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Chapter 3

CORPORATE ETHICAL LEADERSHIP

Corporate Culture and Reputation Management

"Moral Leadership and Business Ethics"	Al Gini
"Leadership in a Values-Based Organization"	Ralph Larsen
"Venturing Beyond Compliance"	Lynn Sharp Paine
"Ethical Business: Survey Results"	Institute of Business Ethics
"Managing Ethics and Legal Compliance: What Works and What Hurts"	Linda Klebe Trevino, Gary R. Weaver, David G. Gibson and Barbara Ley Toffler
"Corporate Codes of Conduct"	International Labour Organization, Bureau for Workers' Activities
"Profitable Ethical Programs"	Jason Lunday
"Corporate Codes and Ethics Programs"	Michael C. Deck
"Do Codes of Conduct Deliver the Goods?"	Maureen Quigley
"Hoffman-LaRoche Case: A Sentencing Guidelines Milestone"	Jeffrey M. Kaplan
"So Then Why Did One Do It?"	John Dunkelberg and Debra Ragin Jessup

The trouble with the rat race is that, even if you win, you're still a rat. —Lily Tomlin

When we speak, we are afraid our words will not be heard, nor welcomed; but when we are silent, we are still afraid.
So it is better to speak,
Remembering that we were never meant to survive all.

—ANDRE LORDE

Take care to guard against all greed, for though one may be rich, one's life does not consist of possessions.

—LUKE 12: 15

IMPLICATIONS AND ACCOUNTABILITY: DOES ETHICS = VALUE?

Good ethics is good business. Have you heard that before? Did you believe it? Theorists argue about whether ethical decisions lead to more significant profits than unethical decisions. While we are all familiar with examples of unethical decisions leading to high profits, there is general agreement that, in the long run, ethics pays. Lao Tzu in the *Tao Te Ching* contends there is no crime greater than having too many desires and no misfortune greater than being covetous.[1] How would Taoism view the acts and intentions of a profit-maximizing firm in today's market?

Consider from a stakeholder perspective the demise of small bookstores all over the country. In the past several years, large, multipurpose bookstores such as Borders Books and Barnes and Noble have seemed to take over the literary consumption landscape. Chicago alone has seen the collapse of a number of old standbys, bookstores that had been in the city for years serving a specific, sometimes idiosyncratic, population rather than the entire book-purchasing community. These stores (Krochs and Brentanos, Stuart Brent, Guild Books and others) could not survive next to chain superstores that provide a greater selection of low-priced alternatives.

Stuart Brent, a longtime bookseller on prestigious Michigan Avenue in Chicago, in 1996 was forced out of business by competition from Borders and other chain bookstores opening down the street. Brent's store was one where the salespeople could remember your name, where there were large comfy chairs in which to peruse the books, where there were experts available on literary issues and where they knew just the right book for your Uncle Gordy. Brent's sales went down 30% with the opening of a Borders bookstore three blocks away. "Supermarkets," he snorts. "Philistines. My father used to speak of 'men you'd have to stand on tiptoes to talk to.' Where are those men today?" Even Mayor Richard Daley mourned the loss in a telegram sent to Brent on closing day, "Michigan Avenue will miss you, as much as it was enhanced by your fine store and elegant presence."[2] A traditional tale of David and Goliath?

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[1]Lao Tzu, *Tao Te Ching,* Book 2, XLVI: 105.
[2]Jeff Lyon, "For Starters," *Chicago Tribune Sunday Magazine,* January 14, 1996, p. 6.

The chain superstores argue that it is not. Instead, these stores contend that they are merely serving the needs of their customers in a more effective, efficient manner and therefore deserve a larger share of the market. "It's no longer simply the big, stupid best-seller stores and the small, elegant, literary bookstores," says shopper and Northwestern University professor Joseph Epstien. "Places like Barnes and Noble and Borders stock the good books, too. I doubt that Stuart Brent had anything these stores don't, except in his specialty of psychoanalytic books."[3] Perhaps these larger bookstores aren't so much predators as they are simply players—answering the needs of the public.

Is there any responsibility of a large chain store entering a small community market? Consider as well the tales of Walgreen stores entering small towns where there is one established pharmacy equipped with a pharmacist who has been serving that public for many years. The pharmacist cannot compete with the economies of scale available to a large firm like Walgreen, so she closes her doors. Is Walgreen to blame? Perhaps. But is it at *fault*? It is using its size to a competitive advantage to reap greater profits for its owners.

Consider what ethical and unethical steps might be taken in the name of profits. Is offering a larger selection, lower prices and a different ambience unethical? Is an act ethical because it results in higher profit or in spite of it? Consider the examples suggested by Jason Lunday and opinion expressed in Al Gini's article. Accountability is directly addressed in the discussion of the Federal Sentencing Guidelines—some ask what better way to encourage ethical behavior than to financially reward those who engage in it and financially punish those who do not? On the issue of accountability, one might also want to check out the perspectives of various consumer and advocacy groups in connection with well-known businesses at any of the following websites:

- www.bankofamericafraud.org
- www.boycottameritech.com
- www.cokespotlight.org
- www.ihatestarbucks.com
- www.noamazon.com
- www.starbucked.com
- www.walmartsurvivor.com

Moreover, though there are many justifications for ethics in business, often the discussion returns to, well, returns—the business case for the return on investment. There is evidence that good ethics is good business; yet the dominant thinking is that, if one can't measure it, it is not important. Consequently, efforts have been made to measure the bottom-line impact of ethical decision making. Persuasive evidence of impact comes from a recent study titled, "Developing Value: The Business Case for Sustainability in Emerging Markets," based on a study produced jointly by SustainAbility, the Ethos Institute and the International Finance Corporation. The research found that, in emerging markets, cost

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[3]John Blades, "Staying Alive," *Chicago Tribune,* March 20, 1996, sec. 5, pp. 1, 4.

savings, productivity improvement, revenue growth and access to markets were the most important business benefits of sustainability activities. Environmental process improvements and human resource management were the most significant areas of sustainability action. The report concludes that it does pay for businesses in emerging markets to pursue a wider role on environmental and social issues, citing cost reductions, productivity, revenue growth and market access as areas of greatest return for multinational enterprises (MNEs).

In addition, studies have found that there are a number of expected—and measurable—outcomes to ethics programs in organizations. Some look to the end results of firms that have placed ethics and social responsibility at the forefront of their activities, while others look to those firms who have been successful and determine the role that ethics might have played. With regard to the former, consider Johnson & Johnson, known for its quick and effective handling of its experience with tainted Tylenol. J&J had sales in 2001 of $33 billion, almost triple those of the previous decade and representing its 69th year of consecutive sales increases. It has had 17 consecutive years of double-digit earnings increases and 39 consecutive years of dividend increases. Its market value ended in 2001 at more than $180 billion, up from $38 billion in 1991—evidence that a firm that lives according to its strong values and a culture that supports those values not only can survive but can also sustain profit over the long term. CEO Ralph Larsen credits these successes directly to the J&J Credo. "It's the glue that holds our decentralized company together. . . . For us, the credo is our expression of managing the multiple bottom lines of products, people, planet and profits. It's the way we conceptualize our total impact on society."[4]

> *There is clear evidence that a good reputation gains a company more customers, better employees, more investors, improved access to credit and greater credibility with government. . . . The difference between a company with ethical capital and one with an ethical deficit—perceived or real—can even determine their "license to operate" in some emerging markets.*[5]

> *Whether at the World Trade Organization, or at the OECD, or at the United Nations, an irrefutable case can be made that a universal acceptance of the rule of law, the outlawing of corrupt practices, respect for workers' rights, high health and safety standards, sensitivity to the environment, support for education and the protection and nurturing of children are not only justifiable against the criteria of morality and justice. The simple truth is that these are good for business and most business people recognize this.*[6]

> *We all pay for poverty and unemployment and illiteracy. If a large percentage of society falls into a disadvantaged class, investors will find it hard to source skilled and alert workers; manufacturers will have a limited market for their products; criminality will scare away foreign investments and internal migrants to limited areas of op-*

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[4]Ralph Larsen, "Leadership in a Values-Based Organization," Sears Lectureship in Business Ethics, Bentley College, February 7, 2002.
[5]J. Nelson/The Prince of Wales Business Leaders Forum, *Business as Partners in Development: Creating Wealth for Countries, Companies and Communities* (London: The Prince of Wales Business Leaders Forum, 1996), pp. 47, 52.
[6]Thomas d'Aquino, CEO of Canada's Business Council on National Issues, quoted in C. Forcese, "Profiting from Misfortune? The Role of Business Corporations in Promoting and Protecting International Human Rights," MA Thesis, Norman Paterson School of International Affairs, Carleton University, Ottawa (1997), referred to in C. Forcese, *Putting Conscience into Commerce: Strategies for Making Human Rights Business as Usual* (Montreal: International Centre for Human Rights and Democratic Development, 1997).

portunities will strain basic services and lead to urban blight. Under these conditions, no country can move forward economically and sustain development. . . . It therefore makes business sense for corporations to complement the efforts of government in contributing to social development.[7]

Our findings, both cross-sectional and longitudinal, indicate that there are indeed systematic linkages among community involvement, employee morale and business performance in business enterprises. To the best of our knowledge, this is the first time that such linkages have been demonstrated empirically. Moreover, the weight of the evidence produced here indicates that community involvement is positively associated with business performance, employee morale is positively associated with business performance and the interaction of community involvement—external involvement—with employee morale—internal involvement—is even more strongly associated with business performance than is either "involvement" measure alone.[8]

Through the readings that follow, this chapter seeks to delineate the nature of an ethical corporation and how one might lead that organization. What is ethical leadership and what are its implications? What is the impact of a corporation's culture; how does one build and sustain an ethical corporate culture and what are the costs of its failure?

ETHICAL LEADERSHIP

The results of a poll conducted by the World Economic Forum released in 2003 suggests that trust is not only declining in institutions worldwide, but also leaders are suffering from an even greater decline in public trust than the companies they lead. Given the scandals of 2000 forward, this finding may not be surprising since the general public blames corporate leadership—correctly in many cases—for the corruption and misdeeds in corporate America. Of the eight leadership categories tested, only the leaders of nongovernment organizations enjoy the trust of a clear majority of their public. In fact, of the eight categories, executives of multinational companies ranked seventh, beating out only leaders of the United States.[9] How does one counteract these perceptions and create instead a perception of ethical leadership?

Another survey may offer insight into these numbers. The results of a survey of 20,000 articles in the U.K press evidence that CEOs of large companies mention ethics or social responsibility issues in only 5% of their communications, compared to 40% that discuss financial matters. (This research was conducted before the collapse of Enron and, in a strange twist of research, the study found that CEOs in the oil and gas sector were the most likely to raise ethical issues!)

Overall, a perception of ethical leadership is most often based on the leaders' communication abilities and opportunities. When employees are satisfied with the way in which

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[7]J. Ayala II, "Philanthropy Makes Business Sense," *Business Day* (Bangkok), September 25, 1995, and J. Ayala II, "Philanthropy Makes Business Sense," *Ayala Foundation Inc.* 4, no. 2 (July–September, October–November 1995), p. 3.

[8]D. Lewin and J. M. Sabater, "Corporate Philanthropy and Business Performance," *Philanthropy at the Crossroads* (Bloomington, IN: Indiana University, 1996), pp. 105–26.

[9]World Economic Forum, "Declining Public Trust Foremost a Leadership Problem," press release, January 14, 2003.

their leaders communicate, the results can be significant. These employees are more satisfied with their jobs; they feel that everyone is on the same team and working toward the same goal; they feel confident of their longevity with the firm; and they feel that their companies' products or services are better than their competitors'.[10] To create that perception, corporate leaders must do more than simply putting their values into action. They must learn to disseminate that ethical decision-making process.

The results of a qualitative study of the nature of ethical leadership emphasize the importance of being perceived as a leader with a people orientation, as well as the importance of leaders engaging in visible ethical action. Traits are also important and include receptivity, listening and openness, in addition to the more traditionally considered traits of integrity, honesty and trustworthiness. Finally, being perceived as having a broad ethical awareness and concern for multiple stakeholders, and using ethical decision processes are also important.[11] Those perceived as ethical leaders do many of the things "traditional leaders" do (e.g., reinforce the conduct they are looking for, create standards for behavior, etc.), but within the context of an ethics agenda. People perceive that the ethical leader's goal is not simply job performance, but performance that is consistent with a set of ethical values and principles. And, ethical leaders demonstrate caring for people (employees and external stakeholders) in the process.

However, as mentioned above, all of these traits and behaviors must be visible. If an executive is "quietly ethical" within the confines of the top management team, but more distant employees don't know about it, she or he is not likely to be perceived as an ethical leader. Traits and behaviors must be socially visible and understood in order to be noticed and influence perceptions.[12] People notice when an executive walks the talk and acts on concerns for the common good, society as a whole and the long term because executives are expected to be focused on the financial bottom line and the short-term demands of stock analysts. When they focus on these broader and longer-term concerns, people notice. Finally, making courageous decisions in tough situations represents another way ethical leaders get noticed. Ethical leaders are "courageous enough to say 'no' to conduct that would be inconsistent with [their] values."[13] This type of courageous decision making is certain to garner attention in the organization and to stand out from a neutral or unethical landscape, conveying information about the importance of standing up for what's right.

CORPORATE CULTURE

Every organization has a culture, represented by a shared pattern of beliefs, expectations and meanings that influence and guide the thinking and behaviors of the members of an organization or group. Though somewhat ethereal, it is important to consider the cultures of firms because it is the culture that encourages and influences decision making. Consider a

[10] Institute for Global Ethics, *Ethics Newsline* 5, no. 13 (April 1, 2002), citing Maritz Research Poll (January 14–17, 2002).
[11] L. Trevino, M. Brown and L. Hartman, "A Qualitative Investigation of Perceived Executive Ethical Leadership: Perceptions from Inside and Outside the Executive Suite," *Human Relations* 56, no. 1 (January 2003), pp. 5–37.
[12] *Ibid.*
[13] *Ibid.*

firm with a culture to play throughout the day—with Ping-Pong tables in the offices and a cafeteria replete with board games and other distractions, but everyone is also expected to remain in the office until all work is complete for that day, no matter how late that becomes. If you enter that firm with a 9 to 5 attitude, where you intend to give your all to work throughout the day but then to leave as the clock strikes 5, you might not have a "fit." The same might hold true for a firm's values. If you join a firm with a culture that supports other values than those with which you are comfortable, there will be values conflicts—for better or worse.

Some common elements of corporate culture include:

- There are no generically effective or ineffective cultures.
- Culture is self-reinforcing and socially learned.
- Strong, cohesive cultures are double-edged swords.
- Cultures are rooted in successful problem solving and actions.
- Culture's influence operates outside of our awareness.
- Culture is linked to organization performance.
- Cultural change takes time and requires multiple strategies.

A firm's culture can be its sustaining value—that which offers it direction during challenging times. It can, however, also constrain an organization to the common ways of managing issues—"that's how things have always been done here," "that's our prevailing climate." Consider a firm that has lingered for decades under weak management, a lack of any internal corporate controls, little oversight, a sales performance-based significant bonus plan and a product that has been successful because it has suited a need. Now that need has changed slightly and the firm is under pressure to survive. With "the way that we've always done it," employees may have the opportunity—even the imperative—to cut corners and make decisions that would never be tolerated in another culture. "When you've got the incentives [in the form of higher pay cause of bigger profits] to take risks, the system ought to at least throw up some red flags. People are going to overcompete and take risks and sometimes break laws."[14] Given recent downturns in the economy, this is precisely the environment at many organizations—"There is enormous pressure on corporations, never been greater earnings pressure. That will lead people at the top to press down [to workers]—'you will make money for the corporation.' "[15]

CORPORATE CULTURE AUDITS

How do you detect a potentially damaging or ethically challenged corporate culture—sometimes referred to as a "toxic" culture? The first clear sign would be a lack of any generally accepted base values for the organizations. In the absence of other values, the only

[14]Kenneth Bredemeier, "A Rogue within the Ranks," *Washington Post,* March 25, 2002, p. E1.
[15]*Ibid.*

value is profit—at any cost. Therefore, without additional guidance from the top, a firm is sending a clear message that a worker should do whatever it takes to reap profits. In addition, there are warning signs in the various component areas of the organization. How does the firm treat its customers, suppliers, clients, workers? The management of its internal and external relationships are critical evidence of its values. How does the firm manage its finances? Of course, a firm can be in a state of financial disaster without engaging in even one unethical act (and vice versa), but the manner in which it manages and communicates its financial environment is telling. PricewaterhouseCoopers offers guidance as to early warning signs of an ethically troubled organization that might indicate areas of concern regarding fraud, conflicts of interest, ineffective controls, imbalance of power, inappropriate pressure or other areas, including (but not limited to):

1. Inability to generate positive cash flows despite positive earnings and growth.
2. Unusual pressure to achieve accounting-based financial objectives.
3. Compensation tied closely or only to financial results.
4. Debt covenants violated (or close to being so).
5. Increased liabilities with no apparent source of funding.
6. Off-balance sheet transactions.
7. Complex or creative structures.
8. Ratios/trends that buck expectations or industry trends.
9. Large returns or revenue credits after the close of the period.
10. Large number of nonstandard adjusting entries.
11. History of unreliable accounting estimates.
12. Numerous related-party transactions.
13. Transactions with no/questionable business purposes.

In addition, PwC suggests the following organizational signals:

1. Unusually complex organizational structure; numerous entities with unclear purpose.
2. Insufficient management depth in key positions, especially positions that manage risks.
3. Rapid growth or downsizing placing stress on organizational resources.
4. Resignations of management or board members for reasons other than retirement, health or conflict of interest.
5. Member of board or senior management possibly involved in or aware of financial manipulation (resulting in restatement) still connected with the organization.
6. Finance/accounting staff understaffed.
7. Internal audit department undersized/understaffed.
8. No audit committee or ineffective committee.
9. Management conveys a lifestyle beyond financial means.
10. Scope of internal audit seems too narrow.
11. Failure to address weaknesses in controls or process.

The Institute for Business, Technology and Ethics cites the following eight traits of a healthy organizational culture:

1. Openness and humility from top to bottom of organization.
2. An environment of accountability and personal responsibility.

3. Freedom from risk-taking within appropriate limits.
4. A fierce commitment to "doing it right."
5. A willingness to tolerate and learn from mistakes.
6. Unquestioned integrity and consistency.
7. A pursuit of collaboration, integration and holistic thinking.
8. Courage and persistence in the face of difficulty.

Finally, the Institute of Business Ethics (U.K.) has created a self-assessment checklist for organizations that allows a company to determine where it stands with regard to core issues common to many social or business ethics standards (see Table 3.1).

Consider the messages sent to each and all stakeholders by these behaviors or activities. These are all responsible for creating a culture that permeates the entire organization.

TABLE 3.1

Self-Assessment Checklist for Businesses

Human Rights and Labor Practices	
Business ethics	Do you have a code of business conduct, ethics or business principles in the company? Is it circulated to all employees and translated as appropriate? Is it available to all stakeholders?
Child labor	Do you comply with ILO conventions prohibiting employment of children under 15 years of age and preventing exposure of staff under 18 years of age to any hazardous conditions?
Suppliers	Do you encourage and/or monitor key suppliers for their compliance with basic workplace standards and human rights? Do you build such information into the selection and review process?
Discrimination, diversity	Do you have an equal opportunities policy? If so, how have you ensured that all staff are aware of your policy? Are salaries, appointments and promotions considered on merit? Is there an objective system of appraisal to enable this?
Freedom of association	Is your workforce freely able to form/join trade unions (or alternative collective units) and to bargain collectively?
Discipline/grievance	Is there a recognized and fair means of discipline in place? Similarly is there a formal and fair grievance process?
Human rights	Are the fundamental principles outlined in the UN Declaration of Human Rights captured in policies of employment and other relevant business practices? Do you have strict codes of conduct for any security personnel employed or contracted?
Health and safety	Do you have a senior manager responsible for ensuring that your product and operations do not pose an unacceptable risk to staff, contractors or visitors? Are all injuries recorded and causes investigated and remedied?
Working hours	Do any of your staff work more than a 48-hour week? If so, do you have systems in place to ensure compliance with the European Working Time Directive?

TABLE 3.1 (Concluded)

Remuneration/reward	Do you meet the minimum wage requirements in all of the countries in which you operate? Are all wages sufficient as to ensure staff can meet at least their basic human needs?
Community Involvement	
Consultation	Do you consult communities on business decisions that may have significant impacts upon them before as well as after the event?
Responsibility	Where decisions have an adverse effect on a community, e.g., redundancies, do you take all reasonable steps to work with local communities to minimize these impacts?
Transparency and Accountability	
Stakeholder engagement	Do you engage with external stakeholders? On what basis have you chosen your stakeholders? Do you build stakeholder views into decision making? Do you provide feedback to these stakeholders on your performance or impacts?
Performance measurement	Do you measure and monitor social performance using qualitative or quantitative indicators? Do you set improvement targets? Are such targets built into management objectives?
Disclosure/reporting	Do you publish or disclose your social performance or social impacts, e.g., via a social report, as part of your annual report or on your website? Is this done regularly? Do you invite feedback from readers?
External verification	Is your CSR management system or your social performance externally audited? Are the results of the audit published?
Sustainable development	Do you have an environmental management system in place? Do you regularly evaluate and seek to minimize your environmental impacts?

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CORPORATE MISSIONS AND CODES

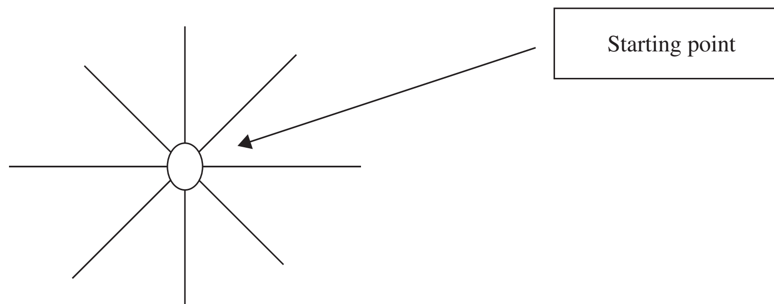
Before articulating the culture through a code of conduct or statement of values, a firm must first determine its mission. A code of conduct then may delineate this foundation both for internal stakeholders such as employees as well as external stakeholders such as customers. The code therefore both enhances corporate reputation and also provides concrete guidance for internal decision making, thus creating a built-in risk management system. When David Packard passed away, his business partner in creating HP, Bill Hewlett, commented, "As far as the company is concerned, the greatest thing he left behind him was a code of ethics known as the HP Way."[16] The vision can be inspiring—should be inspiring. Jim Collins, author of *Built to Last* and *Good to Great,* explains, "Contrary to business school doctrine, we did not find 'maximizing shareholder wealth' or 'profit maximization' as the dominant driving force or primary objective through the history of most of the visionary companies. They have tended to produce a cluster of objectives, of which money is only one—and not nec-

[16]James Collins and Jerry Porras, "Building Your Company's Vision," *Harvard Business Review,* September/October 1996.

essarily the primary one."[17] By establishing (especially through a participatory process) the core tenets on which a company is built, corporate leadership is effectively laying down the law with regard to the basis and objectives for all future decisions. As is evidenced by the Trevino article in this chapter, however, this is only the first step.

