux Round Table

Shareholder Pressure- institutional and individual

Why Should Companies be concerned with Ethics and Good Governance?

The Business Case:

Ethical behaviour assists in reducing costs through reduced turnover

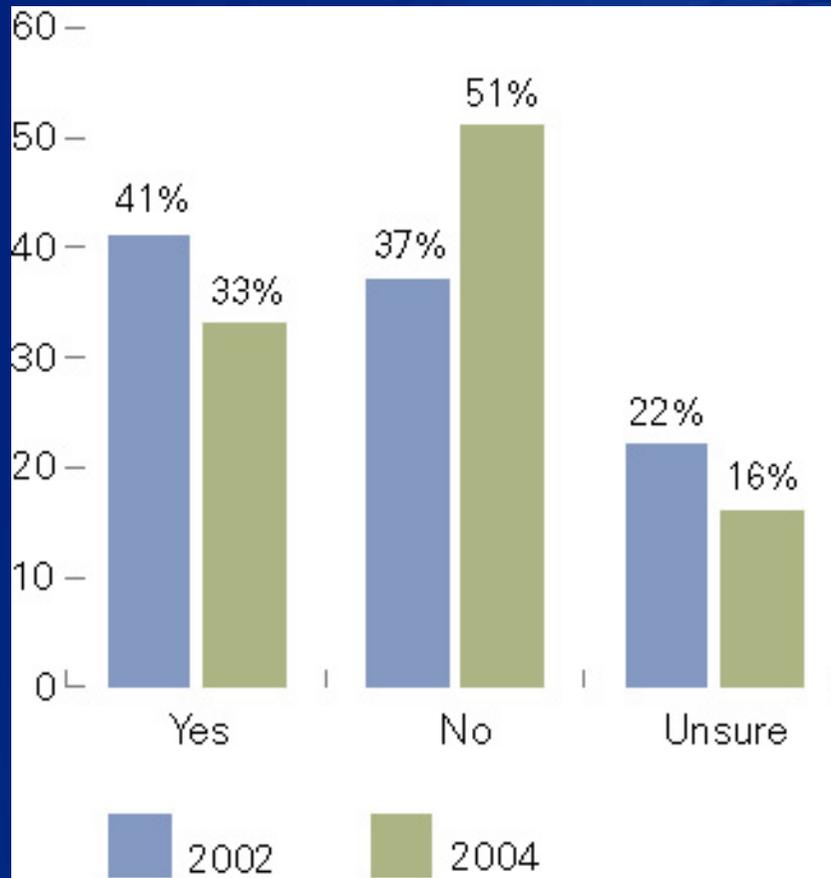
Ethical behaviour helps identify potential risk and damaging decisions

Studies are identifying ethical strategy as contributing to the bottom line

Curtis Vershoor study in the USA identified companies with an ethics strategy had a MAV 2.5 times higher

All business is ultimately based on TRUST. Ethics enhance this basic business reality

Is your business ethical?

