

Why business ethics matter...

to your bottom line



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Why business ethics matter to your bottom line

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STATEMENT OF PURPOSE

*This paper seeks to inform those charged with fiduciary management of enterprises why **ethics can no longer be treated as a discretionary cost to the business**. Management of the ethical dimension is instead a significant contributor to financial success. This is highlighted in the paper through the use of examples of how leading corporations are integrating ethical management into business practices, change programs, and fraud, risk and compliance systems.*

Introduction

Why business ethics matter to your bottom line argues that ethical conduct has moved front and centre as corporations are increasingly exposed to the glare of public scrutiny. In particular, there has been a fundamental shift over the past few years that requires a complete rethinking of the functions of compliance, governance and social accountability, putting ethics into the daily vocabulary of mainstream management.



IT IS NOT THE STRONGEST OF THE SPECIES THAT SURVIVE, NOR THE MOST INTELLIGENT, BUT THE ONE MOST RESPONSIVE TO CHANGE.

CHARLES DARWIN

This paper suggests that Australian business leaders and regulators need to shift their current focus on employee ethics training as the solution to unethical practices, to a new orientation that focuses on building the sort of institutional integrity that supports employees in making ethical choices. It argues that such a shift demands a rethink of business leaders' current mindset about what is appropriate, as well as a critical review of modern day best practices in business ethics management. Effective management of business ethics requires an organisational strategy that is in tune with wider societal values and the public's new expectations of business.

INSIDE THE FINANCE SECTOR

In 2010, John Hartman became the youngest person jailed in Australia for insider trading. The former equities dealer claimed to have earned \$350,000 in salary and bonuses in 2008, when he was then only 23 years old. In sentencing Hartman, NSW chief judge Peter McClellan said the financial services industry had 'corrupted his values'. In a damning characterisation of the culture prevailing in the heady pre-GFC days, the judge wrote: 'The temptations are so great, and the potential rewards so significant, that the fall into criminality of individuals is a significant risk'. He noted that paying a recent graduate generous remuneration so out of kilter with his modest responsibilities 'underlines the extent to which the values which underpin our society can be compromised. The values of productive endeavour and integrity in dealings and business can easily be lost'.

The changing business environment

The physicist and systems theorist Fritjof Capra suggests that over the past few decades, a new economy has emerged that is shaped definitively by information and communication technologies. These forces have delivered a business world and society that is characterised by massively complex systems which permeate every aspect of our lives. They have spun massive technological and social changes that are creating an organisational environment almost unrecognisable from the perspective of traditional management theory and practice. The key drivers are:

SIZE MATTERS

Globalisation has made all societies interdependent and accountable for the social, environmental and political challenges that threaten to undermine our shared future. With 80,000 transnational enterprises and ten times as many subsidiaries and countless millions of small and medium sized businesses, business is the major institution in the world today. Greater corporate responsibility for self-regulation is being demanded as the necessary accompaniment to the process of globalisation. With increased power comes greater accountability.

Ethical challenges for business include international labour standards, human rights, and climate change, as well as marketplace integrity. Transparency International's 2012 Corruption Perceptions Index shows that corruption continues to ravage societies around the world. Two-thirds of the 176 countries ranked score below 50, on a scale from 0 (perceived to be highly corrupt) to 100 (perceived to be very clean). Pressure groups argue that it is big business that continues to facilitate much of this corruption.

THE INTERNET AS THE NEW PUBLIC SQUARE WHERE BUSINESS IS HELD TO ACCOUNT

There is a new global antenna tuned to the perceived negative impacts of business on nation states. Digitalisation has empowered consumers, employees and grassroots activists to take immediate direct action where they find business ethical standards to be unacceptable. Qantas, for example, found itself the victim of a Twitter campaign when it asked its followers: 'What is your dream luxury inflight experience?' The response was some 16,000 tweets anywhere between sarcastic and critical, reflecting the PR disaster that had followed Qantas' earlier grounding of its fleet, stranding tens of thousands of customers worldwide, during an acrimonious industrial dispute. Woolworths' social media platform also became the target of public anger following Alan Jones' derogatory remarks about the Prime Minister Julia Gillard's father 'dying of shame', at a Young Liberals event attended in a private capacity by a Woolworths' corporate affairs manager employee. The executive resigned to avoid any reputational backlash against his employer.