The 1990s brought a proliferation of corporate codes of conduct and mission statements as part of the corporate response to the Federal Sentencing Guidelines (see below)—a 2002 survey found that 75% of these mention the word *ethics.*[18] How successful these codes are depends in large part on the process by which they are conceived and written, as well as their implementation. As with the construction of a personal code or mission, it is critical to first ask yourself what you stand for or what the company stands for. Why does the firm exist, what are its purposes and how will it implement these objectives? Once you make these determinations, how will you share them and encourage a commitment to them among your colleagues and subordinates?

Implementation of a code often requires change—or at least the management of the current environment. Libby Hartman, Senior Director for Organizational Change Management at Cap Gemini Ernst & Young, cautions that one rarely sees change without the prior presence of pain. We don't abandon a current direction unless it is intolerable to continue. So, the first step is to evidence that pain—the basis for the intolerance. Why can't you continue as you are currently? Often the answer is easier if one considers the following image:



You may be very close in ideology if you're near the center but, if you happen to be on a different line than someone else, as time progresses, you'll grow further apart. It may not appear to be problematic in the beginning; but consider how far apart the two lines will become as the company matures.

The second step in support of this change is the articulation of a clear vision regarding the firm's direction. The Ethics Resource Center provides the following guidelines for writing an ethics code:

1. Be clear about the objectives that the code is intended to accomplish.
2. Get support and ideas for the code from all levels of the organization.

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[17] Mark Satin, "We Need to Alter the Culture at Places Like Enron—Not Just Pass More Laws," *Radical Middle Newsletter,* March/April 2002, http://www.radicalmiddle/com.

[18] American Management Association Report, *2002 Corporate Values Survey.*

3. Be aware of the latest developments in the laws and regulations that affect your industry.
4. Write as simply and clearly as possible. Avoid legal jargon and empty generalities.
5. Respond to real-life questions and situations.
6. Provide resources for further information and guidance.
7. In all its forms, make it user-friendly because ultimately a code fails if it is not used.

The third step in this process is to identify clear steps as to how this cultural shift will occur. You have a code, but you can't simply "print, post and pray," as Ethics Resource Center president Stuart Gilman has referred to Enron's experience. Do you just post a sign on the wall that says, "Let's make more profits!" Of course not; you need to have processes and procedures in place that support and then sustain that vision. The same holds true for a vision of ethical conduct and the maintenance of an ethical culture.

Finally, to have an effective code that will successfully impact culture, there must be a belief throughout the organization that this culture is actually possible, achievable. If conflicts remain that will prevent certain components from being realized, or if key leadership is not on board, no one will have faith in the changes articulated.

In evaluating the establishment of codes of conduct according to a set of universal moral standards, Wharton professor Mark Schwartz developed a "code of ethics for corporate codes of ethics." Consider how the principles of trustworthiness, respect, responsibility, fairness, caring and citizenship can be embodied in the code creation process and the code, itself.

1. The above six standards should be included in the code, respected by other code content and given priority over bottom line concerns.
2. Code content should be understandable, achievable and justified.
3. All employees should be brought into the code creation process by offering each employee an opportunity to comment on the code.
4. Codes should be widely distributed and made fully accessible to the public.
5. Sufficient training, support and reinforcement should be provided in relation to the code.
6. The board of directors, CEO, president and all senior managers are obligated to demonstrate their support for the code, particularly by acting as role models through their own behavior.
7. Companies should enforce their codes and do so in a consistent and fair manner.
8. Sufficient protections should be provided to employees who report violations of the code.
9. Companies should ensure that a mechanism is in place to monitor and obtain feedback on their codes.[19]

Schwartz explains that the process by which one can change a culture is fluid. Such a transformation "occurs only after you have successfully altered some people's attitudes, which produces a modification in action, which may produce some group benefit for a period of time. People then need to see a connection between the modified behavior and the benefit, which then encourages them to adopt the new attitude, which then modifies their own behavior."[20]

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[19]Mark Schwartz, "A Code of Ethics for Corporate Codes of Ethics," *Journal of Business Ethics,* no. 41 (2002), pp. 27–43.
[20]*Ibid.*

REPUTATION MANAGEMENT

Several readings in this chapter consider the corporate response to public demands for ethical behavior and the concern for the "appearance of propriety," the corporate reputation. As you review the readings in this section, ponder the following (facetious and sarcastic) recommendations for leadership offered by Gen. Colin Powell as a result of the frustration he experienced during the mishandling of the U.S. hostage crisis in Iran from 1979–81:

1. Release facts slowly, behind the pace at which they are already leaking to the public.
2. Don't tell the whole story until forced to do so.
3. Emphasize what went well and euphemize what went wrong.
4. Become indignant at any suggestion of poor judgment or mistakes.
5. Disparage any facts other than your own.
6. Accuse critics of Monday-morning generalship.
7. Accept general responsibility at the top, thus clearing everybody at fault below.[21]

Why do firms engage in ethical behavior? Earlier chapters have suggested profit motives but, as also discussed, an ethical decision does not always lead to the highest profits possible. Perhaps the firm engages in ethical decision making because "it's the right thing to do," as Sears Roebuck and Co. says in its ethics materials. Perhaps, however, as some of the readings in this section suggest, engaging in ethical behavior, implementing ethics programs, or instituting codes of conduct all contribute both to the internal culture of the firm as well as to the external stakeholders' perceptions of the firm. Is there anything wrong with paying attention to these external perceptions?

ENFORCING CULTURE: THE U.S. SENTENCING COMMISSION GUIDELINES

The United States Sentencing Commission, an independent agency in the United States Judiciary, was created in 1984 to regulate sentencing policy in the federal court system. Before that, disparity in sentencing, arbitrary punishments and crime control had been significant congressional issues. In mandating sentencing procedures, Congress through the USSC has been able to incorporate the original purposes of sentencing, bringing some of these challenges under control.

In 1987, the USSC prescribed mandatory sentencing guidelines that apply to individual and organizational defendants in the federal system, bringing some uniformity and fairness to the system. These prescriptions, based on the severity of the offense, assign most federal crimes to one of 43 "offense levels." Each offender also is placed into a criminal history category based upon the extent and recency of past misconduct. The court is then to input this information into a sentencing grid and determine the offender's guideline range (ranges are either in 6-month intervals or 25%, whichever is greater), subject to adjustments.

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[21]Colin Powell and Joseph Persico, *My American Journey* (New York: Random House, 1995) p. 250.

The relevance of these guidelines to our exploration of ethics and, in particular, to our discussion of the corporate proactive efforts to create an ethical workplace, is that the USSC strived in its guidelines to create both a legal and an ethical corporate environment through these adjustments. The guidelines seek to reward corporations that create an effective compliance system so that they are not penalized (or the penalty is reduced) if they have an effective program but they find themselves in court as a result of a bad apple or two. On the other hand, firms that did not have effective compliance systems would be sentenced additionally to a term of probation and ordered to develop a program during that time.

The relevant language is found in section 8 of the guidelines, which identifies those specific acts of an organization that can serve as "due diligence" in preventing crime. These include:

1. Established effective compliance standards and procedures ("reasonably designed, implemented and enforced so that it will generally be effective in preventing and detecting criminal conduct").[22]
2. Assigned specific high-level person(s) to oversee compliance.
3. Used due care not to delegate important responsibilities to known high-risk persons.
4. Communicated its program effectively to all employees and agents.
5. Monitored and audited program operation and established a retribution-free means for employees to report possible violations to management.
6. Consistently disciplined employee violations.
7. Responded promptly and appropriately to any offenses and remedied any program deficiencies.[23]

Though these steps are likely to lead to an effective program, "[such a program] is more than checking off the seven items on a list. This concept of 'due diligence' is a restless standard, as flexible as changing events reflected in the day's headlines and as creative as the minds of potential wrongdoers."[24] For instance, the Guidelines require an investigation in response to a report of wrongdoing, but they also seem to require more than that. A firm must learn from its mistakes and take steps to prevent recurrences such as follow-up investigation and program enhancements. The USSC also mandates consideration of the size of the organization, the number and nature of its business risks, and the prior history of the organization, mitigating factors such as self-reporting of violations, cooperation with authorities, acceptance of responsibility, as well as aggravating factors such as its involvement in or tolerance of criminal activity, a violation of a prior order or its obstruction of justice. These standards are to be judged against applicable industry standards; however, this requires that each firm benchmark against comparable companies.

In a 1997 survey of members of the Ethics Officers Association, 47% of ethics officers reported that the guidelines were an influential determinant of their firm's commitment to

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[22] USSC, *Guidelines Manual,* sec. 8A1.2, comment (n. 3(k)) (2000).
[23] *Ibid.*
[24] Joseph Murphy, "Lost Words of the Sentencing Guidelines," *Ethikos,* November/December 2002, p. 5.

ethics,[25] and another commission study showed that the guidelines influenced 44.5% of these officers to enhance their existing compliance programs.[26]

To provide some context to this exploration, consider which offenses are most likely to reap a fine for an organization. In 2001, the commission received information on 238 organizations sentenced under Chapter 8 (a 21.7% decrease from the previous year). The sentenced organizations had pled guilty in 92.4% of the cases—30% of fines and restitution were issued for cases of fraud, with the next most common crimes to be antitrust and import/export violations (6.7% each). Of those violations that are not included in the fine list, violations of environmental laws with regard to water topped the list at 13%. The mean restitution imposed was $4 million and the mean fine was $2 million.

As you read the following materials, put yourself in the position of someone who is establishing an organization from the ground up. What type of leader would you want to be? How would you create that image or perception? Do you create a mission statement for the firm, a code of conduct? What process would you use to do so? Would you create an ethics and/or compliance program and how would you then integrate the mission statement and program throughout your organization? What do you anticipate might be your successes and challenges?

APPLICATION TO THE GLOBAL BUSINESS ENVIRONMENT

As discussed with regard to the ethical principles governing global business in Chapter 1, there are a number of externally imposed, voluntary codes of conduct. The items in Chapter 1 refer to global business, while others might be promulgated by professional organizations or accrediting bodies, depending on the organization's industry or the practice involved (i.e., accounting, marketing and so on). Though valuable in many circumstances, the challenges with regard to these voluntary codes are myriad. For instance, based on what values should a global code be developed? Some firms have been accused of imposing American values worldwide, without any sensitivity to the cultural conflicts that might exist in some locations, nor to the sense of colonialism and paternalism that such an imposition creates. In addition, once a firm agrees to either its own codes or that of an outside body, how will the code be enforced? Who will ensure that a firm lives up to the prescribed standards?

With regard to labor codes, and in connection with apparel and footwear manufacturers and brands in particular, an entire industry of monitors has been established. These include internal monitors (firm employees), external monitors (outsiders hired by the firm to monitor its factories or contractors' factories), and external independent monitors (others hired by a third party to monitor according to prior agreement with the manufacturer or brand). The Fair Labor Association, for example, is an industry-supported organization that established a code of conduct and then monitors its signatories to ensure compliance. The

[25] Ethics Officers Association, "1997 Member Survey," 2000, p. 9.
[26] USSC, "Corporate Crime in America: Strengthening the 'Good Citizen' Corporation," 123–91 (1995).

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signatory might have an entire internal monitoring structure but also will allow FLA monitors to visit their factories or contractor factories.

Critics of these voluntary codes and monitoring regimes claim that they replace effective governmental monitoring or regulation of labor environments. Others see voluntary codes simply as marketing tools, designed to enhance the firm's public relations image. They worry that codes can become mere window dressing and not address the key issues facing workers today, such as the right to organize.

MORAL LEADERSHIP AND BUSINESS ETHICS

—Al Gini

How do you judge the ethics of a leader? What makes one leader ethical and another unethical? Does it depend on the impact of that leader on her or his followers? Gini identifies the parameters within which we might appropriately judge a leader and the structural restraints imposed upon corporate leadership. Consider the impact of these restraints on the decisions and actions of leaders. Do they justify any (or all) leadership decisions?

How do we judge the ethics of a leader? Clearly, no leader can be expected to be perfect in every decision and action made. As John Gardner has pointed out, particular consequences are never a reliable assessment of leadership.[1] The quality and worth of leadership can only be measured in terms of what a leader intends, values, believes in or stands for—in other words, character. In *Character: America's Search for Leadership,* Gail Sheehy argued, as did Aristotle before her, that character is the most crucial and most elusive element of leadership. The root of the word "character" comes from the Greek word for engraving. As applied to human beings, it refers to the enduring marks or etched-in factors in our personality, which include our in-born talents as well as the learned and acquired traits imposed upon us by life and experience. These engravings define us, set us apart and motivate behavior.

In regard to leadership, said Sheehy, character is fundamental and prophetic. The "issues (of leadership) are those of today and will change in time. Character is what was yesterday and will be tomorrow."[2] For Sheehy, character establishes both our day-to-day demeanor and our destiny. Therefore, it is not only useful but essential to examine the character of those who desire to lead us. As a journalist and longtime observer of the political scene, Sheehy contends that the Watergate affair of the early 1970s serves as a perfect example of the links between character and leadership. As Richard Nixon demonstrated so well, said Sheehy: "The Presidency is not the place to work out one's personal pathology."[3] Leaders rule us, run things, wield power. Therefore, said Sheehy, we must be careful whom we choose as leaders. Because whom we choose, is what we shall be. If, as Heraclitus wrote, "character is fate," the fate our leaders reap will also be our own.

Putting aside the particular players and the politics of the episode, Watergate has come to symbolize the failings and failures of people in high places. Watergate now serves as a

Al Gini, "Moral Leadership and Business Ethics." Reprinted by permission. Al Gini is an associate professor of philosophy at Loyola University of Chicago and managing editor of *Business Ethics Quarterly.*

[1]John W. Gardner, *On Leadership* (New York: The Free Press, 1990), p. 8.

[2]Gail Sheehy, *Character: America's Search for Leadership* (New York: Bantam Books, 1990), p. 311.

[3]*Ibid.,* p. 66.

watershed, a turning point, in our nation's concern for integrity, honesty and fair play from all kinds of leaders. It is not a mere coincidence that the birth of business ethics as an independent, academic discipline can be dated from the Watergate affair and the trials that came out of it. No matter what our failings as individuals, Watergate sensitized us to the importance of ethical standards and conduct from those who direct the course of our political and public lives. What society is now demanding, and what business ethics is advocating, is that our business leaders and public servants should be held accountable to an even higher standard of behavior than we might demand and expect of ourselves.

Mutual Purposes and Goals

The character, goals and aspirations of a leader are not developed in a vacuum. Leadership, even in the hands of a strong, confident, charismatic leader remains, at bottom, relational. Leaders, good or bad, great or small, arise out of the needs and opportunities of a specific time and place. Leaders require causes, issues and, most importantly, a hungry and willing constituency. Leaders may devise plans, establish an agenda, bring new and often radical ideas to the table, but all of them are a response to the milieu and membership of which they are a part. If leadership is an active and ongoing relationship between leaders and followers, then a central requirement of the leadership process is for leaders to evoke and elicit consensus in their constituencies, and conversely for followers to inform and influence their leaders. This is done in at least two ways, through the use of power and education.

The term "power" comes from the Latin *posse:* to do, to be able, to change, to influence or effect. To have power is to possess the capacity to control or direct change. All forms of leadership must make use of power. The central issue of power in leadership is not, "Will it be used?" but, rather, "Will it be used wisely and well?" According to James MacGregor Burns, leadership is not just about directed results; it is also about offering followers a choice among real alternatives. Hence, leadership assumes competition, conflict and debate whereas brute power denies it.[4] "Leadership mobilizes," said Burns, "naked power coerces."[5] But power need not be dictatorial or punitive to be effective. Power can also be used in a noncoercive manner to orchestrate, direct and guide members of an organization in the pursuit of a goal or series of objectives. Leaders must engage followers, not merely direct them. Leaders must serve as models and mentors, not martinets. "Power without morality," said novelist James Baldwin, "is no longer power."

For Peter Senge teaching is one of the primary jobs of leadership.[6] The "task of leader as teacher" is to empower people with information, offer insights, new knowledge, alternative perspectives on reality. The "leader as teacher," said Senge, is not just about "teaching" people how "to achieve their vision" but, rather, is about fostering learning, offering choices and building consensus.[7] Effective leadership recognizes that in order to build and achieve community, followers must become reciprocally coresponsible in the pursuit of a common

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[4]James MacGregor Burns, *Leadership* (New York Harper Torchbooks, 1979), p. 36.
[5]*Ibid.,* p. 439.
[6]For Senge the three primary tasks of leadership include: leader as designer; leader as steward; leader as teacher.
[7]Peter M. Senge, *The Fifth Discipline* (New York: Double/Currency Books, 1990), p. 353.

enterprise. Through their conduct and teaching, leaders must try to make their fellow constituents aware that they are all stakeholders in a conjoint activity that cannot succeed without their involvement and commitment. Successful leadership believes in and communicates some version of the now famous Hewlett-Packard motto: "The achievements of an organization are the results of the combined efforts of each individual."

In the end, says Abraham Zaleznick, "leadership is based on a compact that binds those who lead with those who follow into the same moral, intellectual and emotional commitment."[8] However, as both Burns and Rost warned us, the nature of this "compact" is inherently unequal because the influence patterns existing between leaders and followers are not equal. Responsive and responsible leadership requires, as a minimum, that democratic mechanisms be put in place which recognize the right of followers to have adequate knowledge of alternative options, goals and programs, as well as the capacity to choose between them. "In leadership writ large, mutually agreed upon purposes help people achieve consensus, assume responsibility, work for the common good and build community."[9]

STRUCTURAL RESTRAINTS

There is, unfortunately, a dark side to the theory of the "witness of others." Howard S. Schwartz in his radical, but underappreciated, managerial text *Narcissistic Process and Corporate Decay,*[10] argued that corporations are not bastions of benign, other-directed ethical reasoning. Nor can corporations, because of the demands and requirements of business, be models and exemplars of moral behavior. The rule of business, said Schwartz, remains the "law of the jungle," "the survival of the fittest," and the goal of survival engenders a combative "us against them mentality" which condones the moral imperative of getting ahead by any means necessary. Schwartz calls this phenomenon "organizational totalitarianism": Organizations and the people who manage them create for themselves a self-contained, self-serving world view, which rationalizes anything done on their behalf and which does not require justification on any grounds outside of themselves.[11] The psychodynamics of this narcissistic perspective, said Schwartz, impose Draconian requirements on all participants in organizational life: do your work; achieve organizational goals; obey and exhibit loyalty to your superiors; disregard personal values and beliefs; obey the law when necessary, obfuscate it whenever possible; and, deny internal or external discrepant information at odds with the stated organizational worldview. Within such a "totalitarian logic," neither leaders nor followers, rank nor file, operate as independent agents. To "maintain their place," to "get ahead," all must conform. The agenda of "organizational totalitarianism," said Schwartz, is always the preservation of the *status quo*. Within such a logic, like begets like, and change is rarely possible. Except for extreme situations in which "systemic ineffectiveness" begins to breed "organization decay," transformation is never an option.

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[8]Abraham Zaleznik, "The Leadership Gap," *Academy of Management Executive* (1990), V.4, N.1, p. 12.
[9]Joseph C. Rost, *Leadership for the Twenty-First Century,* p. 124.
[10]Howard S. Schwartz, *Narcissistic Process and Corporate Decay* (New York: New York University Press, 1990).
[11]Howard S. Schwartz, "Narcissism Project and Corporate Decay: The Case of General Motors," *Business Ethics Quarterly,* V.1, N.3, p. 250.

In *Moral Mazes* Robert Jackall, from a sociological rather than a psychological perspective, parallels much of Schwartz's analysis of organizational behavior. According to critic and commentator Thomas W. Norton, both Jackall and Schwartz seek to understand why and how organizational ethics and behavior are so often reduced to either dumb loyalty or the simple adulation and mimicry of one's superiors. While Schwartz argued that individuals are captives of the impersonal structural logic of "organizational totalitarianism," Jackall contends that "organizational actors become personally loyal to their superiors, always seeking their approval, and are committed to them as persons rather than as representatives of the abstractions of organizational authority." But in either case, both authors maintain that organizational operatives are prisoners of the systems they serve.[12]

According to Jackall, all organizations (to be exact, he is specially referring to American business organizations) are examples of "patrimonial bureaucracies" wherein "fealty relations of personal loyalty" are the rule and the glue of organizational life. Jackall argued that all corporations are like fiefdoms of the middle ages, wherein the Lord of the Manor (CEO, President) offers protection, prestige and status to his vassals (managers) and serfs (workers) in return for homage (commitment) and service (work). In such a system, said Jackall, advancement and promotion are predicated on loyalty, trust, politics and personality as much as, if not more than, on experience, education, ability and actual accomplishments. The central concern of the worker/minion is to be known as a "can-do-guy," a "team player," being at the right place at the right time and master of all the social rules. That's why in the corporate world, says Jackall, 1,000 "atta-boys" are wiped away with one "oh, shit!"

As in the model of a feudal system, Jackall maintains that employees of a corporation are expected to become functionaries of the system and supporters of the *status quo.* Their loyalty is to the powers that be; their duty is to perpetuate performance and profit; and their values can be none other than those sanctioned by the organization. Jackall contends that the logic of every organization (place of business) and the collective personality of the workplace conspire to override the wants, desires and aspirations of the individual worker. No matter what a person believes off the job, said Jackall, on the job all of us to a greater or lesser extent are required to suspend, bracket or only selectively manifest our personal convictions.

> *What is right in the corporation is not what is right in a man's home or his church. What is right in the corporation is what the guy above you wants from you.*[13]

For Jackall the primary imperative of every organization is to succeed. This logic of performance, what he refers to as "institutional logic," leads to the creation of a private moral universe. A moral universe that, by definition, is totalitarian (self-sustained), solipsistic (self-defined) and narcissistic (self-centered). Within such a milieu truth is socially defined and moral behavior is determined solely by organizational needs. The key virtues,

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[12]Thomas W. Norton, "The Narcissism and Moral Mazes of Corporate Life: A Commentary on the Writings of H. Schwartz and R. Jackall," *Business Ethics Quarterly,* V.2, N.1, p. 76.
[13]Robert Jackall, *Moral Mazes* (New York: Oxford University Press, 1988), p. 6.

for all alike, become the virtues of the organization: goal-preoccupation, problem solving, survival/success and, most importantly, playing by the "house rules." In time, said Jackall, those initiated and invested in the system come to believe that they live in a self-contained worldview which is above and independent of outside critique and evaluation.