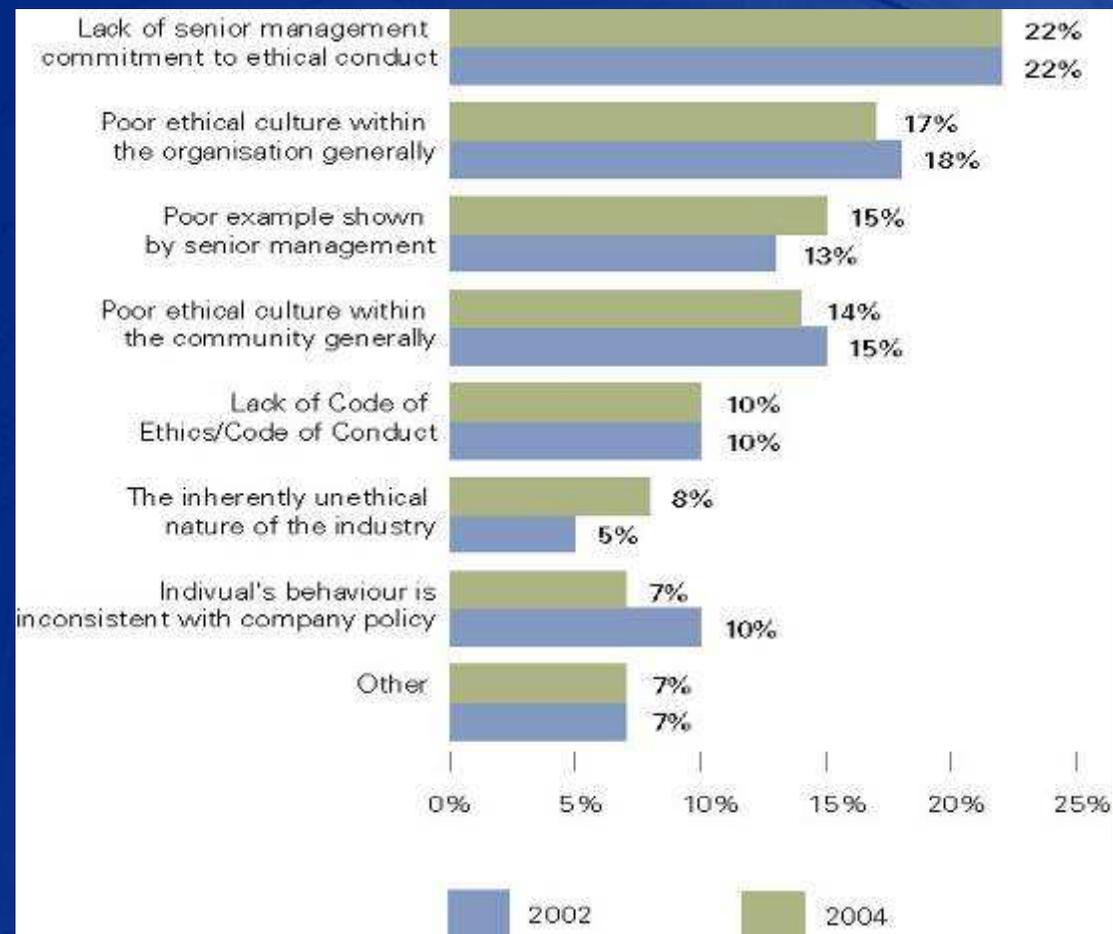


Experience of unethical conduct

Misuse of equipment	17%
False sick claims	14%
Disclosure of information	12%
Sexual harassment	11%
Private business during work hours	9%
Conflict of interest	9%
Credit card (advantage)	6%
Lavish gifts	5%
Contractor favouritism	3%

Source : KPMG Fraud Survey 2004 (Australia)

Is your business ethical?



Cultural factors reported as contributing to unethical behaviour

Source : KPMG Fraud Survey 2004 (Australia)

US Integrity survey 2005 (draft)

- 3747 questionnaires received – 62% response rate
- High incidence of observed misconduct (similar to 2000 survey)
- Observed misconduct considered “serious”
- Misconduct fuelled by internal conditions
- Lack of confidence in reporting mechanisms
- Ethics and compliance programs have a favourable impact on conditions that give rise to misconduct
- Can be used to benchmark organisations conducting the integrity thermometer

Roles and Responsibility of Directors

Directors ought to see their role as including a capacity to:

- recognise the need for and stimulate the development of properly developed corporate philosophy and ethos,
- ensure proper appreciation of the importance of managing values (and not just processes, finances, risk etc.),
- ensure organisational design, under their direction, reinforces (not undermine) the values that it purports to represent,
- provide considered advice and assistance in the debate and resolution of ethical issues and dilemmas that arise

How do we do this?

Corporate Intent

Michael Hoffman, Director of the Center for Business Ethics at Bentley College suggests that a major reason for the outbreak of corporate wrong doing is not because business people are less ethical than others,

Rather, that business has given so little thought to the development of a corporate culture in which individuals can act ethically.