International pressure groups such as Oxfam have changed their traditional focus from reforming government policies to harnessing the power of consumers to target global companies; the influential NGO is demanding companies use their economic power to raise the ethical standards in the countries where they operate.

Nike became the poster child for exploitative sweat shop labour in developing countries. Its initial reaction was to refuse to accept responsibility for its third-party suppliers, but it has now reversed this position to become a champion in setting standards for suppliers. It is now an advocate for raising labour standards in developing countries, and has opened its supply chain management methodologies to all competitors so they, too, can be part of the solution. An ever-increasing regiment of iconic brands have become the standard bearers for a new way for business to operate. These include Coca-Cola, Mattel, Home Depot, Marks & Spencers and Wal-Mart. Responding to such global challenges requires more than a short-term perspective; it can mean that organisational leaders have to trade off competing priorities, such as returns to shareholders, with responsibilities to the environment or community stakeholders.

GFC LEGACY

The worst economic crisis since the Great Depression was largely caused by poor business decisions made by boards of directors and executives in both the financial and industrial sectors. Institutional compensation practices, in particular, were seen to give rise to a new type of amoral business management practice that no longer curtailed the potential negative impacts of business. In the wake of what has also been seen as a crisis in 'institutional integrity', where both business and its regulators failed to protect society, businesses are facing greater scrutiny from global monitoring organisations.

ORGANISATIONAL CULTURAL RISK

The fallout from the GFC has led many boards to concentrate more on compliance than performance. This is the easy way out; it is not making the leap in organisational culture required to avoid ethical risks in the first place. According to the Ernst & Young (E&Y) *11th Global Fraud Survey 2010*, more than three-quarters of board members are worried about personal liability. The *UK Bribery Act*, passed in 2010, created a new offence that can be committed by commercial organisations which fail to prevent persons associated with them from committing bribery on their behalf. It is a full defence for an organisation to prove that despite a particular case, it had adequate procedures in place to prevent persons associated with it from bribing. It follows that commercial organisations need to adopt a risk-based approach to managing such risks. What's significant about the Bribery Act is that it not only creates an offence relating to bribery of a foreign public official, it also creates a new form of corporate liability for failing to prevent bribery on behalf of a company.

The UK Serious Fraud Office, which investigates such cases, has a policy of co-operation with commercial organisations that self-report incidents of bribery. The company's willingness to co-operate and to make a full disclosure will be taken into account in any decision whether it is appropriate to commence criminal proceedings. This, and the fact that the Bribery Act lays down a set of six principles which, if followed, will assist in creating a culture that minimises the risks of individuals breaking the law, is a departure from the traditional 'black letter' approach to ethical conduct. In light of the fact that many global Australian corporations are now potentially subject to the *UK Bribery Act* provisions, it's interesting to speculate whether BHP Billiton was influenced by this new regime in its decision to inform the authorities that they may have been involved in bribing foreign officials at some of its exploration sites. This followed soon after Rio Tinto executive Stern Hu was found guilty of accepting bribes in China.

On a positive note, Transparency International (TI), which publishes a global index on corruption, ranks Australia consistently in the best 10 countries to do business in. However, TI warns that four countries among Australia's top trading partners – India, Thailand, Indonesia and Vietnam – have some of the most corrupt public sectors in the world. As Australian businesses continue to expand their operations into other countries with lower levels of transparency and governance, boards and C-suite executives will have to remain vigilant that ethical standards are maintained.

Notwithstanding that boards are increasingly concerned about risks associated with unethical conduct, this does not seem to be filtering down into effective risk management strategies. Business ethics surveys published by the major accountancy firms, including E&Y's *11th Global Fraud Survey*, consistently demonstrate that employees in all sectors are increasingly working in environments conducive to misconduct, and that effective interventions that largely revolve around strengthening organisational integrity systems to reduce ethics risks are not very common. A chilling example of the impact of organisational culture on employee behaviour was exposed in the *New York Times* by one of Goldman Sachs long-serving employees. Greg Smith, the former executive director and head of the firm's US equity derivatives business in Europe, the Middle East and Africa, in an op-ed in the March 14, 2012 edition of the newspaper, described Goldman Sachs' culture as 'toxic and destructive'. Smith said his reason for resigning from Goldman Sachs was that the firm's culture had changed so much over his time that it had become a place where profits trumps all other considerations; what was good for the firm and made the most money was the dominant value.