For both Schwartz and Jackall, the logic of organizational life is rigid and unchanging. Corporations perpetuate themselves, both in their strengths and weakness, because corporate cultures clone their own. Even given the scenario of a benign organizational structure which produces positive behavior and beneficial results, the etiology of the problem, and the opportunity for abuse that it offers, represents the negative possibilities and inherent dangers of the "witness of others" as applied to leadership theory. Within the scope of Schwartz's and Jackall's allied analysis, "normative" moral leadership may not be possible. The model offered is both absolute and inflexible, and only "regular company guys" make it to the top. The maverick, the radical, the reformer are not long tolerated. The "institutional logic" of the system does not permit disruption, deviance or default. . . .

The term moral leadership often conjures up images of sternly robed priests, waspishly severe nuns, carelessly bearded philosophers, forbiddingly strict parents and something ambiguously labeled the "moral majority." These people are seen as confining and dictatorial. They make us do what we should do, not what we want to do. They encourage following the "superego" and not the "id." A moral leader is someone who supposedly tells people the difference between right and wrong from on high. But there is much more to moral leadership than merely telling others what to do.

The vision and values of leadership must have their origins and resolutions in the community of followers, of whom they are a part, and whom they wish to serve. Leaders can drive, lead, orchestrate and cajole, but they cannot force, dictate or demand. Leaders can be the catalyst for morally sound behavior, but they are not, by themselves, a sufficient condition. Leaders by means of their demeanor and message must be able to convince, not just tell others, that collaboration serves the conjoint interest and well-being of all involved. Leaders may offer a vision, but followers must buy into it. Leaders may organize a plan, but followers must decide to take it on. Leaders may demonstrate conviction and willpower, but followers, in the new paradigm of leadership, should not allow the leader's will to replace their own.[14] To reiterate the words of Abraham Zaleznick: "Leadership is based on a compact that binds those that lead with those who follow into the same moral, intellectual and emotional commitment."

Joseph C. Rost has argued, both publicly and privately, that the ethical aspects of leadership remain thorny. How, exactly, do leaders and collaborators in an influence relationship make a collective decision about the ethics of a change that they want to implement in an organization or society? Some will say, "Option A is ethical," while others will say, "Option B is ethical." How are leaders and followers to decide? As I have suggested, ethics is what "ought to be done" as the preferred mode of action in a "right-vs.-right," "values-vs.-values" confrontation. Ethics is an evaluative enterprise. Judgments must be made in regard to competing points of view. Even in the absence of a belief in the existence of a single universal, absolute set of ethical rules, basic questions can still be asked: How does it impact

[14]Garry Wills, *Certain Trumpets,* p. 13.

on self and others? What are the consequences involved? Is it harmful? Is it fair? Is it equitable? Perhaps the best, but by no means definitive, method suited to the general needs of the ethical enterprise is a modified version of the scientific method: (A) *Observation,* the recognition of a problem or conflict; (B) *Inquiry,* a critical consideration of facts and issues involved; (C) *Hypothesis,* the formulation of a decision or plan of action consistent with the known facts; (D) *Experimentation and Evaluation,* the implementation of the decision or plan in order to see if it leads to the resolution of the problem. There are, of course, no perfect answers in ethics or life. The quality of our ethical choices cannot be measured solely in terms of achievements. Ultimately and ethically, intention, commitment and concerted effort are as important as outcome: What/why did leader/followers try to do? How did they try to do it?

Leadership is hard to define, and moral leadership is even harder. Perhaps, like pornography, we only recognize moral leadership when we see it. The problem is, we so rarely see it. Nevertheless, I am convinced that without the "witness" of moral leadership, standards of ethics in business and organizational life will not occur or be sustained. Leadership, even when defined as a collaborative experience, is still about the influence of individual character and the impact of personal mentoring. Behavior does not always beget like behavior on a one-to-one ratio, but it does establish tone, set the stage and offer options. Although it is mandatory that an organization as a whole—from top to bottom—make a commitment to ethical behavior to actually achieve it, the model for that commitment has to originate from the top.[15] Labor Secretary Robert Reich recently stated: "The most eloquent moral appeal (argument) will be no match for the dispassionate edict of the market."[16] Perhaps, the "witness" of moral leadership can prove to be more effective.

[15]Dolecheck, "*Ethics: Take It From the Top,*" p. 14.
[16]William Pfaff, "It's Time for a Change in Corporate Values," *Chicago Tribune,* January 16, 1996, p. 17.

LEADERSHIP IN A VALUES-BASED ORGANIZATION

—RALPH LARSEN

Ralph Larsen was the outgoing Chairman and CEO of Johnson & Johnson at the time that Bentley College invited him to speak at the Sears Lectureship in Business Ethics in February 2002. In his address, Larsen refers not only to ethical leadership embodied by J&J's now-famous response to the Tylenol disaster in Chicago but also to ethical leadership as it is exhibited every day at J&J and in the decisions of its people. Consider the value of the Credo to J&J and ask yourself whether the Credo would work at all firms. What needs to be present in order for a statement like the Credo to be effective?

I am very pleased to be here representing the more than 100,000 people of Johnson & Johnson, people who work so hard each day, not only building our business, but doing it in the right way.

I'm honored to be a part of this lecture series, and so, the first reason I'm here is because you asked. The second reason is that the older I get, the more I like hanging around with people younger than I am, people on the threshold of their careers. You keep us young and nimble. You have a way of distilling and challenging our thought processes. You remind us of what it's all about.

Last year I spoke with a young lady who was serving as a fellow in our corporate communications department. This is a program we have with the Rutgers School of Communications. These master's students work for us as interns for one or two years as they complete their program. I was struck by her story, and I wanted to share it with you today.

Well, somehow our company made an impression on this young girl in India, thousands and thousands of miles away from the headquarters where she ultimately worked. When she came to us she brought with her the expectation that we would be as community-oriented, thoughtful, values-oriented and as upstanding as she had seen on the outside. She also came with the full expectation that she would find an environment where she could express her values and feel encouraged to do the right thing.

Now, I share Sandhya's story with you because I think it's just terrific that a young person can be touched and motivated by our company's values. And I think it's even more encouraging that this motivation meant that she sought out a job with us. You too might have

This monograph was presented as a lecture in the Sears Business Ethics Lectureship at the Center for Business Ethics at Bentley College on February 7, 2002. Reprinted with permission from the Center for Business Ethics at Bentley College.

some preconceptions about the kinds of organizations you want to join, and if you do end up someplace with a strong set of core values, I can give you a glimpse of what to expect once you get there.

Obviously, I can speak only from my personal experience which is almost exclusively in Johnson & Johnson. As Chairman and CEO for the past 13 years, I have had the best job in corporate America—of that I am sure. The reason is that leading a company like Johnson & Johnson, with a strong foundation built on values and a heritage based on ethical principles, is very special. There are certain boundaries in place: things you simply don't do, well-accepted management practices that just won't work, changes that just won't stick, parts of our history that simply won't give way to certain new ideas.

Leading a company like this isn't for everybody. It's not a job that goes away at the end of the day. It's a responsibility that sinks into you, because often we wrestle with issues and problems that have no easy answers—no clear right or wrong. For all those challenges . . . challenges I'll go into in more detail in a minute . . . for all those leadership challenges, our core values also make leadership a whole lot easier. You see, values are our greatest point of leverage to get things done . . . achieve all we can achieve. Values are the foundation of our business success.

In his renowned book, *The Fifth Discipline,* Peter Senge uses something called a "trim tab" to explain certain theories of leverage within a system. In this case, how do you get something really big, like an oil tanker ship, to change course? Well, you move the rudder, of course. But the rudder itself is so big that there's water pressure keeping it where it is. So, there is this very small piece (a rudder for the rudder if you will) called a trim tab that compresses the water around the rudder. That action makes it easier for the rudder to move through the water. Easier, therefore, for the rudder to change the direction of the ship. You don't see the trim tab. You probably never even knew it was there, but it makes an incredible difference to the navigation of the ship.

Being bound together around the values . . . around our credo . . . being bound together around values is like the trim tab for leadership at Johnson & Johnson. What I mean is that because it is a deep point of leverage, it makes a huge difference. It's the point of leverage that makes leadership not only possible but also meaningful and enjoyable.

Johnson & Johnson's strong values have been instrumental in our charting a course that has proved successful, and for that I am very thankful.

- Sales last year were $33 billion, almost triple what they were a decade ago, representing our 69th consecutive year of sales increases.
- We've had 17 consecutive years of double-digit earnings increases.
- And we've had 39 consecutive years of dividend increases.
- And our shareowners have done very well. The market value of Johnson & Johnson ended last year at more than $180 billion, up from approximately $38 billion ten years ago.

The point is that our business is healthy and the future looks bright. The challenge is to keep it going and growing. I had the incredibly good fortune to be given the opportunity

to lead not only a well-run business, but one that had a very strong guidepost about what we believe in.

At Johnson & Johnson, it's the glue that holds our decentralized company together. It's called our credo, and it is a 60-year-old deceptively simple one-page document. Our credo grew out of General Robert Wood Johnson's (the patriarch of our company) very simple, yet very profound management philosophy. In essence, it says that our first responsibility is to our customers, to give them high-quality products at fair prices. Our second responsibility is to our employees, to treat them with dignity and respect and pay them fairly. Our third responsibility is to the communities in which we operate, to be good corporate citizens and protect the environment. And then, it says that our final responsibility is to our shareholders, to give them a fair return.

In the final analysis, the Credo is built on the notion that if you do a good job in fulfilling the first three responsibilities, then the shareholder will come out all right. That is exactly what has happened over all these years, and that is what we continue to strive for today.

For us, the Credo is our expression of managing the multiple bottom lines of products, people, planet and profits. It's the way we conceptualize our total impact on society. It implicitly tells us what's important: honesty and integrity, respect for others, fairness and straight-dealing. Those are the ethical values on which we operate all over the world.

Johnson & Johnson is a very decentralized company with almost 200 operating companies in 51 countries around the world, selling products in more than 175 countries. These operating companies have their own management boards and are relatively independent. We use this structure because it helps us focus on the markets and people we serve. It's the only way Johnson & Johnson can be such a broadly based health care company.

We are probably best known as a company that is a leader in health care consumer brands you know so well—from Johnson & Johnson Baby Products and Band-Aids to over-the-counter medications such as Tylenol and Motrin.

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Clearly, as the chief executive officer, I am ultimately accountable for everything that happens, both good and bad. But more than anything else, I am responsible for the tone at the top. To run a good and decent company with good and decent people. I work hard at setting the right tone. I spend a tremendous amount of time developing and selecting credo-based leaders and ensuring that we have the proper systems and controls in place.

But with more than 100,000 people throughout our family of companies, I must rely on all of our company leaders and their teams to do the right thing and work with me to instill credo values throughout their organizations. They share with me the challenge of being responsible for making sure we operate in accordance with our credo values in all that we do.

Coming into my job I had the advantage of knowing that our credo had been translated into dozens of languages. I knew that we had programs in place to help ensure that each new employee had read it and was told of its significance, and I knew that copies of it were prominently displayed in offices and plants all over the world. As a new chief executive officer, I viewed the credo as an important framework for management and a key point of leverage, of differentiation, in today's global marketplace. It gives us the incredible advantage of having

a foundation of timeless principles that serve as the "glue" that holds our decentralized organization together through good times and challenging ones.

Now, it has occurred to me that I am making all this sound kind of simple. It is not. In a highly competitive, financially driven world with the tyranny of quarterly earnings and with multiple constituencies, actually living the credo in a meaningful way is a constant challenge. At the end of the day, our credo is all about personal responsibility.

As one read through it, each of the four responsibilities outlined starts with the preposition "to" and that is very important. Said another way, our credo isn't about us being responsible for something. A school child is responsible for her backpack. An assembly line worker is responsible for placing a product in a package. But when you are responsible to, you are responsible "to a person" or "to a group of people." And that's what our credo says . . . we are responsible to our customers, mothers and fathers, doctors and nurses; responsible to employees; responsible to people in communities. This is an intrinsically subjective area precisely because it's personal. It's about owing part of yourself to others. It's a serious responsibility.

I'm no linguist, and so I don't know where the root of the two uses of a particular word in French come together, but I am struck that the word to be physically burdened with lots of luggage, *chargé,* is the same word used to describe a person who has taken on a responsibility. It's part of a title to indicate you're in charge. The idea is simple; when you're in charge, you are responsible. And this responsibility weighs heavily, particularly when you have to balance the interests of different people, all people you are responsible to.

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Several years ago, we made the decision to close approximately 50 small plants around the world. It involved laying off several thousand people, many in communities and countries in which I knew the people would have a very tough time finding comparable employment. We had never done anything like that before.

I worried about my responsibility to the men, women and their families who would lose their jobs. But our operating costs at these small plants were way out of line, and we were becoming less and less competitive. So yes, I was responsible to our employees in those plants, but I was also responsible to the patients who needed our products to keep them affordable. And I was responsible to all of our other employees around the world to keep the company healthy and growing. The harsh reality was that a great many more would be hurt down the road if I failed to act and we became less and less competitive.

In addition to our employees, I was also responsible to the tens of thousands of stockholders (individuals, retired folks, pension plans and mutual funds) who owned our stock. The facts were clear . . . I knew what had to be done, and we did it as thoughtfully and sensitively as possible. But the decision was hard, because it was personal.

At a deeper level, what became crystal clear was that competing on a global basis with Olympic-class companies had changed the ground rules forever. This new world meant that we could no longer guarantee that if you came to work every day and did your job well, you could count on being employed with us for life. That's the way it used to be, but that was a responsibility that we could no longer fulfill. Rather, we had to focus on making people employable for life. And that's where we put our resources, at life-long development of skill sets that could be used in many different companies and industries.

The bright side to all of this is that being responsible to people has a tendency to become mutual. If I am responsible to you, you are more likely to be responsible to me, and that means I have colleagues I can trust. People are committed to people, not just to paychecks. There's a sense that we are all in it together. In our case, we're all working to get life-saving and life-enhancing products to people who need them. Improving the quality of life and healing and curing disease is our heritage and mission. Being bound together in one purpose makes us able to achieve incredible heights, not only as a group but as individuals.

***

Once inside, new leaders, I think, can grasp what we're all about quite readily because we tend to wear our values on our sleeves and talk openly about them. The credo is part of our daily conversation as we wrestle with decisions of all kinds. This means that for the newcomer there is less confusion, less jockeying and less reticence to make decisions. In our company, it's clear where the lines are, and there's a lot of room to act until you get close to those lines. Our experience is that if we have an executive who tends to bump up against the ethical boundaries time and time again, sooner or later they get themselves, and often the company, in serious trouble and that's the end of their career.

The credo is not a rulebook. It is not a list of do's and don'ts. It outlines fundamental principles that apply to not only our corporate but also our personal behavior as we carry out our business responsibilities. It has proven, over time, to be a guiding force that appeals to the ethical aspirations of all kinds of people, from all kinds of places, from all spiritual and religious backgrounds. That is its magic.

At the highest levels of leadership, the greatest risks are often risks associated with moving into new businesses particularly by acquisition. Mergers and acquisitions are, by their very nature, highly risky endeavors. They can change the fundamental make-up of our business, and they can bring thousands of new people into our company overnight.

I'm often asked if our strong set of values propels or inhibits this process . . . does it scare people off, or make us unapproachable, or make it hard for people from acquired companies to fit in. Not a bit. I think our reputation for being a values-based company is a tremendous asset. It serves as a magnet for smaller companies who do not have the resources to fulfill their potential and want to become a part of the Johnson & Johnson family of companies.

The best evidence of this is that over the last 10 years, we have added more than 50 companies, products or technologies to our company. We've successfully transitioned from a company based heavily on our heritage consumer products to a science-based company on the leading edge of medical technology.

***

Leaders can make values a priority that gets measured and rewarded. We can work hard at making sure that the company's values are well-expressed, well-understood, explicit and visible in all that we do, in all of our programs, policies, products. But the most important thing is to set the proper personal example, the tone at the top.

Our values need to be visible to people like Sandhya, young people who will become the next generation of leaders. The leaders who will wrestle with increasingly complex

problems in a complicated world. A world in which often there is no clear answer and where you are not sure of what the "right" thing to do is. Leaders with good judgment who know how to preserve important values and hold fast to them, while at the same time knowing when and how fast to change to meet the challenges of a new world.

If this all sounds interesting to you as you pursue your career, I would urge you to join a company rich in values. There are no perfect people, and there are no perfect companies. We all have our weaknesses and warts. But make sure the company you join has a set of core values that you are comfortable with, that you are proud of, and which will bring out the very best in you.

VENTURING BEYOND COMPLIANCE

—LYNN SHARP PAINE

Lynn Sharp Paine identifies two strategems to encourage and support an ethical corporate culture: legal compliance and organizational integrity. Consider which might be more effective from a long-term perspective? Which would be easier to implement? Which do you think is more prevalent in the business environment?

How can managers insure that individuals in their companies conduct business in a way that is responsible and ethically sound? This challenge involves organizational design and a number of specific managerial tasks.

WHY THE ETHICS FOCUS?

In the past decade, a number of factors have brought ethical matters into sharper focus.

Globalization Global expansion has brought about greater involvement with different cultures and socioeconomic systems. With this development, ethical considerations—such as the different assumptions about the responsibilities of business, about acceptable business practices, and about the values needed to build a cohesive, successful organization—become more important.

Technology The added capabilities of technology have created a new level of transparency and immediacy to business communication. Now the conduct of businesses around the globe is more exposed than it ever was before.

Competition Rising competition brings with it added pressure to cut corners. Simultaneously, leaders are looking for new ways to differentiate their companies and move them to a new level of excellence. Some believe that a proactive ethical stance can have a positive impact on the bottom line.

Public Perception and the Law There is a perceived decline in social ethics that yields uncertainty. Managers are no longer comfortable assuming that employees joining their companies possess the desired ethical values. And public expectations, too, have changed: That which was once deemed acceptable is now more readily scrutinized. New laws and stepped-up enforcement efforts have increased the risk of personal and organizational liability.

Lynn Sharp Paine, "Venturing beyond Compliance," *The Evolving Role of Ethics in Business,* report no. 1141-96-ch, pp. 13–16 (New York: The Conference Board, Inc., 1996). Email: *info@conference-board.org.*

TWO STRATEGIES EMERGE

Most managers are choosing either a *legal compliance* strategy or an *organizational integrity* strategy to support ethics in their companies. These strategies differ markedly in their conception of ethics, human behavior and management responsibility. While the organizational integrity strategy fully acknowledges the importance of compliance with the law, its aim is to achieve right conduct in general. Thus, it is more comprehensive and broader than the legal compliance strategy. Companies that adopt an organizational integrity strategy are concerned with their identity—who they are and what they stand for—and with how they conduct internal and external affairs. These matters are less clear-cut (and hence, more demanding) than those handled by a legal compliance approach.

These strategies differ in several fundamental ways:

Ethos The legal compliance strategy regards ethics as a set of limits, boundaries over which we must not cross. The compliance approach is externally driven. Here, ethics is viewed as something that *has* to be done.

The organizational integrity strategy defines ethics as a set of principles to guide the choices we make. Companies that adopt this approach choose their own standards for conducting business on an individual and company-wide basis.

Objectives The compliance approach is geared toward preventing unlawful conduct and criminal misconduct in particular. The integrity approach, by comparison, has a more lofty goal: to achieve responsible conduct across-the-board, even if not required by law.

Leadership While companies with a compliance approach place lawyers at the helm, the integrity approach is captained by company managers. To insure that their efforts are thorough and effective, these managers are assisted by lawyers, human resources specialists and other experts.

Methods The compliance focus emphasizes the rules people must not violate. It uses increased oversight and stepped-up penalties to enforce these rules. An integrity approach acknowledges the need for a brake on people's behavior from time to time, but treats ethics as a steering mechanism rather than the brake itself. Here, ethics infuses the organization's leadership, its core systems, and its decision-making processes.

Behavioral Assumptions Finally, the two approaches rest on very different philosophies of human nature. The compliance strategy's ideas are rooted in deterrence theory—how to prevent people from doing bad things by manipulating the costs of misconduct. The integrity strategy views people as having a fuller, richer set of needs and motivations. While it acknowledges that people are guided by material self-interest and the threat of penalties, it also identifies the other drivers of human nature—individual values, ideals and the influence of peers.

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LIMITATIONS OF A COMPLIANCE-BASED APPROACH

Why go beyond compliance? While legal compliance is a must, a legal compliance approach to company ethics has several specific limitations:

- Compliance is not terribly responsive to many of the day-to-day concerns that managers and employees face. It follows the law, which is generally backward looking. For a company on the cutting edge of technology, of new financing mechanisms, of new practices, the law is not very helpful as a guide.
- The majority of hot-line calls are not about unlawful or criminal misconduct. They deal with gray areas and with issues of supervisory practice and fair treatment. A legal compliance approach does not provide answers to these types of questions. Therefore, it does not adequately address employees' real concerns and needs.
- The typical legal compliance program runs directly counter to the philosophy of empowerment. Empowerment gives employees discretion, resources and authority, and then trusts them to make good decisions. Compliance programs, though, reduce discretion, increase oversight and tighten controls. If a company tries to put forth an empowerment effort and a compliance-driven ethics program at the same time, the two will cancel each other out. This will result in a lot of employee cynicism.
- A legal compliance program is just not very exciting. Compliance is important, but the law was not designed to inspire human excellence so much as to set a floor for acceptable behavior. Since the law has to apply to everyone, its standards are not as demanding as we might choose for ourselves and for our companies.

CHALLENGES TO AN INTEGRITY-BASED APPROACH

If one are really interested in organizational effectiveness and organizational development rather than just avoiding liability, an integrity-driven approach is far more promising. But four challenges must be met before an organizational integrity approach can work:

1. *Developing an ethical framework.* Organizational integrity requires a much more robust concept of organizational identity and responsibility than does compliance.
2. *Aligning practice with principles.* This can be very problematic, especially in organizations whose structure, systems and decision processes run counter to the values and principles espoused by senior management.
3. *Overcoming cynicism.* In *The Cynical Americans,* Donald L. Kanter and Phillip H. Mervis' study of cynicism in the United States (San Francisco, Jossey-Bass Publishers, 1989, p. 1), it was revealed that almost 43% of Americans fit the profile of the cynic; that is, one who regards selfishness, dishonesty and fakery as at the core of human behavior. People often adopt cynicism as a self-defense mechanism. This frame of reference often prevents people from seeing reality, and can act as a barrier to instilling ethical values.
4. *Resolving ethical conflicts.* We all have conflicting responsibilities from time to time. If we are very creative, we may be able to solve potential conflicts before they unfold. Sometimes, though, hard trade-offs—between right and right, between two "goods"—must be made.