Corporate Integrity as Strategy

If organizations are to create or foster an ethical culture then different organizational types may require different enculturation or institutionalisation strategies.

Hoffman and Fredrick, (1996) suggest corporations need to examine if their structures, policies and processes are compatible with ethical behaviour. If they are not, steps need to be taken to change or supplement them.

Approaches to Integrity

Harvard Business Professor Lynn Sharp Paine, in "Managing with Integrity " Harvard Business Review 1994 distinguishes between two categories of ethical systems:

- a) the compliance approach and
- b) the integrity approach.

Ethics Needs to be Strategic

Both Sharp-Paine (1994) and Hoffman et al. (Moon & Bonny 2001) identify that whether the compliance approach or integrity approach is used, it must be incorporated throughout the organization by using a variety of formal and cultural approaches.

There is common agreement that organisational approach to ethics needs to be part of the strategic framework and role modelled by the leaders of the organization.

Developing Ethical Cultures

Farrell, Fraedrich and Farrell(2000) identify organisations can use cultural techniques, hiring training etc as methods of developing appropriate ethical corporate culture, but this needs to be supported through specific control strategies, such as the development of codes.

Importantly they suggest that the implementation of strategies to make employees make more ethical decision is no different from implementing other types of business strategies.



Why do Organizations Act Unethically?

**THEY DON'T
PEOPLE DO!**

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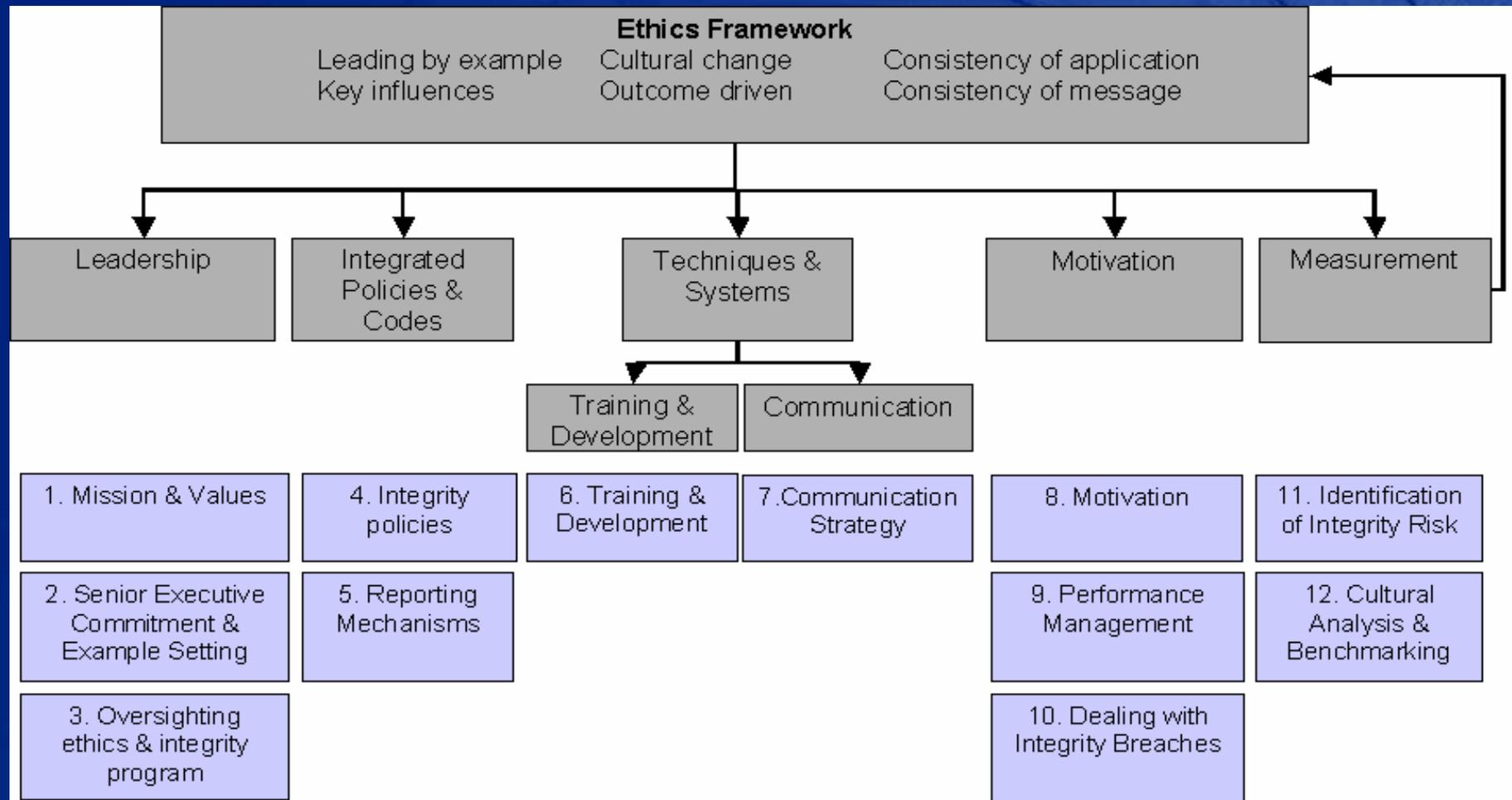
Development & Implementation of Ethics