The linking of ethical behaviour to reputation makes the effective management of reputational risk and ethical business conduct an integral part of what drives company success. Economic performance alone no longer guarantees success and defaulting to what's legal doesn't cut it anymore, as global brand giants such as Google, Apple, Amazon and Starbucks are finding in the UK where they have been held to widespread public account for their adherence to tax minimising regimes that offshore their profits. UK consumers have been busy not only venting their anger in internet forums but also taking direct action by boycotting Starbucks stores. Such was the pressure of public opinion that Starbucks' management had to quickly move from its position of defending its legal position, to bowing to public pressure and social media campaigns; it has now offered to pay an additional £20 million in tax. In what was seen as an additional attempt to ward off further consumer backlash – or as they say in corporate social responsibility speak, 'to retain its social licence to operate' – its UK managing director, Kris Engskov, went even further by announcing that the company would pay 'a significant amount of tax during 2013 and 2014 regardless of whether the company is profitable'.

According to the field research, the top ethical issues confronting business institutions today revolve around:

- Insider trading (see box for example)
- Illegal political contributions
- Environmental violations
- Health or safety violations
- Improper contracts
- Contract violations
- Improper use of competitor's information
- Anti-competitive practices
- Sexual harassment
- Substance abuse
- Stealing.

Global perspectives on integrity management

Applied business ethics in Australia is at a different stage of maturity than in other parts of the world. In Europe and the US, business ethics is recognised as a management discipline informed by a comprehensive body of field research that is used to inform business management practice. The Washington-based Ethics Resources Centre, for example, conducts annual surveys mapping the changing ethical landscape of American businesses and benchmarking their performances against their peers. The UK Business Ethics Institute conducts similar research and works closely with business leaders to benchmark ethical standards in Britain, and the European Business Ethics Network brings academics and practitioners together to share best practices in Europe. Leading global consulting firms produce regular 'ethical pulse checks'. Examples include KPMG's Global Anti-bribery & Corruption surveys, E&Y's Global Fraud surveys, PWC's Business Ethics & Directors surveys, and Deloitte's Ethics & Workplace surveys.

In contrast, in Australia, business ethics is still seen as a discretionary endeavour and the scant research conducted revolves around individual perceptions and attitudes, divorced from any analysis of the organisational context that shapes these. It focuses on the players and misses the bigger picture about how the game is being played. The limited research that exists, however, does indicate that Australian managers and employees face exactly the same organisational pressures as their counterparts in other countries and that these pressures give rise to the same ethical issues and challenges.

Unethical and corrupt business conduct has encouraged legislators around the globe to mandate organisational whistle-blowing mechanisms as a minimum organisational safety net against systemic unethical practices. Implicit in this mandate is the recognition that ethical conduct and organisational culture is not beyond management control; it is instead the outcome of the ways leaders set their organisational context so that employees are encouraged or inhibited to observe ethical and legal standards and are rewarded or penalised for their ethical conduct.

The cultural nature of business ethics is made more explicit in the US, where the *Federal Sentencing Guidelines* (1991) provide a framework for imposing criminal penalties on organisations that commit offences according to whether they have an effective compliance and ethics program in place. Regularly updated to reflect changing social expectations, the guidelines have led to the creation or enhancement of business ethics programs by thousands of companies across the US, and created the position of 'ethics and compliance officer' within all publicly listed companies. In a similar development, the *UK Bribery Act* (2001) recognises the power of organisational leaders to shape organisational culture. The most far-reaching Act in the developed world, this legislation holds company directors accountable for any unethical or corrupt behaviour, with tough penalties for breaches of the Act, including up to 12 years in prison and/or large fines. Here in Australia, the ethical dimension is managed in a more informal and reactive manner. While on paper it might seem that

we are in step with other countries in encouraging corporate compliance, regulation is thin on the ground. Amendments to the *Criminal Code* effective since 1999 state that a corporation can be criminally responsible if it is established that 'a corporate culture existed within the body corporate that directed, encouraged, tolerated or led to non-compliance with the relevant provision' or by showing that 'the body corporate failed to create and maintain a corporate culture that required compliance with the relevant provision'. However, it took until 2011 for the first person to be charged under these provisions, despite what appeared to be overwhelming evidence of bribery and corruption in the case of the Australian Wheat Board and other companies such as Note Printing Australia and Securrency several high profile cases.