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NAVIGATING WITH THE ETHICAL COMPASS

How do you begin to create an ethical compass or a framework for integrity? A useful starting point is to begin by answering some questions related to the four fundamental sources of responsibility.

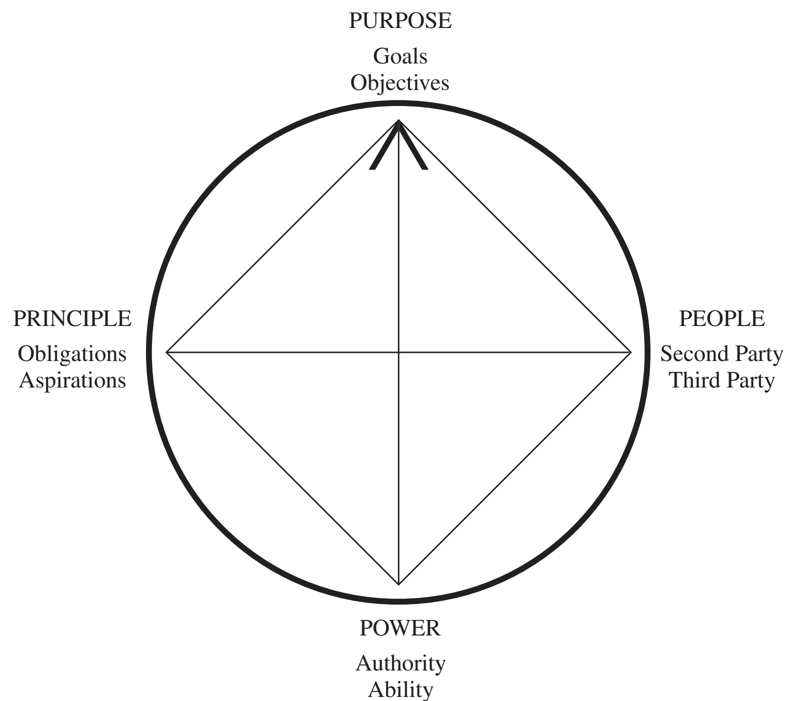
- Purpose—What is the organization's fundamental reason for being—its ultimate aims?
- People—Who are the constituencies to whom the company is accountable and on whom it depends for success? What are their legitimate claims and interests?
- Power—What is the organization's authority and ability to act?
- Principles—What are the organization's obligations or duties, as well as its guiding aspirations and ideals?

If used as a set of reference points, these questions can help develop a framework against which to benchmark progress on ethical matters (see Exhibit 1).

EXHIBIT 1

The Four Points of an Ethical Compass

How can managers develop a framework for integrity?



© Lynn Sharp Paine, 1995

The framework of ideas is only a start. Putting it into practice is the difficult part. People often wonder why a gap exists between the espoused values and everyday behavior, when in fact, a gap *should* exist to some degree. If you are fully satisfying your ideals and aspirations, most likely your standards are not high enough. If the gap between principle and practice becomes a chasm, though, it becomes hypocrisy, which is even worse.

MANAGEMENT: PUTTING IT TOGETHER

Integrity-based ethics management efforts have contributed to organizational effectiveness in several fundamental ways. Companies that have adopted such programs report fewer and less serious problems of misconduct. Often this is because problems are caught earlier and are dealt with at the onset. In some cases, an integrity approach can yield strengthened competitiveness: it facilitates the delivery of quality products in an honest, reliable way. This approach can enhance work life by making the workplace more fun and challenging. It can improve relationships with constituencies and can instill a more positive mindset that fosters creativity and innovation. And while an organizational integrity approach cannot guarantee bottom-line performance improvements, it is important to understand that ethics is a very practical matter. The purpose of ethics is to enhance our lives and our relationships both inside and outside of the organization.

Clearly, achieving and maintaining integrity requires intense commitment and involvement from managers company-wide. This goes beyond the so-called "tone" set by senior management. It involves specific leadership tasks and behaviors, starting with the development of the integrity framework. Managers must insure that company systems support responsible behavior. Then they must personally model responsible decision making. These leadership tasks are all essential to building the high-integrity organization.

ETHICAL BUSINESS: SURVEY RESULTS

—INSTITUTE OF BUSINESS ETHICS

Every three years, the Institute of Business Ethics (U.K.) surveys larger companies known to have codes of ethics/conduct/business principles about the use they make of them and their views about current business ethics issues. The principal findings follow.

WHO IS RESPONSIBLE FOR BUSINESS ETHICS?

CEOs turn to a wide spectrum of corporate functions to handle the ethical aspects of company behavior. Comparatively few (16%) retain it in their own department. This is further borne out by the response to a question asking *which department, function or person is responsible for the code.* Table 2 sets out the percentage responses in each of three years for which there is data.

TABLE 2

Departments Responsible for Codes of Ethics*

	2001	**1998**	**1995**
Corporate/External Affairs	**10%**	11%	1%
Human Resources	**20%**	12%	7%
Company Secretary and/or Legal Department	**46%**	44%	14%
Board/Board Committee/CEO	**16%**	12%	44%
Internal Audit/Finance	**14%**	7%	—
Other	**16%**	14%	34%

*Some multiple answers in 2001.

Nearly half of respondents look to the legal or compliance function to be responsible for ethical conduct of the organization. The human resources departments seem to be regaining their influence probably because of the rise of human rights issues at the workplace and with particular reference to the conduct of their suppliers. It is, however, the corporate governance functions that still predominate in business ethics. This reflects the attention that was paid in the 1990s to changes of practice following inclusion in the Stock Exchange listing requirements of the provisions of the Hampel Committee's Combined Code.[1]

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[1]*The Hampel Report, Committee on Corporate Governance:* Final Report, 1998.

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There is little sign yet that corporate affairs executives are being given increased responsibility for ethical policies following the publication of the Turnbull Report.[2] This requires among other things, that boards of companies assess and report on non-financial risks (i.e., threats to reputation, etc.) as well as the financial ones. It is certainly not too wild to suggest that many corporations will turn to their public affairs staff to advise on, and assume responsibility for, reputation management. It is therefore predicted that by 2004 (when the next survey is due), that function will appear further up the list of those that are responsible for business ethics. The rise in importance of the internal audit department should also be noted.

PURPOSE OF A CODE

Having an ethics policy now seems to be a well-established feature of the corporate strategy of larger organizations. IBE survey data indicates that in August 2001, 73 of the companies listed in the FTSE100 index either had a code of business ethics or had one in preparation. Others are known to be considering the matter seriously. Previous surveys have shown about the same proportion but the constituents of the index have changed significantly since the last count in 1999. Over half the respondents to the survey have had codes for more than three years, while only 7% have introduced them in the past year. See Table 3.

TABLE 3

For How Long Has Your Company Had a Code?	
Less than 1 year	7%
1–3 years	23%
3–5 years	18%
5–10 years	18%
More than 10 years	18%
No answer	16%

It is now seen as part of "good governance" to have and operate such a code.

A question was asked in the survey which sought to find out the motivation or purpose of companies in having an ethics policy. The answers indicate the main benefits that companies expect from the resources they spend on this aspect of their business. See Table 4.

TABLE 4

Importance of Codes to Companies (ranked by those giving each first priority)*	
Guidance to staff	31
Reduces risk	11
Helps to secure long term shareholder value	10
Helps to guard reputation	7
Shows we are a responsible company	5

*Some multiple answers.

[2] *Internal Control, Guidance for Directors on the Combine Code (aka the Tumbull guidance)* ICAEW, September 1999.

The prime motivation is that of giving guidance to staff on how to respond to ethical dilemmas. This is in sharp contrast to the 1998 survey when "guarding of reputation" was seen as the primary purpose by 75% of respondents whereas in 2001, it was down to 18%. Even if risk reduction is added to reputation protection, employee guidance still predominates as a motive today.

USE OF THE CODE

Having a code is a start, but how is [*sic*] it and its contents made known and what uses are made of it?

Table 5a indicates that practically all employees are provided with a copy of the code and increasingly, those outside the company are being informed about the organization's ethical stance.

TABLE 5a

Use of the Code

Circulated	2001	1998
Internally	**93%**	93%
Externally	**46%**	33%

The text of the code in the form of a booklet, memorandum or chapter in a staff handbook, or access via the intranet are still the preferred ways to publicize the code (see Table 5b). The intranet method was mentioned by a third of respondents compared with just 7% in 1998. Inclusion in new staff induction packs seems to be on the decline which is surprising. There is little evidence of the use of face-to-face briefing as a means of communication. Among methods of promulgating codes of business ethics internally which received only a few mentions were: noticeboards, CD-roms, calendars and videos.

TABLE 5b

Methods of Internal Publicity of the Code (multiple answers)

	2001	1998
Booklet/circular/staff manual	**38**	64
Included in induction pack	**16**	23
Face to face briefing	**2**	13
Intranet	**33**	7
Through line management	**7**	—
Compliance reviews	**5**	7
Others	**13**	

As pointed out above, there is less reluctance in 2001 to make companies' codes of ethics available to outsiders. 46% of respondents, compared with 33% in 1998, say they publicize their codes externally (see Table 5a). However, Table 5c shows that only 13% say they mention it in their annual reports which is a sharp decline compared with 1998. On the other hand, 25% of respondents post their code on their corporate website, which leads to the assumption that they are widely available. Because of this, companies are to some extent making themselves more vulnerable to comparisons of theory and practice as far as behavior is concerned.

TABLE 5c

External Publicity of the Code

	2001	1998
Annual Report	**13%**	47%
Given to stakeholders	—	32%
Dedicated report	**5%**	16%
Posted on website	**26%**	5%
Briefing to analyst/journalist	**0**	5%
Other	**15%**	—

Questions are often asked about the use of codes in overseas locations. Generally a code issued by the Board with the endorsements of the Chairman and for the Chief Executive Officer is applicable throughout the company irrespective of where the business operates. A question was asked for the first time about the translation of codes for use outside the English-speaking world. Table 6 sets out the answers.

TABLE 6

If You Have Locations Overseas, Do You Translate Your Code for Local Use?

Yes	43%
No	37%
Not applicable	20%

Assuming that the "no" response implies that no translation of the code is undertaken by 37% of companies with non-English speaking staff in the UK or elsewhere, the response indicates that embedding of the code as part of the ethos or culture of the company is not taken very seriously by a significant number of larger businesses.

BUSINESS ETHICS TRAINING

The number of companies with codes who offer training on business ethics has fallen slightly compared with 1998 and remains stubbornly below 50% (Table 7).

TABLE 7

Do You Offer Training to Members of Staff on the Meaning and Use of Your Code?

	2001	**1998**
Yes	**41%**	46%
No	**59%**	54%

Table 7a sets out the principal methods of training provided by companies. They divide into three: 60% refer to staff seminars and 64% to inclusion in house manuals and guides (though how these are used is not clear). Thirdly, the use of the intranet for this type of training is mentioned by more than half of the respondents; in 1998 it was classified within the 20% of "other" methods used.

TABLE 7a

What Form Does the Training Take? (multiple answers)

	2001	**1998**
In-house training seminars	**60%**	50%
Intranet	**56%**	*
External training	**0%**	2%
Videos/games etc.	**16%**	30%
Staff manuals or guides	**64%**	30%
Other (*included Intranet in 1998)	**20%**	20%

IMPLEMENTATION OF THE CODE

Apart from the promulgation of the code to all businesses and individuals and the provision of training in relation to it, the main ways to make the code "live" involve reactions of staff to its contents and the use of it made by them.

Table 8 sets out responses in the last three surveys on the ways (if any) that are available to employees to raise questions concerning their own or others' conformity to, and interpretation of, their company code.

TABLE 8

Is There a Procedure to Raise Questions About the Code?

	2001	**1998**	**1995**
Yes	**74%**	70%	66%
No	**26%**	30%	34%

Provision of means for issues to be raised has now become a necessary part of any corporate ethics program. It is particularly important in the prevention of what has become

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known as whistleblowing. Staff are usually driven to make public any behavior which they consider to be harmful, illegal or unethical when there are no adequate procedures in an organization for raising such matters and having them addressed. The law now protects those who do go public on a matter but only if they have failed to get the issue taken seriously within the organization in which they work. The strongest deterrent to "speaking out" is the fear of reprisal. It is therefore interesting to note that in 2001, 91% of respondent companies say they protect the identity of the person raising concerns. This compares with 80% in 1998.

Another indication of how seriously a company takes its ethics program is whether conformity to the code is included in the employees' contracts of employment. Table 9 sets out results of a question on this matter.

TABLE 9

Is Conformity to Your Code Included in the Contract of Employment Used by Your Corporation?

	2001	**1998**	**1995**
Yes	**53%**	42%	46%
No	**47%**	58%	54%

A majority of companies now include conformity to the code in contracts but there is still doubt about this among many respondents. This is partly because it implies that nonconformity would be grounds for dismissal. Clearly this would be the case for any deliberate and clear breaches. But ethical decisions based on conformity to a clause in a code—say, accepting a substantial gift from a supplier—are necessarily a matter of judgment and the reluctance of lawyers to agree to its inclusion in a contract of employment can be understood. Nevertheless, if a board of directors is serious about paying more than lip service to business ethics, a sure way of signalling this is to include it in a contract of employment and making it part of all induction training.

The extent to which codes are taken seriously can also be gauged from their use in corporate disciplinary procedures. It will be seen from Table 10 that it is becoming more common.

TABLE 10

Has Your Code Been Used in Disciplinary Procedures in Your Company?

	2001	**1998**	**1995**
Yes	**38%**	33%	32%
No	**62%**	67%	68%

38% compared with 33% in 1998 say that the code has been used to enforce the need to conform to standards of business conduct. As reputation risk is seen to be of growing importance, especially among companies with retail brands, anything which is seen to

endanger the brand reputation will not be tolerated. This includes unethical conduct. It is likely then, that in future there will be a growth in the inclusion of conformity to a code in contracts of employment.

Some boards of directors have felt that there is not enough information about the way their organizations are seen to behave by those with whom they do business (their stakeholders). Others feel they may be vulnerable to accusations of unethical behavior and need to have assessments of where the weaknesses lie and what can be done to strengthen them. A question was asked about the use of ethical/social audits. The results are set out in Table 11.

TABLE 11

Have You Had, or Considered Having, an Ethical/Social Audit of Your Company Carried Out?

	2001	1998
Have had an ethical/social audit carried out	**15%**	5%
Have considered an audit	**35%**	21%
Not interested in such an audit (or no answer)	**50%**	74%

The answers indicate a growing interest in this type of survey. Its value is that it provides a firm starting base on which to make a policy effective. As long as it includes questions to staff at different levels about their perceptions of the organization's behavior to their customers and other stakeholders as well as themselves, it will provide the ingredients for an ethics policy, including the provision and implementation of a code of business ethics.

As audits of this kind frequently form the basis for an external report for stakeholders, the growth in auditing also reflects a greater interest in using the company's commitment to ethics and social responsibility as part of overall communications.

CODE REVISION

One of the most important ways of keeping a company code of ethics effective is to have a process for its regular review and revision. A question asking if a process was in place to undertake this produced a somewhat surprising result as shown in Table 12.

TABLE 12

Have You a Process for Revision of Your Code?

	2001	1998	1995
Yes	**77%**	86%	76%
No	**23%**	14%	24%

It is not clear why there has been a drop in the number of companies having such a process. It could be because 30% of respondents have had a code for less than three years (see Table 3).

For those companies which do have a process, a question was asked about how it was done. Table 13 sets out the responses.

TABLE 13

How Was the Code Review Process Mainly Undertaken?

	2001	1998
Annual review by board	**17%**	40%
Decision of chairman/chief executive	**30%**	25%
Survey of staff	**11%**	11%
Consultation with stakeholders	**15%**	9%
Other	**27%**	15%

While it seems that an annual review by the board is less popular, CEOs are taking more initiative and stakeholders are being included by more companies in the review process, which is likely to be at a less frequent interval than yearly.

CURRENT BUSINESS ETHICS ISSUES

Respondents were asked about what ethical issues have been of recent concern to their companies. Most responded with more than one issue (see Table 14).

TABLE 14

Which Ethical Issues Have Recently Been of Concern to Your Organization? (multiple answers)

	Cited by
Supply chain issues/sourcing	38%
Bribery and corruption	32%
Remuneration of senior staff or board	30%
Work/life balance issues	28%
Product safety	25%
Other	18%
No answer	18%

Media attention in recent years on issues such as use of child labor, health and safety issues and other human rights matters in the organizations overseas where goods are sourced has raised important issues for importing companies. Some reputations have been severely tarnished when it was reported that companies had not taken into account these matters in their purchase and supply policies. It is not surprising, therefore, that this heads the list of current concerns. Bribery and board remuneration issues have continued to cause concern but work/life balance (better: work/home balance!) is a recent issue to appear in a list of corporate concerns.

MANAGING ETHICS AND LEGAL COMPLIANCE

What Works and What Hurts

—Linda Klebe Trevino, Gary R. Weaver, David G. Gibson and Barbara Ley Toffler

Some ethics programs work and others do not. What are the differences between the two groups?

A survey of employees at six large American companies asked the question: "What works and what hurts in corporate ethics/compliance management?" The study found that a values-based cultural approach to ethics/compliance management works best. Critical ingredients of this approach include leaders' commitment to ethics, fair treatment of employees, rewards for ethical conduct, concern for external stakeholders and consistency between policies and actions. What hurts effectiveness most are an ethics/compliance program that employees believe exists only to protect top management from blame and an ethical culture that focuses on unquestioning obedience to authority and employee self-interest. The results of effective ethics/compliance management are impressive. They include reduced unethical/illegal behavior in the organization, increased awareness of ethical issues, more ethical advice seeking within the firms, greater willingness to deliver bad news or report ethical/legal violations to management, better decision making because of the ethics/compliance program and increased employee commitment.

Ten years ago, a Business Roundtable report titled *Corporate Ethics: A Prime Business Asset* suggested that "there are no precise ways to measure the end results of the widespread and intensive efforts to develop effective corporate ethics programs. Despite this difficulty in measuring their accomplishments, corporate ethics and legal compliance programs have become even more widespread over the last decade. Companies are investing millions of dollars on ethics and compliance management. A recent survey of Fortune 1000 firms found that 98% of responding firms address ethics or conduct issues in formal documents. Of those firms, 78% have a separate code of ethics, and most distribute these policies widely

"Managing Ethics and Legal Compliance: What Works and What Hurts," by Linda Klebe Trevino, Gary R. Weaver, David G. Gibson, and Barbara Ley Toffler. Reprinted from *California Management Review* (Winter 1999), with permission of the University of California, Walter A. Haas School of Business.

within the organization. Many employees also receive ethics training and have access to a telephone line for reporting problems or seeking advice. Much of this activity has been attributed to the 1991 U.S. Sentencing Commission's Guidelines for organizational defendants. The Guidelines prescribe more lenient sentences and fines to companies that have taken measures to prevent employee misconduct.

What do these ethics and legal compliance programs actually accomplish? A firm's approach to ethics and legal compliance management has an enormous impact on employees' attitudes and behaviors. In this study, we found that specific characteristics of the formal ethics or compliance program matter less than broader perceptions of the program's orientation toward values and ethical aspirations. What helps the most are consistency between policies and actions as well as dimensions of the organization's ethical culture such as ethical leadership, fair treatment of employees and open discussion of ethics in the organization. On the other hand, what hurts the most is an ethical culture that emphasizes self-interest and unquestioning obedience to authority, and the perception that the ethics or compliance program exists only to protect top management from blame.

In order to investigate what works and what hurts in ethics and compliance management, we administered a survey to over 10,000 randomly selected employees at all levels in six large American companies from a variety of industries. The companies varied in their ethics/compliance program approaches. Because we were relying on employees' perceptions, we had to be concerned about socially desirable responses—having employees tell us what they thought we wanted to hear rather than the truth. We took a number of steps to guard against such biased responding. Surveys were completely anonymous, they were sent to employees' homes and they were returned directly to the researchers for analysis.

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WHAT INFLUENCES ETHICS/COMPLIANCE PROGRAM EFFECTIVENESS?

There are several key organizational and program design factors that are associated with ethics/compliance management effectiveness. . . .

1. Program Orientation

Ethics/compliance programs can be designed with very different goals and orientations. Previous research has referred to two types of approaches, a compliance-based approach and an integrity or values-based approach. According to [L. S.] Paine ["Managing for Organizational Integrity," *Harvard Business Review,* March/April 1994, pp. 106–17], a compliance approach focuses primarily on preventing, detecting and punishing violations of the law, while a values-based approach aims to define organizational values and encourage employee commitment to ethical aspirations. She asserts that the values-based approach should be more effective than a compliance-based approach because a values-based approach is rooted in personal self-governance and is more likely to motivate employees to behave in accordance with shared values. She argues that compliance approaches can be counterproductive because they emphasize avoiding punishment instead of self-governance.

They define ethics in terms of legal compliance rather than ethical aspirations, and they implicitly endorse a "code of moral mediocrity."

A recent study of Fortune 1000 firms was conducted in part to determine the orientations of their ethics/compliance management efforts. The survey found that the compliance and values-based approaches are not mutually exclusive. Rather, most firms' approaches to ethics/compliance management combine these orientations in some way. Nevertheless, the compliance approach predominated over the values-based approach in over half of the firms. The U.S. Sentencing Guidelines (implemented in late 1991) contribute to the development of compliance approaches because fines and sanctions for companies convicted of crimes vary dramatically depending upon management's cooperation and whether the firm has a legal compliance program in place.

Given that a compliance-based approach predominates in most firms, our study needed to test the contention that a values-based approach is "better" (achieves more positive outcomes) than a compliance-based approach. Also, many companies hope to maintain or improve their public image and relationships with external stakeholders by adopting an ethics/compliance program. Therefore, we identified an orientation toward satisfying external stakeholders (customers, the community, suppliers) as a third approach in our study. Alternatively, employees sometimes suspect that an ethics/compliance program is introduced in part to protect top management from blame for ethical failures or legal problems. In fact, Paine associated this suspicion with a compliance-based program, suggesting that skeptical employees may see a compliance-oriented program as "nothing more than liability insurance for senior management." Another of Badaracco and Webb's interviewees put it this way: "I'm cynical. To me, corporate codes of conduct exist to cover the potential problems companies may have. It provides deniability. It gives the employers an excuse. . . . The top officers can say, 'These employees messed up. They violated our way of doing business' " [L. Badaracco and A. P. Webb, "Business Ethics: A View from the Trenches," Winter 1995, pp. 8–28]. Therefore, we also assessed the impact of a "protect top management from blame" orientation.