The development of an ethical culture will not automatically occur because a code of ethics has been developed.

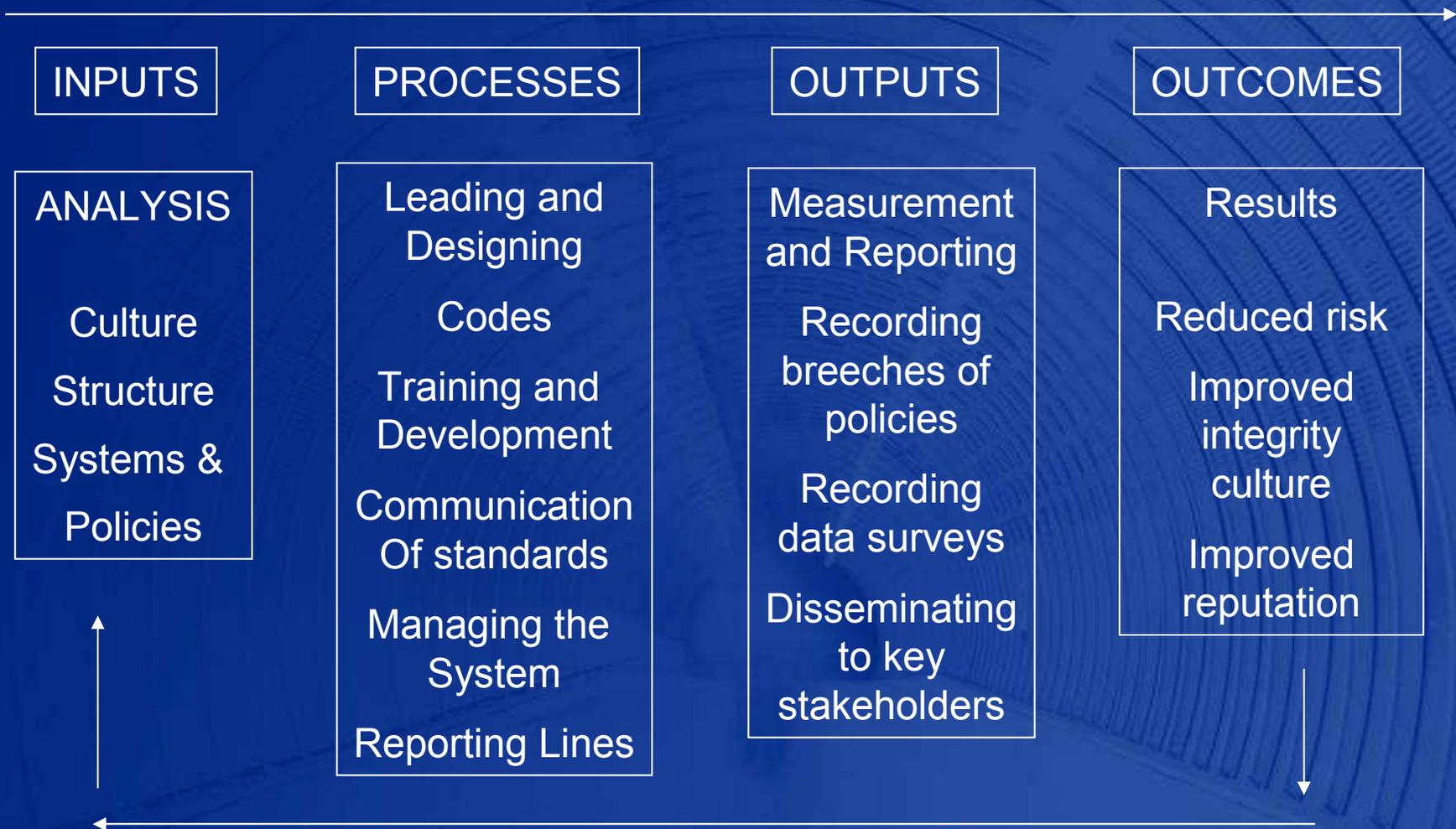
Essentially we can identify various factors which are critical to effective implementation;