The OECD said it was 'seriously concerned' with Australia's lack of enforcement of its foreign bribery laws, highlighting that Australian businesses were highly exposed to foreign corruption. According to Johnson Winter & Slattery partner Robert Wyld, the AFP has received 28 allegations of foreign bribery involving Australian companies and individuals since 2006. Of these cases, 12 have been evaluated, rejected for investigation and terminated, while nine cases were accepted for investigation but have been finalised without resulting in charges because of insufficient evidence.

The cultural perspective of ethics as a discretionary activity or, worse, the preserve of individual morality, sets the bar of acceptable business standards lower than in other advanced economies while ensuring that Australian regulation remains wedded to a compliance approach. Safeguarding institutional integrity remains a subset of risk management rather than a cornerstone of organisational cultural development demanding the constant attention of all C-suite executives.

INTERNATIONAL STANDARDS AND BENCHMARKS ON BUSINESS ETHICS MANAGEMENT

- ISO 1400; SA 8100 & AA1000
- UN Guiding Principles on Business and Human Rights (2012)
- U.N. Convention against Corruption (UNCAC)
- OECD Guidelines on Multinational enterprises
- ILO Core Conventions
- International Covenant on Economic, Social and Cultural Rights (ICESCR)
- Equator Principles
- Global Reporting Initiative (GRI)
- World Business Council Sustainable Development
- Ethical Trading Initiative
- EU Strategy on corporate social responsibility
- Transparency International Global Index on Corruption.

The limitations of compliance

Business ethics is now generally regarded as a form of applied ethics or professional ethics, which examines ahead of time the ethical principles and issues that may arise in a business environment. It applies to all aspects of business conduct from how it develops, produces and delivers its products and services, to its interactions with its customers, suppliers, employees and wider society. Business ethics is widely recognised in most developed countries (as well as in emerging economies including China and India) as a social science where the study of changing social expectations of business as one vitally important element of a well-functioning society is critical to sustaining progressive economies.

To this end, business ethics advocates seek to challenge the cultural legitimacy of assumptions such as agency theory, which promoted the idea that business managers were only driven by self-interest. The theory is they need to be incentivised to align their interests with shareholders. The accompanying premise is that business's primary role is to deliver maximum shareholder benefits. Many argue that agency theory became a self-fulfilling prophecy that led to the emergence of managerial elite that legitimised obscene incentive packages and helped to spawn a generation of amoral managers. According to two studies in the US of graduates of business schools, 'amoral management' has been identified as both intentional and unintentional. Intentional amoral management practices occur where managers operate from a mindset that separates business and ethics in two separate realms. Unintentional amoral management, the studies suggest, emerges where managers fail to canvass the ethical impacts of their decisions and actions. This was most evident in the financial markets at the time of the GFC and was graphically illustrated by the Goldman Sachs case of some investment banks creating toxic debt products in order to bet against the market recovering.

There is an emerging body of field research into how workplace contexts shape managerial and employee behaviour, that suggests that employee ethics are malleable and dynamic, with individuals taking their behavioural cues from the social messaging of their organisations in order to succeed. Social psychology highlights that many people are likely to commit seriously unethical acts in situations that share powerful and distinctive features, including the power dynamics embedded in workplace hierarchies. These typically result in the depersonalisation that typifies large workplaces and enables individuals to abdicate personal accountability. It means that managers and employees can find themselves behaving inconsistently across different situations. This 'argentic shift', first identified by Stanley Milgram's Yale research on obedience to authority and later supported by Stanford's prison experiment, suggests that there can be an erosion of agency within organisations to the point where individuals simply follow directives. In both these famous research studies, participants were found to behave in ways consistent with the context they found themselves in, even if it was strongly inconsistent with their personal ethical standards. It is generally agreed that situational and social forces are more important than individual differences in explaining unethical behaviour.