2. A Values Orientation Is the Most Effective Single Orientation

Across the six firms in this study, employees perceived the presence of each of the four orientations (compliance-based, values-based, external stakeholder and protect top management) to varying degrees, and all of them were important in influencing outcomes. However, it is clearly most important to have a program that employees perceive to be values-based. In these six companies, if employees perceived a values-based program, each of the seven outcomes studied was significantly more positive and the relationships were quite strong. Unethical/illegal behavior was lower, awareness of ethical/legal issues was higher, and employees were more likely to look for advice within the firm, to be willing to deliver bad news to management, and to report ethical violations. They also were more committed to the organization and more likely to believe that decision making was better because of the ethics/compliance program.

3. Compliance and External Orientations Are Also Helpful

Outcomes were also more positive if employees perceived a compliance or an external stakeholder orientation. Contrary to Paine's argument, if employees perceived a compliance-based program, all of the outcomes were significantly more positive. How-

ever, the relationships were not as strong as with the values orientation. If employees perceived an external stakeholder orientation, once again the same outcomes were significantly more positive. However, the relationships were even weaker than those for compliance orientation.

4. Combining These Orientations May Be Effective

The data also supported the idea that these orientations are not mutually exclusive. For example, values orientation is highly correlated with compliance orientation (correlation = .60) and with external stakeholder orientation (correlation = .53). So, it is clearly possible to design a program that combines these different orientations, while also emphasizing a values-based approach. A values orientation can be backed up with accountability systems and discipline for violators. Values can include a concern for customers, suppliers and the community as well as shareholders and internal stakeholders such as employees. The ideal mix of orientations likely depends on specific organizational circumstances, such as the organization's culture, product and industry.

5. "Protect Top Management" Is Clearly a Harmful Approach

Not surprisingly, where employees perceived that the ethics/compliance program was oriented toward protecting top management from blame, all of the important outcomes were significantly more negative. These relationships were particularly strong and negative for commitment to the organization, for the perception that it's okay to deliver bad news to management and that employees would report ethical/legal violations to management. In addition, unethical/illegal behavior was higher, employees were less aware of ethical issues and they were less likely to seek advice about ethical concerns. Furthermore, they did not believe that decision making was better because of the ethics/compliance program.

SUMMARY OF PROGRAM ORIENTATION FINDINGS

A key finding of this study is the importance of designing an ethics program that is perceived by employees to be first and foremost about shared organizational values and about guiding employees to act on their ethical aspirations. Such programs motivate employees to be aware of ethical or legal issues, report bad news to management, report ethical or legal violations and refrain from engaging in unethical or illegal conduct. In addition, unethical/illegal behavior is reduced, employee commitment is higher and employees believe that decision making in the organization is better because of the ethics program.

This values-based approach can be supplemented with an orientation toward legal compliance and satisfying external stakeholders. Valuing external stakeholders such as customers and the community has a positive impact on all outcomes, as does holding employees accountable for their behavior through monitoring and disciplinary systems. Discipline for rule violators serves an important symbolic role in organizations—it reinforces standards, upholds the value of conformity to shared norms, and maintains the perception that the organization is a just place where wrongdoers are held accountable for their actions.

Finally, a program must avoid conveying the message to employees that it exists to protect top management from blame. Having a program that is perceived in this way by

employees may be worse than having no program at all. Recall Paine's proposal that employees were likely to associate a compliance approach with this "protect top management from blame" orientation. Our data did not support this contention. There was little association between employees' perceptions of the program as compliance-oriented and their perceptions of the program as being oriented toward protecting top management from blame. However, this protect-top-management orientation was even less likely to be associated with a program that employees perceived to be values-based. Perhaps the most important message to executives is that this protect-top-management perception is real. Employees judge top management's motives in implementing an ethics/compliance program. Also, it is important that they perceive it to be a sincere attempt to have all employees do what's right rather than just an attempt to create legal "cover" for executives in case of a legal mishap.

FORMAL AND INFORMAL ETHICS/COMPLIANCE PROGRAM CHARACTERISTICS

With regard to specific ethics/compliance program and organizational characteristics, we asked employees about formal characteristics including the official policies, procedures, offices and supporting structures (e.g., telephone hotline). We also asked for employees' perceptions of the more informal ways ethics and compliance concerns are handled every day (e.g., how well the company "follows through" on its policies).

FORMAL PROGRAM CHARACTERISTICS ARE RELATIVELY UNIMPORTANT

All six companies in the study had the "basics" of a comprehensive ethics/compliance program: an ethics/compliance office and officer, a formal code of conduct and a telephone hotline. Despite the existence of these formal program characteristics, employees may be more or less aware of them and more or less likely to use them. Therefore, we asked employees how familiar they were with the code's contents and how frequently they referred to the code for guidance. Interestingly, these factors had little impact on the outcomes, especially unethical conduct. It simply did not matter much whether employees were familiar with or referred frequently to the company's code of conduct. We also asked employees whether their company has a formal mechanism for raising ethical and legal compliance issues and concerns and whether ethics is a formal part of performance evaluation in the company. Both of these program characteristics are dynamic, requiring some kind of ongoing attention from the organization; whereas a code can be drafted, distributed and forgotten. To the extent that employees perceived the company to have a formal mechanism for raising concerns and to make ethics a formal part of performance appraisal, all of the outcomes were significantly more positive.

PROGRAM FOLLOW-THROUGH IS ESSENTIAL

With regard to program follow-through, we asked employees whether the company works hard to detect violators, whether the company follows up on ethical concerns raised by employees and whether there is consistency between ethics/compliance policies and actual or-

ganizational practices. Follow-through tells employees that a focus on ethics and legal compliance represents a sincere commitment on the part of management.

The more that employees in our study perceived the organization to be following through, the more positive were all of the outcomes. Further, employees' perceptions of follow-through were much more important than their perceptions of the formal characteristics. Employees' perception that the company's actions are consistent with its policies were particularly important. Employees need to perceive that policies are not just "window dressing" and that the company follows words with actions. Therefore, an approach that goes beyond the mere establishment of formal programs is necessary if employees are to be convinced that the organization really means what it says.

ETHICAL CULTURE IN THE ORGANIZATION

Managing ethics in organizations is not just about managing formal ethics/compliance programs. Researchers have suggested that the broader ethical context in an organization—referred to as the ethical climate or culture—is particularly important, perhaps more important than specific ethics/compliance program goals or characteristics. The elements of ethical culture that guide employee thought and action include leadership, reward systems, perceived fairness, ethics as a topic of conversation in the organization, employee authority structures and an organizational focus that communicates care for employees and the community.

EXECUTIVE AND SUPERVISORY LEADERSHIP

A decade ago, the Business Roundtable report *Corporate Ethics: A Prime Business Asset* referred to the crucial role of top management. "To achieve results, the Chief Executive Officer and those around the CEO need to be openly and strongly committed to ethical conduct, and give constant leadership in tending and renewing the values of the organization."

We were interested in the role of executive leadership because executives play a crucial role in creating, maintaining and changing ethical culture. We also wanted to investigate the role of supervisory leadership. Leaders at every level serve as role models, and employees have more daily contact with their supervisors than they do with executive leaders. Supervisors are responsible for rewards and punishments and they carry the message of how things are really done in the organization. Therefore, in separate sets of questions we asked employees for their perceptions of executive and supervisory ethical leadership.

Perceptions of these two groups were highly related (correlation = .78), suggesting that employees don't think differently about supervisors and executive leaders with regard to their attention to ethics and legal compliance. Essentially, if executive leaders value and pay attention to ethics, so do supervisory leaders.

Leadership was a key ethical culture factor—one of the most important factors in the study. Where employees perceived that supervisors and executives regularly pay attention to ethics, take ethics seriously and care about ethics and values as much as the bottom line, all of the outcomes were significantly more positive. Employees paint all leaders with the same broad ethical brush. When it comes to ethics, leaders are leaders, and the level (supervisory or executive) doesn't seem to matter much to employees.

FAIR TREATMENT OF EMPLOYEES

We also explored a less obvious aspect of ethical culture—employees' perceptions of general fair treatment in the organization. Why should general fair treatment of employees be related to ethics-related outcomes? First, the word *ethics* can mean different things to different people or groups. Kent Druyvesteyn, former ethics officer at General Dynamics, said that when managers say "ethics," employees hear "fairness." To most employees, ethics means how the organization treats them and their coworkers. This helps to explain why so many calls to ethics hotlines concern human resources issues of fair treatment in hiring, layoffs, performance appraisals and promotions. Also, recent research has highlighted the importance of fair treatment for ethics-related outcomes such as employee theft. When employees feel that they are treated unfairly, they may try to "balance the scales of justice" by engaging in unethical behaviors such as stealing from the organization. Some companies have acknowledged this connection between fair treatment and ethics management. For example, we know of a company that sees the elimination of executive dining rooms and other perks as important to making their ethics programs work. Employees see that rules apply to everyone because every employee, up to the CEO, has to have expense reports signed. "That sends a good message [to employees]. . . . Nobody is above the rules and code of conduct. . . . A high level person could get dismissed if they violated [a rule] as much as another person." Another company pegged executive pay to employee pay because of similar concerns about the implications of fair and consistent employee treatment for ethics management.

It is important to note that the survey questions concerning fair treatment had nothing to do with the ethics/compliance program. Rather, they were general questions that asked whether employees think of the company as fair in terms of rewards and punishments (do employees get the rewards and punishments they deserve), whether employees are treated fairly in general and whether supervisors treat employees with courtesy, dignity and respect. Employees' perception of fair treatment was strongly related to all outcomes and was one of the most important factors in the study. It had the strongest correlation with employee commitment and with the perception that it's acceptable to deliver bad news to management.

Companies demonstrate their good ethics to employees primarily through fair treatment. If a company passes the "fair treatment test," employees are more likely to be open to ethics and legal compliance initiatives and to cooperate in making them successful.

ETHICS IN DISCUSSIONS AND DECISIONS

We also asked employees whether people in the company talk openly about ethics and values and whether ethics and values are integrated into decisions. One of the ways ethics and values get "baked into" the corporate culture is to make these sorts of discussions the norm. Our previous experience with one company provides an example of how this should not be done. An oil company employee asked if he could bring an ethical problem to a meeting of divisional presidents. Their immediate response was, "If he wants to talk ethics, let him talk to a priest or a psychiatrist. The office is no place for it." Imagine what employees would think of a formal ethics/compliance program in such an environment.

In our study, perceptions that ethics is talked about and integrated into decision making were important for all outcomes. Open discussion of ethics and values in the company was particularly important for employee commitment, the perception that it's acceptable to deliver bad news, the belief that employees would report an ethics violation and that decision making is better because of the ethics/compliance program.

REWARD SYSTEMS THAT SUPPORT ETHICAL CONDUCT

Good managers know that people do what's rewarded and avoid doing what's punished. Therefore, an ethical culture should include a reward system that supports ethical conduct. We asked employees whether ethical behavior is rewarded and unethical behavior is punished in their organizations. Perceptions of both of these dimensions were important for all outcomes. However, employee perceptions that ethical behavior is rewarded were more important than were perceptions that unethical behavior is punished. The belief that ethical behavior is rewarded was particularly important for employees' commitment and their perceptions that it's okay to deliver bad news to management and that employees would be likely to report ethical violations.

UNQUESTIONING OBEDIENCE TO AUTHORITY

An ethical organizational culture must emphasize each individual's accountability and responsibility for his or her own actions and an obligation to question authority when something seems wrong. An unethical culture is more likely to require unquestioning obedience to authority—"Just do as I say and don't ask any questions." In this study, we found that where employees perceived a structure that expects unquestioning obedience to authority, all outcomes were significantly more negative. Most affected were employee commitment to the organization, willingness to report an ethical or legal violation and willingness to deliver bad news to management.

ORGANIZATIONAL FOCUS

Research on ethical climate has found that employees' perceptions of the organization's focus are associated with both unethical behavior and employee commitment. In this study, we considered three types of focus: employee focus (where employees perceive an organizational focus on what's best for them and their coworkers); community focus (where employees perceive an organizational focus on what's best for customers and the public); and self-interest focus (where employees perceive that everyone in the organization is simply out for himself or herself).

Where employees perceived the organization to be focused on what's best for employees (employee focus) or for customers and the public (community focus), all of the outcomes were significantly more positive. However, where employees perceived that people in the organization were mostly out for themselves (self-interest focus), all outcomes were significantly more negative.

SUMMARY OF ETHICAL CULTURE FINDINGS

As a set, the ethical culture factors emerged as the most important influential factors. Of these factors, leadership, fairness perceptions, the perception that ethics is discussed in the organization and the perception that ethical behavior is rewarded were the most significant factors in the study. As to "what hurts" in ethics/compliance management, two culture factors were quite harmful. Outcomes were more negative where employees perceived an expectation of unquestioning obedience to authority, and where they perceived a focus on self-interest rather than concern for employees and/or the community.

WHAT WORKS AND WHAT HURTS IN ETHICS/COMPLIANCE MANAGEMENT: PRESCRIPTIONS FOR ACTION

What should firms be doing if they want to achieve the most positive outcomes from their ethics/compliance management efforts? What should they avoid doing?

1. Tap the Trenches—Employee Perceptions Matter

Badaracco and Webb recently presented "a view from the trenches" in a report that summarized the results of in-depth interviews with recent graduates of the Harvard MBA program. These young managers reported pressures to be unethical, insufficient help from formal ethics programs and executives who were "out-of-touch" on ethical issues. The authors recommended in-depth interviews with lower-level employees to learn more about employee perceptions. While few companies have the resources to conduct in-depth interviews with a large number of employees, they can conduct surveys and focus groups to learn what their employees are thinking. Employees can tell a company a great deal about what's going on in its trenches. Our survey suggests that they are willing to report both the positive and the negative, such as the extent to which they perceive strong ethical leadership, employee fair treatment and consistency between words and actions, or the extent to which they perceive a focus on self-interest and unquestioning obedience to authority. Obviously, asking these questions may make ethical issues more salient to employees. Therefore, asking the questions assumes that you want to know the answers and that you are willing to take corrective action.

2. Build a Solid Ethical Culture

The ethics officer in a Fortune 500 company once stated, "I have a hard time when people [ask] me, 'Tell me about your company's ethics plan.' I want to tell them about everything we do. Because in my mind, everything we do is part of it." This quote demonstrates that ethics/compliance management is first and foremost a cultural phenomenon. As noted, ethical culture factors were among the most powerful factors in this study. It is not enough to have formal policies and programs. To achieve desired outcomes, concerns for ethics and legal compliance must be baked into the culture of the organization. Therefore, attention to the ethical culture should come first in any corporate ethics/compliance effort. Executive leaders and supervisors must regularly show they care about ethics and shared values (including demonstrating that values are as important as the bottom line), and they must show

that they care through words and consistent actions. Consider employees' reactions when the CEO of a major bank who preached responsible use of corporate resources sent a corporate plane to California to pick up a pair of shoes for his wife. This CEO didn't understand that his actions spoke louder than his words.

3. Create a Values-Based Program That Incorporates Accountability and Care for Stakeholders

When it comes to creating a formal ethics/compliance program, managers need not choose between values-based and compliance-based approaches. Rather, these approaches are complementary. They are further complemented by an approach that is concerned about external stakeholders. However, to be most effective, formal efforts to manage ethics and legal compliance should be oriented primarily toward values. A values approach can include valuing customers and the community, as well as employee accountability for ethical conduct.

4. Focus on Formal Program Follow-Through

Some companies approach ethics/compliance management with the idea that all they need to do is check off the U.S. Sentencing Commission's seven requirements for due diligence by appointing an ethics officer, writing and distributing a formal code of conduct, communicating standards via codes and training programs and setting up hotlines and investigative procedures. The results of this study suggest that simply putting formal staff, structures and procedures into place does little to influence important outcomes. More important were employees' perceptions that the company follows through on its formal codes, policies and procedures by working hard to detect violators and by following up on ethical concerns raised by employees. Most important was the perception that actual practice is consistent with formal policies. Again, actions speak louder than words.

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CONCLUSION

Contrary to the Business Roundtable's decade old statement, our study found that there are ways to measure the end results of corporate ethics and compliance programs. There are a number of important outcomes that can be measured reliably via employee surveys and that can be linked to key program and organizational influences.

A values-based cultural approach to ethics/compliance management works best. This approach requires the sincere commitment of leadership at all levels, including ongoing attention to key issues such as fair treatment of employees, rewards for ethical conduct, concern for external stakeholders and consistency between words and actions. The ethics/compliance program itself should be values-based, motivating employees to aspire to ethical conduct, encouraging them to question authority when ethics are at stake and holding them accountable for rule violations. The results of such an approach are impressive. They produce highly committed employees who are aware of ethics and compliance issues, who seek advice within the organization and who are willing to deliver bad news to their managers or report ethical/legal violations. Results also include less unethical/illegal behavior in the organization and better decision making because of the organization's ethics/compliance efforts.

CORPORATE CODES OF CONDUCT

—International Labour Organization, Bureau for Workers' Activities

Corporate codes of conduct have no globally accepted definition. The concept usually refers to companies' policy statements that define ethical standards for their conduct; however, there is great variance in the ways these statements are drafted. The following document prepared by the International Labour Organization offers an in-depth discussion of the origins of corporate codes of conduct, their various formats, transparency, monitoring and enforcement.

BACKGROUND

Defense Industry Scandals

Worldwide interest in corporate conduct was initially awakened in the 1980s by scandals in the defense industry and on Wall Street. Companies viewed business ethics as a way of promoting self-regulation and deterring government intervention and regulatory action. Corporate interest quickly led to the "institutionalization" of business ethics programs, consisting largely of codes of conduct, ethics officers and ethics training. (See, KPMG, *The Age of Ethics.* KPMG is the abbreviation for the names of the founding members: Klynveld, Peat, Marwick, Goerdeler. KPMG is a business services firm operating in 155 countries.)

Among the first companies to establish codes of conduct were General Electric, General Dynamics, Martin Marietta (now Lockheed Martin), and other defense contractors. These companies had all experienced procurement scandals (although General Dynamics and Martin Marietta were not formally charged with wrongdoing). Now, the defense sector actively polices itself. In 1986, 17 contractors signed the Defense Industry Initiative on Business Ethics and Conduct, which declares that each of the companies will review its ethical practices annually.

Naturally, corporate codes of conduct existed prior to the movement of the 1980s. For example, Johnson & Johnson's *Credo* was published in 1943. As early as 1935, General Robert Wood Johnson urged his fellow industrialists to embrace what he termed "a new industrial philosophy." Johnson defined this as the corporation's responsibility to customers, employees, the community and stockholders. According to Johnson & Johnson, the corporation has drawn heavily on the strength of the *Credo* for guidance through the years—at no time was this more evident than during the Tylenol® crises of 1982 and 1986, when the

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company's product was adulterated with cyanide and used as a murder weapon. (Johnson & Johnson's home page: http://www.j&j.com.)

Following the pricing scandals that rocked the defense industry in the 1980s, General Electric became a prime example of an American corporation in need of an image overhaul. In response, the company created a corporate ombudsman's office, originally for the purpose of examining its government defense contracts. The company also drew up a summary of in-house rules on ethical concerns, called "Integrity: The Spirit & the Letter of Our Commitment," which is 80 pages long and is available in most languages that are spoken in the General Electric worldwide network, including Arabic and Urdu. In early 1993, the office started a network of toll-free help lines for each business unit in the United States. Employees can call the hot lines anonymously to ask questions about the guidelines and to report suspected violations.

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Consumer Power

While the long arm of the law is a factor in business decision making, sometimes the arm of ethics is longer still. Consumer power is increasingly being wielded to affect company behavior. The boycott mechanism has long been a means for political protest; for many years, a significant number of consumers avoided buying South African products. Recently, however, boycotts have been called to protest against the actions of specific companies. Nestlé's sales suffered from the boycott protesting about its policy on selling baby formula in the third world, and Shell was forced to change its plans for disposal of the Brent Spar oil platform when German consumers stopped buying Shell petrol. A 1995 poll of 30,000 consumers in the UK showed that one in three had boycotted stores or products in the past because of concerns about ethical standards, and 6 in 10 were prepared to boycott in the future. Almost two in three of those surveyed were more concerned about ethical issues now than five years ago. (See, International Society for Business, Economics and Ethics, *How Ethical Auditing Can Help Companies Compete More Effectively at an International Level?*)

Pressure groups are growing more professional and more vociferous. While in the past, unethical behavior by a company might have been kept quiet through skilled public relations, there is now a greater likelihood that employees from within a company will alert relevant pressure groups, as loyalty to employers has lessened while concern for the public good has grown. It is also more likely now than in the past that the pressure group will be successful in generating significant publicity about the incident. (International Society for Business, Economics and Ethics, *How Ethical Auditing Can Help Companies Compete More Effectively at an International Level?*)

In response to consumer pressure, a whole sector of ethical corporations has arisen in recent years. Some companies have made principled withdrawals from countries where they could otherwise manufacture profitably—this was the course taken by Levi Strauss in China. Levi Strauss has adopted a strong "good guy" image, because of its refusal to use subcontractors that exploit workers in developing countries. Protest from outraged consumers may force companies manufacturing in India or Thailand to sack the underage children they were previously employing. Codes prohibiting child labor have been introduced, especially among apparel manufacturers, merchandisers and retailers. (See the apparel company codes in the list of company codes.)

Globalization

Consciousness of the growing interdependence of all people on the earth—globalization—calls for more uniform treatment of people and their environment in every corner of the world. Globalization is one factor that has pushed multinationals to initiate uniform standards of conduct in all countries in which they operate. It may have seemed acceptable decades ago for Shell to apply lower environmental standards to its drilling in Ogoniland than those applied in Europe or North America, but in an era of acute consciousness of the interdependence of the world ecosystem, the same standards are rightly expected on every continent.

In 1986, Frederik Philips (former President of Philips Electronics) and Olivier Giscard d'Estaing (Vice-Chairman of INSEAD) founded the Caux Round Table of business leaders from Europe, Japan and the United States. Caux is committed to energizing the role of business and industry as a vital force for innovative global change. At the urging of Ryuzaburo Kaku, Chairman of Canon Inc., the Round Table has focused attention on the importance of global corporate responsibility in reducing social and economic threats to world peace and stability. Caux Round Table Principles for Business were drafted by a committee composed of Japanese, European and U.S. business representatives, and include a relatively long section on workers' rights.

NUMBER OF CODES

Although, a number of surveys have been carried out on corporate codes of conduct, it is difficult to estimate how common they actually are. Certainly, codes are very common among those companies that respond to surveys, but the rate of response tends to be low. For example, only 264 companies out of 1,900 responded to the Conference Board survey in 1991.

However, this survey is important, because it is the only international survey that follows up on the results of a previous survey, conducted in 1987. By and large, the participants were the same companies that had participated in the earlier survey, from the United States (186 companies), Canada (34 companies) and Europe (40 companies). Most of the companies surveyed were large, with median annual sales of the participants at $1 billion.

In 1991, 82% of the responding companies had codes of conduct. As was the case in 1987, companies in the financial sector were less likely to have codes (57%). Nearly half of the codes discussed or submitted by survey respondents had been enacted since the last study was published (45%). Codes were much more typical of U.S. companies than of European companies. (The Conference Board, *Corporate Ethics Practices,* 1992.)