- **leadership**
- **development of appropriate policies**
- **developing supporting systems and techniques**
- **motivation**
- **and measuring**

Better Practice Integrity Framework - Overview of framework



Integrity Framework



Implementing Ethics: Leadership

Clear direction and support from top management is crucial to the successful implementation

Ethics implementation needs a champion-someone must make it happen

The Leadership must be ethically aware-

Leaders establish organisational culture through articulation of values and strategy

Implementing Ethics: Leadership

Role Modelling: Employees look to leaders for clues about appropriate behaviour, what is really valued, and then will emulate the leader's behaviour.

A key area of the leadership function is the establishment of an ethics committee which should be chaired by a member of the board.

Implementing Ethics: Integrated Policies & Codes

Mission and Values Statements

Codes of ethics: statements of values- aspirational

Codes of conduct: specific behavioural rules- need to be relevant to specific groups and sections- one size does not fit all!

Supporting Policies:

Performance Management

Reward

Discipline Procedures

Reporting systems

Implementing Ethics: Communication

Trevino and Nelson (1999) concluded an effective communication policy is designed after analysing the audience and their specific needs. The basic guidelines to be followed are:

1. Communicate relevant rules to the people who need them
2. Prioritise policy: some policy statements are clearly more important than others: these need to be identified and highlighted for employees
3. Make it understandable: elimination of legalistic terminology allows the majority of employees to understand the intention of the policy.
4. Make policy come alive: lastly they suggested that communication only occurs when a message has been received and understood

Implementing Ethics: Communication

Website : the company website is an important source of information for internal and external stakeholders. As such its values, mission and ethical perspective should be featured strongly including the code of conduct or code of ethics.

Recruiting brochures: again the inclusion of company values or mission statements and codes of conduct are highlighted.

Orientation materials: in addition to the values and codes, examples of typical ethical dilemmas and advice for handling, including reporting mechanisms, should be a feature of such documents.

Newsletters and magazines: these can be effective in promoting stories about corporate heroes, employees who illustrate or live the values of the company. Such examples are an important part of cultural strategies and the creation of myths and rituals.

Implementing Ethics: Communication

The most effect communication strategies involve the senior executives

Role modelling of behaviour by senior executives demonstrate behaviour

Statements made by executives reinforce the ethical message

Unethical actions by senior executive undermine and lead to the disintegration of ethical cultures

Implementing Ethics: Training

The implementation of any ethical system presupposes congruence between the standards enshrined within the values of an organisations and the actual behaviour of the employees

Connock & Johns (1995) point out this can only be assured when employees are educated about the ethical values, the required actions, the implications concerning punishment and rewards based on that behaviour.