Global research suggests that boards are slow to recognise and be accountable for the integrity of the organisations they steer. According to E&Y's 2011 global survey, as many as 52% of C-suite executives think their boards are out of touch in understanding the ethical issues facing the business, and especially so in rapid-growth markets.

In Australia, narrow assumptions around what constitutes the appropriate 'tone at the top' has similarly left a legacy of initiatives that focus on promoting individual morality, the latest being the 2012 Australian Bankers Oath. There is no substitute for boards insisting on appropriate systems to monitor, promote, reward and support collective ethical standards.

There is already much criticism around the lack of diversity at Australian board level – not just in gender terms but also in terms of world views. The composition of Australian boards, while slowly changing, is well-seasoned in what's legal but sometimes less confident in the new values and expectations of stakeholder capitalism. These revolve around corporate social responsibility, sustainability and what the public regard as fair and ethical business practices. The boards of iconic Australian institutions such as the Reserve Bank, Qantas, Telstra, Pacific Dunlop, Amcor, AWB, Rio Tinto, James Hardie and the major Australian retail banks have all experienced the blowtorch of stakeholder criticism in recent years. These boards were held to account not for poor employee ethical standards but for the unethical and sometimes illegal institutional business practices that were by-products of their organisational cultures. For Qantas, Amcor and Visy, these revolved around price-fixing in the marketplace; for James Hardie around failures of corporate governance; for Telstra alleged abuse of market power and for the banks around questionable lending practices.

52%

OF C-SUITE EXECUTIVES
THINK THEIR **BOARDS**
ARE OUT OF TOUCH IN
UNDERSTANDING THE
ETHICAL ISSUES FACING
THE BUSINESS.

The high cost of failure to manage ethics at work

The huge costs recently incurred by Starbucks are only the tip of the iceberg of the combined costs of unethical behaviour. Other examples include:

- In November 2012, UBS was fined £29.7 million for failures in its systems and controls that allowed former employee Kweku Adoboli to conduct Britain's biggest bank fraud
- In December 2012, HSBC agreed to pay a record \$1.92 billion to settle charges that the banking giant violated US sanctions by transferring billions of dollars for prohibited nations, it enabled Mexican drug cartels to launder tainted money through the American financial system, and it worked closely with Saudi Arabian banks linked to terrorist organisations
- In 2012, Barclays was fined £290 million for manipulating key interest rates
- In April 2012, the *New York Times* reported that a 2005 internal investigation at Wal-Mart found evidence that executives in the company's Mexican subsidiary paid more than \$24 million in bribes to officials in 'virtually every corner of the country' to clear the way for the rapid expansion of the retail empire. The allegations are unusual in that knowledge of wrongdoing is said to have subsequently reached the top of the organisation. The newspaper reports that the company is now under investigation for possible violations of the *Foreign Corrupt Practices Act*
- In 2010, Rio Tinto made headlines when four employees from the mining giant were charged with bribery and stealing trade secrets in China
- In 2010, Daimler, the German car maker, agreed to pay a \$185 million fine for bribing foreign government officials, including Russian and Chinese officials
- In 2009, L'Oréal, the French cosmetics giant, was found guilty of racial discrimination for barring black, Arab and Asian women from selling its shampoo
- In 2009, engineering giant KBR settled a Nigerian corruption case for \$579 million
- In 2008, the Swiss agriculture and chemicals company Syngenta was fined for pesticide-related infringements, and one of its former employees was awarded nearly \$2 million after she was wrongly fired for reporting discrimination in the workplace
- In 2008, Siemens settled a global corruption case for \$1.6 billion.

Following its prosecutions in the UK for paying bribes, defence systems company BAE commissioned a far reaching report into best practise in ensuring institutional integrity. The research looked at ethics management systems and process of 12 global companies from the US, the UK and Europe. It concluded by saying:

'A company should aim to develop an organisational culture that is self-policing and that positively encourages concerns about ethical behaviour to be raised at all levels and in all locations.'

For directors it recommended boards must not only ensure that ethical conduct and the impact of ethical risk are explicitly taken into account, but that this is also reflected in decision-making throughout the company at all levels and adhered to in the face of financial and operational pressures.