KPMG surveyed 1,000 Canadian companies in 1996, but only 251 responded. Of these, 83% indicated that they have a published mission statement, and 66% reported having a code of conduct. (See KPMG, *1997 Business Ethics Survey Report.*)

In an International Center for Human Rights and Democratic Development (ICHRDD) survey in 1996, the proportion of Canadian companies that had codes of conduct was much smaller. Only one in five of the 43 Canadian companies that responded reported having adopted a code of conduct for international operations. A total of 98 companies were surveyed. (See, ICHRDD, *Canada's Largest Corporations Lack Codes of Conduct on Treatment of Workers Overseas.*)

FORMATS OF CODES

In the Conference Board survey, the *compliance code* was the most common code type in all regions. Over 90% responded that their company's statement requires particular types of employee or company behavior. Three-fourths of the responding organizations with codes said their statement is a credo that explains the company's accountability to its key constituencies (e.g., employees, customers and suppliers). *Management philosophy declarations* are the least common format—still, more than half of the companies with codes use this type of statement. Canadian firms are more likely to use philosophy declarations than are U.S. or European firms. (The Conference Board, *Corporate Ethics Practices,* 1992.)

Survey responses indicated that most codes are hybrids of more than one type. Of the three types, the compliance code is likely to have been in existence the longest. The median date of adoption for compliance statements is 1985.

The reports of 1987 and 1991 indicate that code drafting is a dynamic process. Nearly two-thirds of the compliance codes were revised between the two surveys.

In the KPMG survey (251 Canadian companies in 1996), 79% of companies with a published code of conduct said that the code is appropriately described as a set of "Guiding Principles," while 32% felt that "Rules and Regulations" was a fitting label.

In a U.S. Department of Labor survey, which focused on child labor in the apparel industry, 33 of 42 companies that provided reportable responses had corporate codes of conduct, statements of principles, or compliance certificates specifically addressing child labor in overseas production. Twelve further respondents did the same through contract requirements contained in purchase orders, letters of credit, or buying agent agreements. Nine respondents used a combination of both types of policy, while six had no policy on overseas child labor. (See United States Labor Department, The Apparel Industry and Codes of Conduct, Chapter E: Development of Apparel Industry Codes of Conduct.)

A comparison of the codes of conduct . . . provides an idea of how differently codes can be formulated. An example of a specific and clear format is Halliburton's code, in which concepts and scope are well defined. Administration of the code is clear and unambiguous, including such issues as allocations of responsibility, delegation of substantial discretionary authority, communication of policies, monitoring and auditing, the reporting system, investigation of violations and disciplinary measures. Under each issue regulated by the code, there are sections regarding the purpose, policy and procedures related to the issue. However, this code seems to be an exception. Most codes are rather brief and general statements, which leave a good deal of room for interpretation and contain no administrative details.

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CONTENT OF CODES

All Issues

The Conference Board questionnaire identified 13 issue areas dealt with in corporate codes. Most codes include some formal statement of the company's fundamental principles. Nine specific issues in codes were named by more than 66 companies. Among these, six relate in some degree to the employee's contract with the company.

Purchasing guidelines and security of proprietary information—issues focused on employee honesty—were the only specific areas of concern cited by over half the code companies. Of the remaining human resource-oriented issues, three acknowledge company commitments to the employee (workplace safety, confidentiality of employee records and employee privacy), and one focuses on employee obligations (intellectual property safeguards). The three remaining major subject areas relate to corporate social accountability—for example in environmental, marketing and product safety responsibility.

There were few regional variations in subject matter. Codes in the United States are more likely to include sections on the security of proprietary information. Workplace safety is a more frequent subject of European ethics statements.

Over the period between the 1987 and 1991 surveys, 20% of the European companies had added environmental responsibility to their codes. Among U.S. companies, the most common addition was fundamental guiding principles of company. Among Canadian companies, the most common additions related to intellectual property and marketing.

Besides fundamental guiding principles, environmental responsibility was the only issue added in over 10% of the codes. (For examples of environmental accountability statements, see the codes of Nestlé and Waste Management.)

The interest in environmental problems has grown in the last ten years especially among chemical companies. Member companies of the Chemical Manufacturers' Association have adopted six codes of management practices under the Responsible Care initiative, which was launched in 1988: Community Awareness and Emergency Response, Pollution Prevention, Process Safety, Distribution, Employee Health and Safety and Product Stewardship.

In the KPMG survey of 251 Canadian companies in 1996, participants were first asked to score for importance seven issue areas in their codes of conduct. The scoring was on a scale of 1 to 4, and the criteria for scoring was [sic] the potential risk to their business posed by the issue area in question. The most important categories identified by the respondents were employee and workplace issues and the handling of company assets.

Next, the companies were asked to rank individual issues as to their associated risk factor. Worker health and safety was the second most important issue in rank.

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TRANSPARENCY OF CODES

Dissemination

According to the Conference Board report, companies were more willing to discuss their codes openly in 1991 than in 1987, when only a handful of respondents returned a copy of their code with a completed questionnaire. In 1991, more than one-third of companies with ethics statements supplied them with the questionnaire.

According to the KPMG survey of 251 Canadian companies in 1996, external distribution of the code was reported by less than 30% of respondents that had codes of conduct.

The ICHRDD survey of 43 Canadian companies in 1996 indicated that Canadian companies are reluctant to speak about their relations with workers abroad. Even companies that report having codes of conduct are reluctant to share them with the public. The study sug-

gests that "Canadian business places a very low priority on communicating its response to issues it confronts in its overseas operations to the non-governmental sector. A large number of firms expressed no . . . interest in the subject."

According to the U.S. Department of Labor survey of 42 U.S. apparel companies in 1996, a few companies made an effort to communicate information on their codes of conduct and monitoring programs to the general public, including their shareholders: Levi Strauss and The Gap have sections on their codes of conduct in their annual reports to shareholders.

Distribution

Within the Company According to the Conference Board report, there is a clear trend in favor of distributing the company's code to all employees. In 1987, nearly two-thirds of the responding code companies gave it to all their employees. Among 1991 survey participants, 77% followed this practice. The figure for Canada (83%) was slightly higher than that in the United States or Europe. Of companies that have codes, 22% limited distribution to top and middle management (down from over one-third in 1987), and just three companies gave the code only to top managers.

Distribution to employees in overseas divisions is common, but not universal—72% of survey participants engaged in this practice. Canadian companies were somewhat less likely to distribute codes in this manner than were U.S. or European companies.

European companies were more likely to modify their documents for use outside the home country (25%) than were U.S. (14%) or Canadian companies (13%). In fact, nearly half of all European companies had branches, subsidiaries or divisions with their own codes (45%). This practice is much less common in U.S. and Canadian firms.

The KPMG survey (251 Canadian companies in 1996) revealed that just over 80% of companies with a published mission statement believed that "the average employee is likely to be aware of it." A lower proportion of those with mission statements (73%) indicated that the mission statement was often referred to in policies and other statements. A published code of ethics, practice or conduct was somewhat less common. Of those who had a published code of conduct, all but 4% indicated that the codes were widely distributed internally.

To Contractor Companies According to the U.S. Department of Labor survey (42 U.S. apparel companies in 1996), only a very few respondents indicated that they have tried to ensure that production workers in overseas facilities know about their code or policy by specifically requiring that copies of such statements be posted. Only three companies stated that they unconditionally require contractors to post their code. The Gap requires that its code, which has been translated into 39 languages, be posted in each contractor facility. Liz Claiborne, which has translated its Standards of Engagement into more than 10 different languages, requires all contractors to post the Standards in the local language in common areas, such as cafeterias or locker rooms, of every facility where Liz Claiborne products are made. Phillips-Van Heusen stated that it insists that every facility post its "PVH Shared Commitment" poster, which contains guidelines and standards on worker's rights. The poster is printed in English and Spanish, and is sent to Asia with instructions for it to be translated into local languages. Nike and Sara Lee stated that their

codes are posted at some facilities. Nike indicated that its code is posted in all its footwear contractors' factories in two or three languages, but this is not necessarily the case for its apparel contractors. Nike stated that its footwear contractors produce exclusively for Nike, while its apparel contractors often produce for many other companies. Nike often uses individual apparel contractors for only a short period of time. Sara Lee indicated that it posts notices of employees' rights at its wholly owned facilities in English and the host language.

Managers of two-thirds (47 out of 70) of surveyed plants that currently export to U.S. apparel companies indicated that they were aware of codes of conduct issued by their U.S. customers. Based on company visits, awareness among managers about codes of conduct was highest in El Salvador (all eight companies visited knew about the codes) and Guatemala (six out of nine companies knew). In three other countries visited—the Dominican Republic, Honduras and the Philippines—managers interviewed were more evenly divided between those who were aware and those who were not. In India, only two out of seven producers visited were aware of the codes of conduct of their U.S. customers. However, only 34 of the 47 companies that indicated they were aware of codes of conduct had available a copy of the code (or contractual provision) that they could show and discuss with the visiting Department of Labor official. Thus, managers at less than half of the plants visited were able to produce a code of conduct upon request.

The plant visits by Department of Labor officials suggest that while posting of a U.S. garment importer's codes of conduct seems to be common practice in El Salvador, it is not the norm in the garment industries of the other countries visited. In all, 21 of the 70 plants visited by the officials had posted a code of conduct of a U.S. customer, and seven of these were in El Salvador (out of eight total plants visited in that country). Elsewhere, two plants visited in the Dominican Republic had codes of conduct posted, one plant in Honduras, two in Guatemala, two in India and seven in the Philippines.

Although a significant number of suppliers knew about the U.S. corporate codes of conduct, meetings with workers and their representatives in the six countries visited suggested that relatively few workers were aware of the existence of codes of conduct, and even fewer understood their implications.

The lack of awareness on the part of workers about codes of conduct may be attributable in part to the relatively low level of effort on the part of producers to inform their workers about the codes. Management regards codes of conduct—and compliance with labor law—as a management problem, and approaches the monitoring and supervision of these matters as management responsibilities. Workers are not seen by management as having a role in these activities.

Managers in 22 of the companies visited told the Department of Labor officials that they informed workers about codes of conduct—13 companies indicating they do so orally, and only 9 stating that they do so both orally and in writing. Of all the plants that were visited in the six countries, there was only one example of a producer that had an explicit policy of informing workers about the code of conduct of its U.S. customer. (For more detailed, company specific, information, see United States Department of Labor, The Apparel Industry and Codes of Conduct, section Transparency.)

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MONITORING OF THE CODES

Just over 40% of the participants in the KPMG survey (251 Canadian companies in 1996) indicated that there was a senior-level manager whose role specifically includes the implementation, monitoring or assurance of the ethics program. Of the 102 companies with such a senior manager, 16 reported that this manager had the title "Compliance Officer," while three indicated that the title of this manager was "Ethics Officer." Most often (in 22 cases), the "Human Resources Manager" was indicated as having this responsibility.

Of the 251 responses, 76 indicated there was a position within the firm that had responsibility for enabling "upstream communication" and equitable resolution of ethics or compliance problems. Of these, 14 reported that this role is a full-time assignment. In companies that reported this type of "ombudsperson" role, almost two-thirds had established the position three or more years prior to the survey.

In 78% of the responding companies, there was no formal policy to protect employees that report ethics violations or non-compliance with the law or with company policies. Of the 54 companies that indicated they did have such a policy, over half said that the policy was supported by a confidential hot-line or similar procedure.

A specific policy on conflicts of interest and specific guidelines in this regard were reported by 58% of all respondents. Of these, three-quarters require a compliance sign-off, and almost half have reviewed or updated the policy within the last year.

Over 60% of the respondents reported that they had never undertaken a comprehensive review of their ethics-related policies and performance. Over half of the companies that have undertaken such a review indicated that it was completed within the year prior to the survey.

According to the U.S. Department of Labor survey (42 United States apparel companies in 1996), eight companies had no monitoring system to implement their codes of conduct. A further 28 companies had developed internal monitoring systems, using local or regional company personnel or employees from United States corporate offices to monitor labor practices. Internal monitoring may be used by companies that are reluctant to grant access to their facilities, procedures and business practices to outside monitors. It is most common among large, vertically integrated companies (i.e., those in which the corporation owns or directly controls all stages of the production process). Internal monitoring is less common for companies, particularly retailers, that do not own or control the factories that make the products they sell. Some retailers internally monitor only those plants producing private-label merchandise, which they import directly. United States retailers and manufacturers who use hundreds or thousands of foreign contractors may find it a logistical or financial hardship to monitor all of the facilities from which they source.

Buying agents were relied on to monitor compliance with corporate codes by 12 companies in the survey. This procedure avoids the financial and logistical burden of monitoring, but also removes the U.S. corporation from the direct line of control in implementing its policy. Only four companies used an outside auditor, and only two an NGO for the monitoring of their codes. (For more detailed, company specific, information, see United States Department of Labor, The Apparel Industry and Codes of Conduct, Implementation of Apparel Industry Codes of Conduct.)

All 70 of the plants exporting garments to the United States that were visited by Department of Labor officials confirmed that they are subject to regular visits by their U.S. customers or their agents to verify product quality and to coordinate production and delivery schedules. About 90% of the companies visited stated that monitors or inspectors verifying product quality generally also examined working conditions in the plant, with emphasis on safety and health issues (climate control, ventilation systems, fire escapes, etc.).

Whether monitoring visits are announced or unannounced differs widely from company to company. In 41 of the companies interviewed (58%), monitoring visits by the U.S. importer, its agent or its representatives were announced in advance. In 13 companies (18%) they were unannounced, while there were both announced and unannounced visits in 16 companies (23%).

While monitoring for product quality and even for health and safety conditions is customary in the garment industry, the field visits by Department of Labor officials suggest that monitoring for compliance with labor-related provisions of the U.S. garment importer's codes of conduct is not. This applies particularly to child labor. Where such monitoring does occur, the degree to which it extends to all labor standards addressed by the codes—as opposed to exclusively safety and health issues—seems to vary widely across suppliers. Foreign suppliers that are wholly owned by a U.S. corporation, or contract directly with a U.S. corporation with a presence abroad, seem to be subject to the most frequent and most thorough monitoring of codes of conduct, including those related to child labor and other labor standards.

Monitoring the implementation of child labor provisions of codes of conduct is very challenging. Generally, the closer the relationship between a U.S. garment importer and the actual producer of the items, the greater the ability of the U.S. company to influence labor practices in the production process, including prohibitions on child labor. Conversely, it is more complex and challenging to implement labor policies in longer chains of procurement and production—in one example drawn from the Philippines, there were five steps between producer and final buyer. With more levels of buying agents, contractors and subcontractors, the U.S. importer has less ability to influence labor practices.

The field visits also revealed numerous instances of contractual monitoring of codes of conduct. Contractual monitoring is most prevalent in the case of U.S. retailers, which do not have a significant presence abroad.

In these situations, the burden of monitoring compliance with the U.S. importer's child labor policies rests with the foreign agent, contractor or subcontractor, typically through a self-certification process. In these instances, the role of the U.S. importer in monitoring compliance of its code of conduct is minimal. In Honduras, Fabena Fashions is required by Macy's and Wal-Mart to sign a contract including a no-child-labor clause. In Tirupur, India, the producer Chenduran Textiles exports about one-half of its output to the United States. Its main U.S. customer is Tropic Textiles of New York City, a supplier to Wal-Mart. Tropic requires Chenduran to certify that no slave or child labor is used in the production of goods through a paragraph in the contract or bill of lading. Tropic accepts Chenduran's self-certification of the clause and does not have any in-country monitoring, education, implementation or enforcement programs. Also in India, Pankaj Enterprises is an exporter of

mid-grade apparel items based in New Delhi that exports to the United States. Pankaj's U.S. buyers require that no child labor be used in the manufacture of garments. Pankaj buys its fabric, and guarantees that no child labor is used in the production of garments through a self-certification process. There is no monitoring by the importer or its agents.

In some instances, U.S. importers use a combination of contractual and active monitoring, using auditors from the importer itself or its agents to verify compliance. In the Philippines, Liz Claiborne has a policy of monitoring and supervising its contractors, which must certify that they are in compliance with the code of conduct. In addition, contractors are subject to frequent visits from Liz Claiborne's Philippines office, which monitors implementation of the code of conduct as well as quality control. Warnaco requires that contractors certify that child labor has not been used, and also audits suppliers in Honduras for full compliance with its child labor policies, including age verification. Macy's, Wal-Mart and The Limited have checked personnel records at Fabena Fashions to verify the age of workers. In India, Zoro Garments supplies 75% of its production to the U.S. market. Zoro's major U.S. customers are Rustic River, Quick Silver, Blue Print and JCPenney, while Phillips-Van Heusen is a former customer. According to Zoro's management, representatives of U.S. customers have visited Zoro's factory occasionally for quality control inspections. Most of these visits were walk-throughs with some general questions raised about the use of child labor, but no checklist of requirements was administered. Phillips-Van Heusen had previously raised the subject of codes of conduct with Zoro's management and asked the company to fill out a questionnaire. When Zoro was producing for Phillips-Van Heusen, there was a clause in its contract related to child labor. Primo Industries in El Salvador, a contractor for Liz Claiborne, Lands' End, Polo and JCPenney, met with Liz Claiborne several years ago to discuss and sign the Liz Claiborne code of conduct. The plant manager told Department of Labor officials that Liz Claiborne is "the toughest on child labor." He also said that American inspectors visit the plant approximately twice a month to check on quality control and see whether their rules and regulations are being implemented.

Based on field visits, it appears that most monitoring conducted by U.S. corporations primarily covers quality control issues. As such, there seems to be relatively little interaction between monitors on the one hand, and workers and the local community on the other. It also appears that monitors have a technical background in production and quality control and are relatively untrained with regard to the implementation of labor standards. (For more detailed, company-specific information, see United States Department of Labor, The Apparel Industry and Codes of Conduct, chapter E: Monitoring.)

ENFORCEMENT OF THE CODES

None of the surveys discussed above dealt with the issue of enforcement of codes internally within the companies themselves, in cases where management or employees of the company may violate the code. A quick overview indicates that most codes do not include any enforcement provisions or are not specific regarding enforcement measures. For example, the Boeing code states simply that "violations of the company standards of conduct are cause for appropriate corrective action including discipline."

However, there are also codes that are specific regarding disciplinary measures. A good example is Halliburton's code, which states that:

1. The Company shall consistently enforce its Code of Business Conduct through appropriate means of discipline. Pursuant to procedures adopted by it, the Executive Committee shall determine whether violations of the Code of Business Conduct have occurred and, if so, shall determine the disciplinary measures to be taken against any employee or agent of the Company who has so violated the Code of Business Conduct.

   The disciplinary measures, which may be invoked at the discretion of the Executive Committee, include, but are not limited to, counseling, oral or written reprimands, warnings, probation or suspension without pay, demotions, reductions in salary, termination of employment and restitution.

   Persons subject to disciplinary measures shall include, in addition to the violator, others involved in the wrongdoing such as (i) persons who fail to use reasonable care to detect a violation, (ii) persons who if requested to divulge information withhold material information regarding a violation and (iii) supervisors who approve or condone the violations or attempt to retaliate against employees or agents for reporting violations or violators.
2. Documentation. Subject to the applicable document retention program, the Company shall document its compliance efforts and results to evidence its commitment to comply with the standards and procedures set forth above.

According to the U.S. Department of Labor survey (42 U.S. apparel companies in 1996), companies that pass the screening process and become contractors of U.S. corporations may face a range of corrective measures should they fall short in complying with the code of conduct.

In Guatemala, although garment contractors and subcontractors were unable to articulate the U.S. companies' policies to address violations of their codes of conduct, they expressed great concern about the possibility of losing their contracts if they were found to have child labor problems. A representative of Phillips-Van Heusen stated that in May 1996, his company had identified three young workers (under 15 years of age) in a plant operated by a subcontractor in San Pedro de Sacatepequez. Upon learning of their presence, Phillips-Van Heusen required the company to dismiss the three young workers immediately.

In the Dominican Republic, many companies stated that U.S. clients had requested changes in the physical conditions of the factories during their visits to the companies. These changes often included requirements for eating facilities, restrooms and more lighting or ventilation. In most cases, changes affecting working conditions were related to safety and health issues. Most of the companies that had contracts with Levi Strauss in the Santiago Zona Franca said that all companies were requested to reinforce, move or rebuild wooden mezzanines—where sewing machines were stationed—as a fire safety precaution.

Undergarment Fashions mentioned that JCPenney, in addition to performing periodic visits to the plant, also had a rating system to evaluate the contractor's performance. Under this rating system, a company must receive at least 50 points in order to maintain its current contract. If the company does not obtain a satisfactory rating, it is put on probation and given a reasonable period of time to make the requested changes.

High Quality Products, located in Zona Franca Los Alcarrizos, a contractor for the Jones Apparel Group, said that Jones Apparel terminated a contract with Bonahan Apparel (in Zona Franca Bonao) because of Bonahan's refusal to recognize the establishment of a union in its plant.

In Honduras, Rothschilds made a number of recommendations regarding clean toilets, lighting, ventilation, drinking water and hours of work for 14- and 15-year-old workers at Global Fashions.

In part because of the priority to improve quality, but also because of a concern about violations of labor standards (and child labor provisions in particular), U.S. garment importers have cut back sharply on subcontracting and also reduced the number of their foreign suppliers. From the point of view of foreign garment producers, the streamlining of suppliers in the U.S. garment industry has resulted in clear winners and losers.

On the one hand, suppliers to the United States market that can meet the considerations of quality and timeliness of product while complying with codes of conduct have been rewarded with continued orders. They have also received additional orders which have been diverted to them from producers that rely on subcontracting schemes.

On the other hand, marginal suppliers—in terms of quality and timeliness of output, physical plant or ability to comply with labor standards—have lost their contracts with United States importers. They have had to resort to sales to other, less profitable markets, including their own domestic market.

Continued access to the U.S. market is a very large incentive for overseas garment producers to meet quality and timeliness requirements and to comply with codes of conduct. Thus, the prospect of continued ability to ship to the United States reinforces compliance with appropriate standards. Foreign countries also have a great deal at stake, as unused import quota allocations translate into the loss of export revenue in the short term and loss of the import quota in the longer term. (For more detailed, company specific, information, see United States Department of Labor, The Apparel Industry and Codes of Conduct, chapter F: Enforcement.)

PROFITABLE ETHICAL PROGRAMS

—Jason Lunday

In response to a previous e-mail to a listserver on teaching business ethics, Jason Lunday identifies some apparently successful ethical business practices from the annals of business history.

. . . Some apparently successful ethical business practices:

(In some cases, the companies claim a very direct bottom-line effect to certain ethical practices. Others claim that their ethical practices contribute to an overall corporate climate which cuts waste, encourages efficiency, promotes community/marketplace goodwill, allowing the company a healthy bottom line.)