Training is identified by Ferrel, Fraedrich and Ferrell (2000); Hubbard 2002; Preston (1994); Ritchie (1996) and Trevino and Nelson (1999) as an ongoing and critical strategy to reinforce the ethical system.

Implementing Ethics: Training

Francis (1994, 2000) identified the importance of training of training as a means of establishing ethical behavior. He argues effective training programmes incorporate the following objectives:

- promote and support the organisation's values and standards;
- make managers more aware of the ethical dimensions of their business decisions and conduct;
- educate staff in the organisation's ethical policies;
- strengthen the staff's ability to apply the organisation's ethics
- Devise training appropriate to differing levels
- Train All – (absence of senior executives raise ethical cynicism)

Implementing Ethics: Motivation

Ferrell Fraedrich & Ferrell (2000); Francis (1994, 2000); Hoffman (1995); Ritchie (1996) and Lagan (2000) and identified that employees need to be motivated to behave in a manner consistent with the ethical objectives of the organisation

- Recruit ethical people
- Link ethical performance to reward strategy
- Link ethical performance to promotion
- Dealing with Integrity Breaches to communicate
- Celebrate the internal whistleblower

Implementing Ethics: Structural Changes

In order for programmes to function effectively, the creation of committees, avenues of communication, liaison devices and the crossing of hierarchical levels suggest that structural considerations if not structural changes need to be considered.

- Ethics Committee & Ethics officers (US Solution)
- HR Department (Australian Trend)
- Responsibility/Accountability/Expertise

The Centre for Business Ethics has identified that almost 80% of American companies which have introduced ethical programmes have not made changes to their structural make up.

Implementation of Ethics: Measurement

The degree of effectiveness of the ethics system must be constantly evaluated and updated

The Social Audit: examines organisational activities in a number of sensitive areas, ie that may be prone to unethical behaviour. eeo, community programmes, oh&s remuneration, environmental record etc.

Disclosure: organisations ought disclose audits results both within and without the organisation, this strengthens commitment& performance of an ethics program & provides opportunity for constituents to contribute

Why Do Organisations Fail to Develop Ethical Cultures?

Unfortunately the primary reasons why codes fail also rests with senior executives (Newton, 1995) .

1. The Principle of Participation.
2. The Principle of Validity
3. The Principle of Authenticity

Australian Experience

- Understanding of Ethics and Integrity
- Most organisations have embraced the notions of integrity /ethical systems, however, inconsistency as to the extent or detail of what is required
- Synonymous use of codes conduct/practice/ethics
- These codes are generally prescriptive in nature aimed predominantly at employee behaviour.
- Few organisations benchmark or research what system is appropriate.
- Few undertake detailed and on going audits to identify cultural issues and areas of integrity/ethical risk.
- Training and development continues to be poor undermining effective implementation.

Australian Experience

- The Integrity systems do not seem to be well supported with few organisational mechanisms such as ethics committees, officers or procedures being utilised.
- This leads to the conclusion that few processes actually exist for the codes to be operationalised within the organisation.
- Most organisations did have a range of policies and procedures in place that can be considered part of an integrity system, however, these operated independently, thus few organisations approached integrity/ethics from a strategic and holistic perspective.

Integrity framework – the high water mark

- Comprehensively prepared code of ethics / code of conduct
- Linked to the entity's vision and mission
- Reviewed and updated
- Effective communication program
- Comprehensive training program – induction and ongoing
- Functional ethics committee with clear accountabilities
- Organisational benchmarking of ethical culture over time
- Ethics incorporated into performance measurement system
- A committed senior management team that leads by example
- Consistent response to ethical issues as they arise

“A major flaw in business ethics literature is the absence of practical and relevant strategies that can be adopted by businesses.”

(MacDonald, G. (1999) “Business Ethics: Practical Proposals for Organizations” Journal of Business Ethics, Dordrecht; April, Vol 19, Issue 2)