STANDARD ETHICS AND COMPLIANCE PROGRAMS INCLUDE:

- Charging the leadership team with accountability for establishing ethical cultures
- Publishing a code plus other directional documents
- Deploying global training and communications to all employees
- Managing the global Ethics and Compliance Line
- Administering annual certification process, reporting on issues raised & on violations.

The impact of ongoing change on institutional integrity

According to the 2011 biennial National Business Ethics Survey from the Washington-based Ethics Resource Center (ERC), the percentage of employees who perceived pressure to compromise standards in order to do their jobs has increased while retaliation against employee whistle blowers has also risen sharply. Employees' cynicism regarding the tone being set from the top has similarly increased.

ERC surveys consistently show that there's a very strong correlation between a strong ethical culture and lower observed misconduct. In 2011, misconduct was observed in only 29% of companies with a strong ethical culture but seen in 90% of those with a weak ethical culture. Pressure to compromise ethical standards was felt in 33% of companies having a weak ethical culture versus only 7% where the ethical culture was strong. Employees in companies with weak cultures failed to report observed misconduct 48% of the time, but only 6% of employees in companies with strong cultures didn't report misconduct they observed. Retaliation after reporting misconduct was also more prevalent in weaker cultures.

A 2012 survey by the UK Ethics Centre of 500 financial services professional across the US and the UK resulted in some likewise alarming statistics:

In Australia, according to a 2010 KPMG report 51% of respondents said they experienced unethical behaviour at work, while a similar survey of professionals in 2009 found that one in four respondents believed their organisations could do more to promote ethical standards. The same number reported that profits or funding concerns had a higher priority than ethical standards.

30% OF RESPONDENTS said that their organisation's compensation plan created **pressure to compromise ethical standards** or break the law

24% OF RESPONDENTS said that financial services professionals may need to **engage in unethical or illegal conduct** to be successful

39% OF RESPONDENTS said that their competitors are likely to have engaged in **illegal or unethical activity** to be successful

26% OF RESPONDENTS indicated that they had observed or had **firsthand knowledge of wrong doing** in the workplace

20% OF RESPONDENTS said they were unsure or had **serious doubts** about how their **employers would handle a report of wrongdoing**

22% OF FEMALE RESPONDENTS said they would be **retaliated against** if they **reported wrongdoing** in the workplace

The business benefits of organisational integrity

While the picture so far might appear mostly doom and gloom, there are many upsides and 'green shoots' of ethical performance.

The Hay Group's annual survey of The World's Most Admired Companies (WoMACs) highlights just how much the management of culture matters. The results show that the world's best performing companies by shareholder value are also the ones that value the importance of culture and place priorities on promoting positive people management practices and systems. WoMACs were found to have outperformed average shareholder growth, which has averaged approximately 12% per annum for more than 100 years, and by about 3–5% per annum. That represents a premium over standard shareholder value performance of about a quarter to two-fifths above normal returns.

The US-based think-tank, Ethisphere, also charted the stock performance of publicly traded award winners from 2007, and noted that the most ethical companies consistently and significantly outperformed the S&P500 by more than double. Another US-based research and advisory firm, Corporate Executive Board, also confirmed that companies with high integrity capital enjoy financial benefits. Their research shows that integrity leaders incur only one-eighth the costs of misconduct than competitors, and have 12% lower labour costs because their employees invest more discretionary effort. CEB attributes these two organisational integrity dynamics as key factors in delivering shareholder returns 5.8% higher than the average company.

Another important green shoot is the clear link between institutional integrity and employee engagement. Gallup's research on employee engagement shows that organisations with highly engaged teams outperform their competitors by 26% in gross margin and 85% in sales growth. In Australia, UTS Emeritus Professor Dexter Dunphy has shown that organisations with staff that are highly engaged tend to be places where there is genuine alignment between institutional values and corporate social responsibility objectives, thus bucking the western trend towards lower levels of employee engagement.

At a global level, research points to a seismic values shift, with a new generation demanding ethical ambition among its employers. Net Impact's research *What Workers Want in 2012* found 61 to 70% of people across all generations believe they have a responsibility to make society better rather than leave it to the future. Employees who were able to make a positive impact through their workplace reported being more engaged and twice as satisfied with work as those denied this opportunity.