1. 3M—through its Pollution Prevention Program (3P), initiated in the mid-1970s, the corporation claims to have decreased its production and emission of air, solid and water pollutants by billions of pounds AND saved the company over $500 million during its first 15 years. It did so by using its expertise in innovation to find new ways of manufacturing which led to fewer pollutants. To qualify for the 3P program, ideas had to meet three of four measures, only one of which was cost savings. [See Alfred Marcus, *Business and Society: Strategy, Ethics and the Global Economy,* Irwin, Chicago, 1996.]

While 3M was considered the first, I understand that a large number of companies have successfully accomplished similar environmental initiatives, reducing pollutants and saving money. Contact the Management Institute for Environment and Business, Washington, DC, for examples.

2. Levi Strauss—with a strong history of employee goodwill, LSCO has worked for numerous years to insure that its employee policies demonstrate respect for workers and their lives. It has consistently paid workers at the top of the industry and granted benefits uncommon among its competitors (like year-round employment). Further, it has encouraged strong employee communication and idea-sharing. It has expected that such treatment would create mutual respect. This apparently came true when a South American operation effectively communicated one of its new product launches to headquarters during a time of overall lagging sales. The idea, Dockers, became the biggest product introduction in U.S. history and reinvigorated the company. [See Jeffrey Edwards and Jason Lunday, *Levi Strauss & Co.: The South Zarzamora Street Plant,* Darden Graduate Business School Case Bibliography.]

There are other stories of how factory employees have taken pay cuts, done without raises, and accepted other risks at certain times because of the company's fair treatment and with an expectation that such a well-managed company will overcome periodic difficulties.

3. South Shore Bank—the company came up with the great idea to help its local community, a depressed area of Chicago, where few could get bank loans. In finding ways to

Jason Lunday, "Profitable Ethical Programs," e-mail, June 18, 1996. Reprinted by permission of the author.

grant credit where other banks would not, South Shore not only helped a community pick itself back up, it increased bank earnings.

[Sorry, don't have a reference handy. South Shore has won Business Ethics Magazine's annual award in recent years, so a past edition of the magazine will overview the company's story.]

4. Johnson & Johnson—need we say more on this one? For a treatment of this, see *Managing Corporate Ethics,* Francis Aguilar, Oxford University Press, New York, 1994.

5. Delta Air Lines—Delta also has a strong history of employee relations, to the extent that, for years, it was the only non-unionized airline. This allowed the carrier flexibility during recessions to move workers around in order to maximize manpower in key areas. It also traditionally allows the airline to have employees perform multiple tasks so that it does not have to hire additional workers. The airline had, for many years, consistently been at the top of the Department of Transportation's lowest complaint list. It generally is still there, occasionally being beat out by Southwest. Employee goodwill because of the company's treatment also helps the company keep a very low employee/seat miles ratio. Some years back, because of exceptional treatment, the employees chipped in and bought the company a passenger jet. Delta has also ended up as one of the country's most admired companies for many years. [Personal unpublished research—if you want article references, just ask. I've got a lot.]

6. Lincoln Electric—arc welding. Company claims that strong employee orientation has allowed it to earn exceptional profits. [See *Managing Corporate Ethics,* Francis Aguilar, Oxford University Press, New York, 1994.]

7. Honda—attention to customer quality allowed it strong entrance into U.S. market. [*Business and Society,* Alfred Marcus, Irwin, Chicago, 1996.]

8. BFI—effort to help New York rid itself of corruption in the trash hauling business gave the company early entry into a lucrative market. [See recent *Fortune* cover story.]

9. Socially responsible companies Body Shop, Ben & Jerry's, Tom's of Maine, etc.: each claims that their orientation to meeting stakeholder needs—in a variety of forms—allowed them to become large players in their respective markets. [See *Body and Soul,* Anita Roddick, *The Soul of a Business,* Tom Chappell, don't know Ben & Jerry's book.]

10. Merck—another company at the very top of Fortune's Most Admired Companies. The company ended up paying millions of dollars to formulate, manufacture and distribute a drug which cures river blindness, which is generally found in poor regions of lesser developed countries. The goodwill alone from this has apparently, like J&J and Tylenol, given it many consumers' trust. Granted, it would be difficult to quantify how much that is worth, but I doubt that Vagelos or the current chairman would deny it has been worth a lot.

11. Sears, Roebuck—when questions arose about possible inappropriate sales practices of product warranties, which, by the way, were making BIG money for the retailer, they retrained their associates to ensure that the warranties were not being pushed on customers or otherwise sold unethically. Expecting a drop in warranty sales, they instead were hit with a sizeable increase. [See *Ethikos* back issue, can't remember the date. Also, personal consulting experience with them.]

Business ethics books are generally filled with cases of companies which have gotten into trouble. We don't see enough of the good stories since, I suppose, we simply expect this. However, the positive examples can go a long way in encouraging prosocial behavior, which, like deterrence theory, is another aspect of business ethics.

CORPORATE CODES AND ETHICS PROGRAMS

—MICHAEL C. DECK

In the following selection, Michael Deck explains research conducted to gather and to analyze 200 codes of conduct. The researcher found that while many firms have codes, they are not always communicated to stakeholders, nor are they always adhered to. Consider whether any firm you have worked for has had a code and whether you felt it was completely integrated into the decision-making functions of the firm.

STAKEHOLDER THEORY

Our research program has examined more than 70 Canadian corporations over the last 10 years. As we studied the data, it became clear that the managers of successful companies no longer regard shareholders as the sole and necessarily most important stakeholders in the corporation. The concept of shareholders endowed with a right to the maximization of profits is being replaced by the concept of stakeholders, of which shareholders comprise only one group. The shareholder is no longer the preeminent stakeholder, to be rewarded at the expense of other stakeholders. . . .

What this research shows is that when management or the board of a company favor one group of stakeholders at the expense of other primary stakeholder groups, difficulties always develop. When shareholders are favored unfairly, when maximizing the bottom line takes full priority, customers or employees or suppliers invariably will be shortchanged. . . .

MANAGING ETHICS IN THE WORKPLACE

If we agree that values, ethics and moral principles are essential to sound decision making, how does a manager go about managing that aspect of the organization?

In looking for an answer to that question, we thought it would make sense to begin looking for the values, ethics and moral principles of an organization in its Code of Ethics. Beginning three years ago, our Centre undertook to gather and to analyze 200 corporate codes. We learned that while corporations do indeed have values, ethics and moral principles, these are not always communicated in a code of ethics and may in fact be quite different from what the code might lead one to believe.

Michael C. Deck, "Corporate Codes and Ethics Programs," www.kpmg.ca/ethics/eth_clks.htm First presented at "Business Practices under NAFTA: Developing Common Standards for Global Business," University of Colorado–Denver, December 8–10, 1994. Reprinted by permission of the author.

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While it would be ingenuous to think that ethical behavior within an organization can be changed simply by posting a list of high sounding principles, it is equally naive to imagine that the ethics of an organization "just happens and there's nothing to be done about it."

Every organization, as Steven Brenner points out, has an ethics program, whether it knows it or not.[1] The ethics program is that set of factors both explicit and implicit which communicate corporate values, define parameters of decision making and establish the ground rules for behavior. This is similar to what Robert Jackall has described as "institutional logic." An effective ethics program encourages behavior consistent with corporate principles.

Explicit elements of a corporate ethics program include the things which an organization says it believes in, and the efforts made to communicate those principles directly. The centerpiece of the explicit components is the corporate code. In order to evaluate the effectiveness of a corporate code, the purpose of the code must be considered. Corporate codes can serve a variety of purposes: from "image enhancing" to "due diligence defense," from guidance for employees who want to "do the right thing" to helping an employee resist pressure from a superior. The corporate code and its implementation can raise issues of ethics to a conscious level and legitimate discussion.[2]

Our research on about 200 corporate codes revealed some interesting details about their nature and purpose.[3] Using the Stakeholder Model, we sorted out the statements made in these codes according to which stakeholder's interests were being addressed. One observation is that most of the text in these codes is concerned with the duty and responsibility of the employee to the company. Put more strongly, it seems that the most common purpose of a corporate code is to protect the firm from its employees. This is borne out by the observation that the most frequently cited "reason why" for ethical behavior is that violations will hurt the company. The problem with this approach is that if the possibility of getting caught (and incurring the penalty) is apparently small, then the reason for ethical behavior evaporates. . . .

The analysis of these codes also looked at the "approach" used for each statement, categorizing each as Guiding Principle, Act & Disclose, Seek Advice or Rule. These categories lie along a scale which we describe as "Source of Control."

. . . This analysis [made it] clear that there were really three basic types of codes, differentiated by the source of control.

The terms "*Code of Ethics,*" "*Code of Conduct*" and "*Code of Practice*" are often used interchangeably. It is useful, however, to distinguish among these terms in order to establish a basic typology. Each basic code type has a different intent and purpose.

Codes of Ethics are statements of values and principles which define the purpose of the company. These codes seek to clarify the ethics of the corporation and to define its responsibilities to different groups of stakeholders as well as defining the responsibilities of its employees. These codes are expressed in terms of credos or guiding principles. Such a code says: "This is who we are and this is what we stand for," with the word "we" including the company and all its employees, whose behavior and actions are expected to conform to the ethics and principles stated in the code.

Codes of Practice are interpretations and illustrations of corporate values and principles, and they are addressed to the employee as individual decision maker. In effect they

say: "This is how we do things around here." Such a code seeks to shape the expression of the corporation's stated values through the practices of its employees. Codes of practice tend to rely on guidelines for decision making, using such rules of thumb as "act and disclose" or "seek advice." This approach takes a view of ethics as "what we do because it is our character."

Codes of Conduct are statements of rules: "This is what one must (or must not) do," as distinct from the code of ethics, which is stating: "This is how we expect one to behave." Codes of Conduct typically are comprised of a list of rules, stated either affirmatively or as prohibitions. Penalties for transgressions may be identified and systems of compliance and appeal defined. Potential conflicts of interest are often described, with appropriate rules for guidance. This approach takes a view of ethics as what is not to be done (or seen not to be done) in view of the consequences.

In practice, corporate codes tend to include elements of all three types, but for analytical purposes it is helpful to consider these three basic types as benchmarks. Each of the three types is useful and each can be appropriate or necessary in particular business and organizational settings. For example, in a divisionalized corporation, it would be appropriate to draft a Code of Ethics in order to enunciate the company's overall purpose and the guiding principles and ethics that govern its actions and behavior. At the divisional and functional area levels, different and divisionalized Codes of Conduct and Practice are appropriate, so long as the rules, examples and guidelines are not in conflict with the statement of the corporation's guiding principles and ethics. . . .

HAVE ETHICS PROGRAMS FAILED?

It is interesting to note at this point that recent research has found no significant correlation between corporations having a code of ethics and a reduction in ethical violations.[4] Is the problem that the code was badly written? Probably not. Is there a problem with implementation? A more likely suspect, since, of the 90% of companies that have codes, only 28% do any training. There is, however, another factor which, I would suggest, accounts for these findings. I referred earlier to the implicit components of an ethics program. It may well be that the failure of the explicit components to produce results is the result of their having to fight an uphill battle against the implicit components.

If the goal is to produce behavior which is in line with the explicit values, principles and ethics of the organization, then congruency between the explicit and implicit components of the ethics program is essential.

To evaluate the potential effectiveness of an ethics program we propose several criteria which can be applied to the explicit components, beginning with the published code of ethics/practice/conduct. Assuming that the corporate code is satisfactory, the next step is to evaluate implementation efforts. Ultimately, the success and effectiveness of the program will depend on the next step, which is an honest and objective audit of the "implicit" components.

One danger of using a phrase such as "ethics program" is that it might suggest a requirement for a large scale, disruptive and expensive process. Just the opposite is true. As I said at the beginning of this section, every corporation already has an ethics program. What

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is proposed here is a framework for looking at the effectiveness of what is already in place and for identifying what, if any, aspects need strengthening or modification. The ethical ground rules, values and practices of an organization develop incrementally over time and will require time to change.

NOTES

1. Brenner, S. N., "Ethics Programs and Their Dimensions," *Journal of Business Ethics,* Vol. 11: 391, 399, 1992.
2. Metzger, M., D. R. Dalton, and J. W. Hill, "The Organization of Ethics and the Ethics of Organizations: The Case for Expanded Organizational Ethics Audits," *Business Ethics Quarterly,* Vol. 3, Issue 1, 1993, pp. 27–43.
3. The details of this research are expanded in M. B. E. Clarkson and M. C. Deck, "Applying the Stakeholder Management Model to the Analysis and Evaluation of Corporate Codes," in *Business and Society in a Changing World Order,* pp. 55–76 (Best Papers volume of the 1992 Conference of the International Association for Business and Society), Dean C. Ludwig, Editor. Edwin Mellen Press, New York. 1993.
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DO CODES OF CONDUCT DELIVER THE GOODS?

—MAUREEN QUIGLEY

Mission statements are constantly and consistently developed by firms, though there is only some conclusive evidence of their impact. Maureen Quigley asks the questions that many corporations therefore would like answered!

Companies adopt a range of ways and means to tackle ethical problems found within their supply chains, such as abuse of safety standards in factories in developing countries. Each approach has inherent strengths and pitfalls, yet each represents a step in a process of improving conditions. Companies most commonly start by adopting codes of conduct and internal monitoring systems. But are such steps enough? Experiences of the Pentland Group suggest that companies facing the difficult and complex demands of ethical trading will need more than formulaic codes or monitoring.

A code can be an essential first step. It defines key principles and aspirations, and companies can often use their purchasing power to urge suppliers' compliance with it. Yet such leverage is limited in scope because:

- It hinges on a buyer committed to taking a large percentage of a supplier's production.
- It offers no advantage to smaller companies that lack significant purchasing power.
- It could be used unfairly to discriminate against small to medium-sized enterprises.
- It is piecemeal, tackling issues on factory-by-factory basis rather than addressing larger root causes.
- It may be used cosmetically to guard corporate reputations rather than improve conditions.

A second, more progressive phase is where a company implements a code of conduct, either by imposing it on suppliers or by more collaborative means, then works to integrate the principals of the code into its own supply chain management and other management systems. The blending together of principals and actions is essential to sustainable ethical trading.

Nonetheless, the roots of the problems and dilemmas found in manufacturing are too complex to be sorted out on a factory-by-factory basis. Tackling problems found in worker health and safety involves looking at external forces and conditions, such as the capacity of

"Do Codes of Conduct Deliver the Goods?" by Maureen Quigley. Reprinted by permission of *Insights* and of the author.

civic institutions to regulate, enforce and provide essential services to businesses and workers. The route to lasting improvement is to overcome contextual barriers, inefficiencies and inequalities commonly associated with underdevelopment, that impede sustainable change. Companies that seek to be a positive force for change need to take a developmental approach that is characterized by (although not limited to):

- Local ownership of issues.
- Collaborative relationships with suppliers.
- Multi-sectoral partnerships.
- Capacity building of institutions.

These values define a long-term strategy that fuses integrated management systems with partnership development. Traces of this method have been found traditionally within extractive industries. However, it is an option and an opportunity for companies of varying size and in all sectors. Strategic partnerships enable small companies to overcome vast resource requirements of a developmental approach by complementing partners' expertise and material contributions. Partnerships cannot be limited to suppliers and workers, but must include competitors, local and foreign governmental institutions and NGOs if they are to build a comprehensive strategy for change.

Debate within ethical trading circles remains steeped in issues of how best to monitor and to evaluate company codes. As more companies develop codes, it is clear that codes represent only part of a process. Given the vast effort expended on monitoring, one must question whether resources might be better applied to treating the root causes of problems rather than to monitoring symptoms. Advocates for ethical trading must be aware of the risk of failing to see the forest for the trees. The challenge for corporations, nongovernmental organizations, unions and governments is to develop viable, collaborative programs to root out the causes of human rights abuses and unsatisfactory working conditions.

HOFFMAN-LAROCHE CASE

A Sentencing Guidelines Milestone

—Jeffrey M. Kaplan

When the corporate sentencing guidelines went into effect in November 1991, prosecutors, compliance officers and others noted that fines under the new law could reach as high as $290 million or even greater. After the Daiwa Bank *prosecution in 1996—which resulted in a $340 million criminal fine—punishment beyond the $290 million figure was no longer just a theoretical possibility. Later that year, a Delaware court, in the* Caremark *decision, raised the prospect of individual liability for a fine under the corporate sentencing guidelines, by permitting shareholders to sue directors personally for losses arising from failure to ensure that their company had put in place "an effective program to prevent and detect violations of law," which is the guidelines' articulation of a meaningful compliance program.*

Now, another sentencing guidelines milestone has been reached. In May 1999, F. Hoffman-LaRoche, Ltd.—a large Swiss pharmaceutical company—was convicted of an antitrust conspiracy and fined $500 million. This is the largest criminal fine in the history of American law.

According to documents filed in court and other accounts, Hoffman-LaRoche, BASF AG (a German firm) and Rhone Poulenc SA (of France), engaged in a conspiracy from 1990 to 1999 to control the price and sales volume of a wide range of vitamins used as nutritional supplements or to enrich human food and animal feeds (including vitamins A, B2, B5, C, E and beta carotene). The conspiracy involved annual meetings to plan production, divide the market and fix prices, with follow-up sessions to enforce compliance. One member of the cartel referred to it as "Vitamins, Inc."

U.S. Assistant Attorney General for Antitrust, Joel Klein, said that "[t]his conspiracy has affected more than $5 billion of commerce in products found in every American household." According to some estimates, prices of vitamins were pushed up by 15–40%.

In addition to the record fine against Hoffman-LaRoche, BASF AG will pay a fine of $225 million, which is also one of the largest financial penalties ever imposed in a criminal case. Rhone Poulenc, on the other hand, was not prosecuted at all. Because it brought evidence of the conspiracy to the government's attention, it was a beneficiary of the Antitrust

Jeffrey M. Kaplan, "Hoffman-LaRoche Case: A Sentencing Guidelines Milestone," *Ethikos and Corporate Conduct Quarterly* 13, no. 1 (July/August 1999), pp. 1–11. Reprinted with permission of *Ethikos and Corporate Conduct Quarterly.*

Division's amnesty program. According to Gary Spratling, Deputy Assistant Attorney General, Rhone Poulenc's cooperation "led directly to the charges and the decision of the defendants" to plead guilty.

The fines will likely not be the only costs to the companies for their offenses. They also face class action lawsuits from businesses that bought vitamins. Hoffman-LaRoche and BASF have announced that they will attempt to settle the cases, but doing so may be costly in light of the admission of liability. Additionally, Karel Van Miert, the EU Competition Commissioner, declared after the U.S. prosecutions were announced, "This kind of cartel needs to be fined very heavily. It needs to be punished." Indeed, authorities in Canada, Europe and Australia have begun their own investigations into the matter.

In addition, the former head of Roche's global marketing division, Dr. Kumo Sommer, was charged with participating in the conspiracy and with lying to government investigators. He agreed to plead guilty, serve four months in prison, and pay a $100,000 fine. (The extent of *individual* financial liability under the sentencing guidelines is often underappreciated. In one recent antitrust case, an executive was fined $10 million.)

Hoffman-LaRoche is clearly an important prosecution. But looking beyond the headlines, what are the implications of this case for those engaged in business ethics and compliance work?

LESSON 1: THE NEED FOR STRONG ANTITRUST COMPLIANCE

Many of the largest fines under the corporate sentencing guidelines have involved antitrust violations. In addition to the penalties against Hoffman-LaRoche and BASF, at least three other companies have been fined $100 million or more in the past few years. Indeed, there are apparently about 35 federal grand juries investigating price-fixing in a variety of industries. The number of *state* investigations is harder to ascertain but could also be large, given the increasing emphasis on antitrust enforcement at the state level (as evidenced, among other ways, by the participation of many state attorneys general in the *Microsoft* case).

Despite this, many companies—particularly those that are moving from purely regulated into more entrepreneurial endeavors—have not adopted meaningful antitrust compliance measures. The risk of such inaction is great, given that the Antitrust Division has been on record for several years in setting forth the types of steps it expects to see in compliance programs. These include, according to Deputy Assistant Attorney General Spratling, "both regular and unannounced audits of price changes, discount practices and bid sheets, conducted by those familiar with the firm's past and present business practices and trained in recognizing questionable divergence, [and] [b]oth regular (scheduled) and unannounced audits of front-line pricing and bidding personnel to test their level of understanding of the antitrust laws and their degree of compliance with a program's requirements and standards relating to prevention and detection, backed up by disciplinary mechanisms and potential penalties for failures."

Spratling has also emphasized that "the elements of a compliance program, particularly the audit elements, should be 'customized'—that is, designed and targeted to the firm's specific organization, operation, personnel and business practices."

In the face of this clear guidance and the dramatically escalating penalties for non-compliance, any company's failure to take meaningful antitrust compliance measures will likely be inexplicable to the government, shareholders and others.

LESSON 2: THE VALUE OF SELF-REPORTING

The importance of *timely* self-reporting could not be more starkly apparent than from the results of the vitamin price-fixing conspiracy. Two firms—Hoffman-LaRoche and BASF—will pay fines totaling $725 million. Yet the third conspirator—Rhone Poulenc—avoided prosecution altogether, because it was the first to report the crime to the government.

While the value of such cooperation may be most dramatically evident in the antitrust area (given the amnesty program), the same general principle applies to virtually every other risk area as well. Indeed, the *Daiwa Bank* case, involving a $340 million fine under the corporate sentencing guidelines, was premised largely on the defendant's *late* reporting of a crime by one of its employees.

Yet self-reporting requires more than good intentions (or, in the case of some companies, a formal self-reporting policy). Unless companies have the means to *uncover* internal wrongdoing it is unlikely that they will receive the type of early warning that is often the key to prompt self-reporting. For this and other reasons, compliance auditing—emphasized in Spratling's recommendations—should not be limited to the antitrust area.

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LESSON 5: THE WORST IS LIKELY YET TO COME

Assistant Attorney General Klein announced that with the Hoffman-LaRoche and BASF pleas, the Antitrust Division had "already secured more than $900 million in criminal fines in this fiscal year," which, he said, is "more than three times our previous annual record; in fact, more than the total amount of fines in the entire history of U.S. antitrust enforcement."

But records are clearly made to be broken, and it is likely that some prosecutors are already looking for a way to top the $500 million mark. Indeed, as great as the penalties were against Hoffman-LaRoche, they actually could have been worse. Spratling noted that the sentencing guidelines would have permitted a fine of as high as $1.3 billion.

Which company will make history with the first *billion* dollar fine? It will likely be one whose executives fail to heed the lessons of *Hoffman-LaRoche.*

SO THEN WHY DID YOU DO IT?