In another study titled *The Workforce Crisis*, workplace change expert Tamara Erickson examined ten work expectations of baby boomers, Gen X and Gen Y, and found while there were no significant differences in their underlying values, there were differences in their expectations. Younger generations demonstrated a greater expectation for 'more transparent attitudes on requiring a strong ethical leadership brand in the companies for which they work'.

AUSTRALIAN RESEARCH LINKS PEOPLE MANAGEMENT TO PROFITS

Ground-breaking research examining 78 Australian organisations has provided hard evidence of the correlation between best-practice leadership and bottom-line results. The study, conducted by the University of NSW, Australian National University and Copenhagen Business School released in 2011, found that companies which focus on intangible assets such as innovation, leadership, fairness, employee and customer experience – as well as financial indicators – were nearly three times more profitable than their peers. Leaders in the best performing companies, according to the Leadership, Culture and Management Practices of High-Performing Workplaces in Australia report, spend far more time and effort managing staff, are more inclined to give employees ample recognition, and can articulate a clear vision and goals.

61-70%

OF PEOPLE ACROSS ALL GENERATIONS BELIEVE THEY HAVE A **RESPONSIBILITY TO MAKE SOCIETY BETTER RATHER THAN LEAVE IT TO THE FUTURE.**

Leaders in institutional integrity

There are a growing number of leaders who are prepared to stand up and be counted for their ethical acumen. They have moved beyond the values rhetoric to embedding their values into day-to-day organisational practices.

General Electric chief executive, Jeff Immelt, has been named one of the 'World's Best CEOs' three times & GE named 'America's Most Admired Company' by *Fortune* magazine. GE has also received the gong one of 'The World's Most Respected Companies' from the *Financial Times*.

Immelt's message to business leaders talks to the zeitgeist of the times:

'This is a time when the world isn't going to be the same. Now is a time when *people want a reason to believe in their leaders*; they want to be involved in creating a new story that is geared to produce a better and more equitable future. This is a time when *leaders are being asked to sign up to a higher accountability to the people they seek to lead*; to rebuild trust and engagement with the challenges on hand. No one promises the landscape will be easy, but neither will would-be leaders be allowed to escape public scrutiny.'

Businesses of the future recognise that there is a fundamental readjustment going on from a rules-based society to a principles-based society. These leaders understand the role they can play in enhancing not only business success, but overall societal well-being. They know that ethical leadership involves managers leading by example. They put strong boundaries on competitive behaviour even as they recognise that they are operating in adversarial markets. They insist on more attention to good governance rather than hiding behind outdated notions of total control. They are the employers of choice because they are responding to a new generation of employees looking for organisations with a comparable set of values, and a responsible attitude towards their community. Their business models appreciate the importance of business with purpose, organisational integrity as the basis of employee engagement and satisfaction, and ethical standards as the basis for sustainability. Traditional transactional command-and-control leaders have given way to these transformational ones who work on culture, bring their people with them, instil pride in the mission of the enterprise, and deliver benefits to the societies from which they profit.

Sir Stuart Rose, the former Marks & Spencer chairman, is one such transformational leader. His Plan A eco-initiative in 2007 set out 100 ethical and sustainability targets. Another is Paul Polman, the chief executive of consumer goods giant Unilever. He throws down the gauntlet to recalcitrant leaders when he says he doesn't believe fiduciary duty is to put shareholders first. Instead, his focus is on the company improving the lives of the world's citizens and coming up with genuine sustainable solutions – ultimately, this will result in better shareholder returns.

Polman points to the growing number of high-performance companies that are continually working on their corporate cultures to fuse high performance with high integrity. Examples include Proctor & Gamble, Coca Cola, Novo Nordisk, Danone, Nike, Heineken, DSM, Novartis, Interface Inc and Patagonia. Together these companies are helping to create a critical mass for change by pushing sustainability through their global supply chains and transforming how business gets done. Perhaps the poster child for this new era in business is best captured in Google's culture statement: 'You can make money without doing evil'.

TOP ORGANISATIONAL MEASURES TO PROMOTE AN ETHICAL CULTURE

Consistent findings from annual ethics and fraud surveys by the global accountancy firms agree following 5 key steps:

- STEP 1** Implementation of proper guidelines and policies
- STEP 2** Regular employee education
- STEP 3** Regular identification and prioritisation of risks
- STEP 4** Ongoing evaluation of mitigating controls
- STEP 5** Continuous monitoring.