—John Dunkelberg and Debra Ragin Jessup

What causes unethical behavior and what can we learn from those individuals who have had spectacular ethical lapses? The profiles of several prominent individuals, including Dennis Levine and Charles Keating, are examined in the following article to try to provide some insight into what might lead them down the slippery slope to criminal and unethical behavior. What was found was that all those examined certainly knew they were breaking the law and that most went to extraordinary lengths to cover up what they were doing. Additionally, the authors found that each individual had attained a position of authority that enabled them to break the law without being seriously challenged by others who knew, or suspected, what was being done. Each person was highly compensated for their efforts; yet they chose to engage in unethical and illegal activities in the pursuit of lust, a little more money or power.

A recent study examined the background and environment of 129 individuals who either pled guilty or were found guilty of a crime that generated an article in *The Wall Street Journal* between January 1, 1990, and December 31, 1997. No general pattern emerged from that paper of the variables studied that could explain their criminal activity. The current paper, however, will delve into a deeper examination of some of these individuals in an attempt to see what lessons can be learned from their stories. They range from a man with very little education who became the CEO of a large defense contractor to a couple of attorneys with a privileged upbringing who worked for the most prestigious law firms in Chicago. What led these people down the slippery slope to criminal activity and what penalties did they pay? More importantly, what can we learn from their mistakes?

The individuals presented in this paper include: Dennis Levine who pled guilty to four felony charges of insider trading, Charles Keating who was found guilty of 73 counts of racketeering and fraud involving Lincoln Savings and Loan, Robert Fomon who was the CEO of E. F. Hutton during its rise as a lending brokerage firm and subsequent demise caused by unethical leadership . . . and Robert Citron who pled guilty to six felony counts of securities fraud involving the loss of $1.64 billion in Orange County funds. . . .

John Dunkelberg and Debra Ragin Jessup, "So Then Why Did You Do It?" Copyright 2001 Kluwer Academic Publishers. Reprinted with permission from *Journal of Business Ethics,* 29: 51–63 (2001).

DENNIS LEVINE—INSIDER TRADING

Dennis Levine was born and raised as the youngest of three brothers, in a Jewish middle class area of Queens. His father sold aluminum and vinyl siding to support his family and Dennis admired his work ethic. Dennis, however, aspired to a higher standard of living. From an early age, he wanted to be a Wall Street player and he seemed dazzled by expensive clothes, cars and large estates. He was not, however, willing to work hard to achieve his goals and did not excel as a student or as an athlete in high school. He went on to graduate from Baruch College with an undistinguished record. He obtained a job with Citicorp and, after not getting a promotion, moved to Smith Barney. Within a year, he was sent to Paris and soon set up a Swiss bank account. To Dennis the Swiss bank account meant that he was "playing like the big boys now." On his return to the New York office he talked his way into the mergers and acquisition department. Within his team he was noted for his dismal math skills and an inflated view of his skills and contributions, but he was part of a group that worked on the details of mergers before they were known to the public.

Dennis saw the price of stocks moving up before mergers were announced and was convinced that everybody was getting rich on insider information but him. During his Citicorp days, Dennis had met and become friends with Robert Wilkis. Wilkis had an excellent education, Harvard, then Stanford Business school, and who spoke five languages fluently. Within a week of his move to Smith Barney, Dennis had called Wilkis with a stock tip and Wilkis purchased a couple of hundred shares. The stock rose dramatically and the beginning of a partnership that would end in jail sentences, large fines and public humiliation was formed. Dennis and Wilkis agreed to trade only on the other's information, never share tips with anyone else, and to use code names when calling the other partner. The knowledge and monetary benefits gained from one "friend" proved insufficient to satisfy Dennis Levine's dreams and he soon recruited a ring of associates. As a group they worked for almost all of the major firms engaged in the merger and acquisition practice during a time when this business was very lucrative. They traded information gathered as part of their confidential work with these firms. Using this information, Dennis Levine's trading profits grew to over $11.6 million in less than five years. He even had an arrangement with Ivan Boesky in which Levine would be paid a percentage of any "profits" Boesky made with the "tips" he received from Levine. The revelation of this insider trading ring would make national headlines and shake the faith of the financial system as it had been rarely shaken before.

After his arrest, Dennis agreed to cooperate with the government, implicating all the people with whom he had traded information, even placing calls that were recorded by the government investigators to those with whom he had conspired. In pleading guilty, he agreed to pay restitution to the Securities Exchange Commission of the $11.6 million in alleged trading profits. He was allowed to keep his Park Avenue co-op, his personal effects, including a BMW and personal savings, but lost all of his real estate investments, retirement account, Drexel shares and his beloved Ferrari Testarossa (with only 3,847 miles on it). He was sentenced to two years in prison. The night before going to prison, he tried to explain to his five-year old son why he would be away for the next couple of years. He said that there are rules for big people just like there are rules for children and that he had broken those rules and now must pay. His son listened and then said, "Daddy, did one know

what one were doing was wrong?" Dennis answered, "Yes." His son then replied: "So then, why did you do it?"

Dennis had indeed known the rules. He had used cash to fly to Geneva, and later to a bank in the Bahamas, where he set up secret bank accounts under coded names. He used code names in dealing with his co-conspirators, photocopied secret documents and agreed to a formula providing cash payments for his tips to Ivan Boesky. On one occasion, he even stole his father's passport and photocopied it for a trip to Nassau. He knew he was to blame for his own actions but he had a huge desire for fast, easy money. "Money became the way you gauged your level of success, compared to those about you," and the more money the better. "When I was an associate, I wanted to be a Vice-President, when I was a VP, I wanted to be a Senior VP, and when I was a Senior VP, I wanted to be a managing director." On another occasion Dennis noted that when "I was earning $20,000, I wanted $100,000; when I was making $100,000, I wanted $200,000; when I was making $200,000, I wanted $1 million, and then $3 million." There was never any satisfaction.

Insider trading reached its peak in the late 1980s. The scandal brought national attention to such infamous names as Mike Milken, who paid a fine of over $1 billion and spent time in jail, and Martin Revson, of Revlon fortune fame, who traded tips with a group of his well-known socialite friends known as the Southhampton Seven. Why were these men, and dozens of others, willing to trade their good reputations for the small additional marginal utility of a little more money? Maybe because they did not think that if they broke the rules sooner or later they would have to answer the question, "So then why did you do it?"

CHARLES KEATING—SAVINGS AND LOAN SCANDAL

Charlie Keating was raised in very modest conditions. His father, who had managed a local dairy, became disabled when Charlie was seven by Parkinson's disease. He received a Jesuit school education and was known as an excellent student. However, he flunked out of the University of Cincinnati and then enlisted in the Navy as a fighter pilot but he never saw combat. After World War II, he went back to college, received a liberal arts degree, and won gold medals in the NCAA and Pan American Games in the breaststroke. After college he earned a law degree and later started working for Carl Lindner, Jr., a well-known multimillionaire in Cincinnati. During this time, he built a national reputation for his hatred of pornography and in one year flew over 200,000 miles around the country giving talks on the subject. He kept lots of pornography around just to show people how bad it was. Interestingly, at least twelve of his secretaries had breast enlargements, allegedly because Charlie loved to walk around and look down their blouses.

In 1976, Charlie Keating and Carl Lindner parted company. Charlie moved to Phoenix, Arizona, and took over American Continental Corporation (ACC), a home building business with assets of half a million and liabilities of over $110 million. By 1983 the firm was in the black and building over eight homes a day. During this turn-around, Charlie hired all employees and almost all the men were white, tall and blue-eyed. The women were blond, good-looking and buxom. He fired people easily and often but paid those that he kept excellent wages. The offices of ACC were all white, the carpeting, walls and even the desks, and the desktops were always utterly clear of any material.

In September of 1983, Keating bought Lincoln Savings and Loan for $54 million, although its net worth was $34 million. Lincoln had $1.2 billion in assets of which $250 million were judged to be "risky ventures." By 1984, assets had grown to $2.5 billion and the risky ventures had grown to $1.6 billion. Much of the growth in assets had come from brokered loans. (Brokered loans are those sold by brokers who obtain the highest yield possible from the competing financial institutions for these FDIC-insured deposits. Thus the U.S. Government became the insurer of these very risky loans.) Ultimately these brokered loans would total about $5 billion of Lincoln's assets.

With this money, Charlie went on a spending spree. He built or refurbished hotels in Detroit and Phoenix, spending hundreds of millions of dollars on the finest décor. A residential real estate scheme in the desert outside of Phoenix included plans for thousands of homes, a PGA-caliber golf course and a huge clubhouse. Over $100 million of these federally insured deposits went in Ivan Boesky's investment schemes and hundreds of millions into Mike Milken's junk bonds. There were over 52 large real estate deals that never had a credit check and the real estate appraisals were grossly inflated. Files on these loans would be brought "up-to-date" months after the loan was made and corrected to existing regulations.

Charlie Keating gave generously, of money from ACC, to charitable groups. He was proud of his Catholic faith and gave millions to Mother Teresa, in India, and Father Bruce Ritter, in New York. To live in style, Keating had a $2 million home in Phoenix, a $5 million home in Florida, and a fabled retreat in the Bahamas. The care and feeding of his pilots and aircraft was over $35 million. Parties for his staff were first class with one Christmas party costing over $460,000. Since he saw himself as a business tycoon, he spent like one with one meal for four at Le Cirque in Manhattan costing over $2,495 and a single stop to buy a few sports jackets and slacks at Giorgio's on Rodeo Drive totaling $7,694. He and his family flew often and all over the world. In addition, he kept the regulators at bay by giving large sums to political campaigns including five senators (John Glenn, John McCain, Dan Riegle, Dennis DeConcini and Alan Cranston) all later known as the Keating Five. With all the money flowing to others, Charlie also paid himself and his top staff extremely well. He and his family were paid $34 million over five years. In 1987, he had over $5 million in income, but no personal donations to charity.

With spending like this the end was, of course, in sight. ACC used very creative accounting to show a profit and thus kept Charlie Keating going. With over 54 subsidiaries, ACC would buy properties from one subsidiary and sell to another and book the profit. Upstreaming is another example of the schemes used to keep this giant cash machine going. In this scheme, Lincoln would loan money to an individual who would use the money to purchase an asset. The asset would be sold at a higher price and the profits were booked. Since these two transactions were linked, the buyer is a straw buyer, not a real buyer, and this makes the deal a felony. However, with the spending out of control, even schemes of this type could not keep ACC viable.

In September of 1989, ACC declared bankruptcy. The corporation showed $6 billion in assets, but a couple billion was missing. The next day the U.S. Government took over Lincoln Savings and Loan. The case was the largest bank fraud case ever. Lincoln was charged with using straw buyers, sham land sales, inside stock deals, upstreaming of money

and fraudulent loans. Charlie Keating was charged with 73 counts of fraud but he claimed he was innocent. Instead he became the poster boy for all that went wrong with the S&L failures in the late 1980s. He was tried, found guilty and sentenced to 10 years in prison and required to pay a fine of $250,000. The judge in this case described Charlie Keating's treatment of Lincoln as "an adult taking candy from a helpless child." Judge Sorkin also wondered how the accountants and the law firms involved with ACC and Lincoln could not have seen the problems. At the time of sentencing Keating was sixty-six years old.

Why did a man who publicly made so much of love of his family and his Catholic religion, his hatred of pornography and drugs, use fraudulent techniques to enrich himself, his family and his friends? His motivation seemed not to be the money but the power and acceptance that money brings. He was earning his way into a club that he coveted, the Boesky, Milken, Lindner club. As a swimmer he had been driven to win because he liked the applause. As the CEO of a company it was the power and seduction and control of people and events.

ROBERT FOMON—CHAIRMAN OF THE BOARD OF E. F. HUTTON

Wall Street probably has never occupied so prominent a place in the public's consciousness as it did during the 1980s. A great bull market was in progress and many individuals were amassing fortunes buying and selling, both stocks and corporations. The news media made several of these individuals virtual heroes and extolled their financial and business acumen. Unfortunately too many of these heroes later turned out to be frauds who made money through unlawful manipulations. Others skirted just inside the law but employed dubious ethical tactics to accumulate wealth during this time. When money comes so easily to so many, few are willing to stop and critically examine how the money is being made. As a result, several corporations became spectacular failures during this time but all these failures were preventable. E. F. Hutton was but one of these firms and its demise is worth examining (Stevens, 1989 and Sterngold, 1990).

E. F. Hutton started in 1904, on April Fool's Day, and grew into a brokerage powerhouse using such famous marketing lines as: "I'm J. Paul Getty and E. F. Hutton is my broker," and "When E. F. Hutton talks, people listen." In the 1970s and the first six years of the 1980s, Hutton was led by Robert Fomon a short, paunchy man who was adept at manipulating images and people. Bob Fomon's early life was one of little joy and less love. His mother died of cancer when he was four. His father, a physician, had very little desire to have the responsibility of raising children, so he sent his three sons to be raised by his wife's spinster sister. He visited his sons no more than twice a year, at Christmas and during his summer vacation. Bob Fomon was a prankster throughout his school years and was thrown out of a Catholic high school and then a public high school just before graduation. He went to the University of Southern California and graduated, with a very undistinguished record, in 1947 with a fine arts degree. After a brief fling in law school he dropped out and tried to determine what he should do with his life.

Through his fathers' connections, Fomon had met many people from the moneyed side of society and he liked the life they led. He saw the stock brokerage business as one that

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could be quite lucrative. After being rejected by Merrill Lynch and Dean Witter, a friend of his father helped him get a job with E. F. Hutton. Although he demonstrated little in the way of investment acumen, he had a remarkable knack of selling himself to the country club set and they eagerly handed him their business. After building a power base in California, he rose to be the CEO of Hutton through a mixture of charm and double-cross. The charm included a mixture of hard drinking with other brokers in his office and tales of his prowess as a seducer of women.

During his tenure as CEO, E. F. Hutton grew through the raiding of top brokers from other firms and the purchase of other brokerage firms to become one of the nation's most well regarded brokerage houses. Although in an industry that preferred to maintain a rather staid image, Bob Fomon retained his notorious personal behavior of hard drinking and womanizing. When he was in his fifties, he was dating young women in their late teens and early twenties. He also contributed to this rakish behavior with scandalous public statements. For example, he once was quoted describing women as objects of decoration, better seen than heard. Interestingly, his second marriage was to Sharon Kay Ritchie, a former Miss America. Although Hutton did little business in Paris, Fomon had Hutton open an office there, which was overseen by girlfriends from California. Another girlfriend, a young lady in her twenties, was given the job as head of advertising although she had no training of any kind in this field. He also had Hutton pick up the hotel tab for guests at his daughter's wedding and his son charged over $100,000 in expenses in just one year.

Encouraged by E. F. Hutton's culture and to maintain the profit growth, the firm started several questionable practices that would later not only be embarrassing but lead to its ultimate demise. One of these practices was the selling of products, such as tax shelters, that were notable more for the high commissions generated for Hutton brokers than the tax benefits generated for their customers. To help secure public finance business (selling tax-exempt bonds) in various states, Hutton entertained some state officials at brothels. Several brokerage units found money laundering to be profitable business and, in one case, a customer regularly paid for his security purchases with a gym bag full of small bills. To obtain the lucrative commissions from selling bonds, Hutton underwrote some "junk" bonds with the par value guaranteed, thus if the bonds' ratings slipped, Hutton could, and did, lose millions of dollars. Hutton also entered into the risky second mortgage business charging up to eighteen percent interest, plus up-front fees that pushed the rates closer to forty percent. All of these practices paled before the grand scheme that gained Hutton much unneeded notoriety—check kiting.

By 1980, E. F. Hutton was looking for new ways to make profits; and many of its brokerage units across the United States wrote large checks against uncollected balances to create a float for Hutton and inflate its bank balances. Hutton engaged in an illegal practice known as "pinwheeling." A pinwheel occurred when multiple checks were passed from one Hutton account to another to earn interest on the float. This is a felonious action and Hutton's accountants, Arthur Andersen, had warned management about it. Playing the float was too lucrative a practice to be stopped and became Hutton's most profitable product, earning $95.9 million in one year. The end, however, was in sight.

In 1985 Hutton pled guilty to over 2,000 felony counts of defrauding its banks of several million dollars, and customers started fleeing the company in large numbers. Several of the tax shelters defaulted, the junk bonds were down-rated and Hutton had to buy them

back at par value, costing the firm additional millions. The Providence, Rhode Island, office was charged with laundering money for organized-crime figures and entertaining customers in a notorious call-girl ring involving several Brown University coeds. With its capital almost gone, Hutton put itself up for sale. Shearson purchased the once proud firm, in what amounted to a fire sale, in December of 1987. In the aftermath, 8,000 of Hutton's 18,000 employees lost their jobs, but Bob Fomon and the directors of the firm were rewarded handsomely for their stewardship. For example, Bob Fomon sold his 230,000 shares of Hutton stock before the problems at the firm became public knowledge. His golden parachute gave him $4 million in cash, $500,000 a year for seven years, plus a pension of $612,450 for life. The directors also gave him an additional 76,000 shares of stock worth about $3 million.

Of all the individuals studied in this paper, only Bob Fomon was never charged with a crime, yet he presided over a firm that had an impeccable reputation before his arrival and was notorious for its sordid activities at the end. His unethical behavior led the firm to its demise and cost many of his employees their livelihood.

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ROBERT CITRON

Robert Citron had been the Orange County Treasurer-Tax Collector for over 24 years when he was indicted for securities fraud. As treasurer, he was responsible for investing billions of dollars in county tax revenue. His investment record was amazing in that he had consistently matched or outperformed managers in other counties. Why did his investment empire crumble before his eyes, landing Orange County in the largest municipal bankruptcy in U.S. history?

Citron was born in Los Angeles and grew up in Burbank. He never finished college and had been married to the same woman for 39 years and lived in the same house for 22 years. As treasurer, Citron was responsible for the county's investment pool. His investment record showed an average return of 9.03% during the ten years just prior to the bankruptcy, which was double what comparable pools made. Citron was known as one of the best county finance officers in the nation and once received an award naming him one of the top five best government investors nationwide.

Citron's strategy was simple, he used the investment pool's U.S. treasury bill and bonds as collateral to borrow short-term loans at low interest rates. He then invested the borrowed funds in mid-term corporate bonds and securities that paid a higher rate of return. This type investment strategy can result in large returns if the interest rates stay low and stable. However, if interest rates rise, the entire investment strategy collapses.

The public was forewarned about the potential problems with Citron's investment strategy when he ran for reelection in 1994. John Moorlach, his political opponent, questioned his investment practices. Of course, this criticism fell on deaf ears because Citron had been singled out as one of the best county finance officers in the nation. He had also received an award for one of the five best government investors nationwide. Nevertheless, Moorlach persisted throughout the campaign, accusing Citron of "overly risky strategy that left the county's investment pool vulnerable to rising interest rates."

It appears that Moorlach had a crystal ball. When interests rates went up, Citron's world collapsed. On December 6, 1994, Citron resigned due to reports that the county's investment fund had lost $1.5 billion in value due to rising interest rates and risky investment transactions. In fact, the interest rate increases wiped out, on paper, almost one of every five dollars in the fund. Citron gave no reason for his resignation; however, his lawyer said that "no one shares the county's pain more than Mr. Citron."

After his resignation, someone who knew Citron said that his successful investments made him believe he was infallible, that he started to believe his own press. Others said that Citron loved to be praised and he spoke often of his own accomplishments.

Citron was charged with defrauding investors and misappropriating public money in connection with the county's investment pool. He pled guilty and the evidence showed that he diverted over $100 million in other agencies' money into the county's account. Prior to sentencing, Citron's attorney sought information that would implicate others involved, stating that they were "more sophisticated and knowledgeable about matters concerning securities and accounting." He also said that Citron "relied on financial and legal experts." Everyone was shocked to discover in court, that two of the "experts" were a mail-order astrologer and a psychic. The psychics were right about one thing: Citron was told that December of 1994 would be a bad month, but after that, his money worries would be over.

Citron was sought and was given leniency by the judge for his cooperation with the prosecutors. The judge sentenced Citron to one year in the county jail and a fine of $100,000. He was also placed on probation for five years, ordered to perform 1,000 hours of community service and undergo psychological counseling.

Citron reported to the county jail on January 10, 1997, and stayed 20 minutes, then went home. The sheriff agreed to let him serve his time by doing clerical work during the day and returning home at night. What do you know, the psychics were right again, they said he wouldn't go to jail.

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CONCLUSION

The objective of this paper was to provide a detailed look at individuals whose level of illegal or unethical behavior brought them national attention in order to learn something about what caused them to fall into their destructive pattern of action. A possible common thread seems to be an addictive behavior that started with a simple, almost insignificant, act that grew into an uncontrollable habit of unethical and illegal behavior. The drive for this irrational behavior seems to be a feeling of power that comes from having more control over others, more money, or a higher status position.

All of these individuals share common characteristics even though they all took different paths to success. They all had attained a level of success in their field that was enviable by others yet they decided to break the rules, risking and then losing everything. So why did they do it? They were all driven by a desire to have more power, more money or more recognition. They were driven to the point of obsession and lacked the ability to rationally assess their conduct. Specifically, all of the individuals studied, acted as though

they believed they were above the rules. Add the autonomy that came with their jobs and you have the perfect combination for disaster.

What can we learn from these ethical lapses? We offer these suggestions. First, create an ethical environment that encourages and rewards ethical behavior. This can be done in a variety of ways. Professor Robin discusses this issue in his book, *Questions & Answers about Business Ethics* (1999). He tells us to combat unethical behavior,

> *the company must constantly support and develop the culture. The culture should make it clear that peers will find unethical behavior unacceptable and will report it, thus, the perceived probability of getting caught increases. When ethical misdeeds are detected, the company should punish the individual fairly but openly.*

Thus, it is imperative that companies implement policies and procedures that make it clear that unethical conduct will be detected and the employee punished. The punishment should be direct, publicized and long-lasting. The company must send a message that unethical conduct will not be tolerated.

Additionally, Professor Robin tells us that "employees entering the workplace are looking for guidelines for acceptable behavior." New employees will look to role models and mentors to set the standard for ethical behavior. The "ethical tone" of the business must be set by top management and trickle down to the entry-level employees. If the ethics of top management is beyond reproach, this sends a clear message that ethical conduct and success go hand in hand.

Secondly, these individuals have taught us that there must be balance between power and autonomy. The desire to commit unethical acts is nothing without the autonomy to do so. Autonomy is the factor in the equation that sends intelligent successful people over the ethical edge. They believe they are invincible because no one is looking over their shoulder. We certainly cannot assume that all highly successful people would behave unethically; however, we can guard against the possibility by refraining from giving an individual complete autonomy over their duties.

In conclusion, ethical behavior within the business structure has to be a priority, right up with making a profit. Ethical business environments do not miraculously appear. The ethical business environment must be meticulously cultivated and failure to do so can result in great loss to the company, the profession, and society.

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