Business ethics as the basis of business strength

Enlightened organisational leaders are beginning to realise that there are a lot of preventative measures that can and should be used to lower the incidence of marketplace failure. Tone at the top is about boards and business leaders accepting their role in building institutional integrity capital to ensure that every manager is capable of managing the ethical dimension inherent in every business decision. But just as important is 'the mood in the middle'. Leadership from the top is vital to successfully changing a toxic culture, and so is the critical role of middle managers in not only accepting the need for change but also being the champions of that change. We say that 'people listen with their eyes'; in other words they look at what behaviours are recognised and rewarded and take their lead from those.

According to Corporate Executive Board (CEB) research, organisations with 'integrity capital' have lower levels of misconduct along with higher levels of reporting when employees do witness wrongdoing. They argue that integrity capital is embedded in the culture, not instituted through controls, and it helps shape employee behaviour, which could include defrauding the company or offering bribes to get business. Their research identifies five key factors in building organisational integrity:

1. Management takes action when it becomes aware of misconduct
2. Employees are comfortable speaking up about misconduct and don't fear retaliation
3. Senior leaders and managers treat employees with respect.
4. Managers hold employees accountable
5. High levels of trust exist among colleagues.

However, putting a robust organisational integrity system in place takes time and requires commitment to ethical leadership that is often missing. The best protection any corporation can put in place is not a regime of compliance but a culture of integrity.

THE BOARD'S ROLE IN BUILDING ORGANISATIONAL INTEGRITY*

- Participating in setting and safeguarding the values and standards for the business
- Think strategically about corporate responsibility in the context of market pressures
- Being constructive about regulation, delivering self-regulation and supporting government intervention to correct market failure
- Aligning performance management, rewarding responsible success over the long-term
- Advocating for a culture of integrity, setting the right tone at the top and cultivating the right values in the corporate culture
- Ensuring internal controls exist beyond paper and are embedded in daily practices.

* Key recommendations for board directors from a report commissioned by a group of leading UK institutions: Business in the Community, About FTSE Group, *Insight Investment Dec 2005*.

What needs to be done?

What gets measured gets done and organisational culture is no different. At its simplest, organisational culture refers to the shared practices, behaviour standards and underlying assumptions that guide how people choose to act at work. It is the regular measurement and management of culture that differentiates high-performing organisations from their peers. Leaders need to lift their standards beyond the letter of the law, embracing a spirit that encompasses a duty of care to protect the common good.

- CEOs must put in place an ethical management framework that encourages and rewards the right behaviour, while exposing and sanctioning inappropriate behaviour
- Boards of directors need to motivate CEOs to manage their organisation's culture by ensuring that remuneration packages reward culture builders and not just bottom line inflators. Incentives should promote long-term accountabilities that align executives' self-interests with collective interests. Regular ethical cultural reviews should be undertaken as part of effective risk management
- Industry bodies, too, must play their part. They should conduct relevant field research to identify systemic sources of unethical behaviour in each sector and then build sound metrics and initiatives designed to raise industry standards
- Institutional investors can contribute to raising standards by moving beyond the prevailing preoccupation with short-term results. They can recognise that sustainable business practices often necessitate a long-term perspective to building revenues
- External regulatory reform can encourage self-regulation. A legislative framework such as the US Federal Sentencing Guidelines for Organisations (FSGO) in 1991 and the Sarbanes-Oxley Act in 2002 successfully enlisted business organisations in a self-policing effort to deter unethical behaviour and move leaders from passive bystanders to active advocates for an ethical workplace culture.

It's time we moved away from focusing on the players to focusing on business itself. Clearly, there are things that executives and employees must not do in pursuit of profits – this has been profoundly evident over recent years. As thousands of corporations and millions of workers in the US can attest, Educating organisational members from the top down floats all ethical boats upwards. Only by creating cultures where people understand the impact of their decisions on all stakeholders and where people have a system of ethical decision making that has integrity can we build organisational integrity and ensure that the marketplace continues to exist for the good of all participants and delivers positive benefits to the wider societies where it operates.

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