Is Ethics Awareness Enough?

WE CAN READILY AGREE THAT LORD ACTON'S axiom, "Power corrupts those who wield it, and absolute power corrupts absolutely," certainly has been applicable to political dictators over the years. It also may be easy to agree that this axiom likely isn't true for all of society in general. But given the number, breadth, and industry dispersion of the many recent corporate scandals, the association between power and corruption is hard to overlook in the business world. Senior executives and financial managers, securities analysts, attorneys, bank lending officers, and auditing firms took the low road to financial gain for themselves and occasionally their organizations instead of the ethical high road that considered the rights of others. Also at fault are seemingly rubber-stamp insider boards of directors and those regulators who caved in to political pressure. Both groups are charged with oversight and failed in their responsibilities.

The resulting legislative solution, the Sarbanes-Oxley Act of 2002 (SOX), adds many requirements and has been described by some as too far-reaching and costly. It's perhaps well that the legalistic mind-set of former SEC Chairman Harvey L. Pitt, who resigned under fire along with the chief accountant he appointed, Bob Herdman, previously of Ernst & Young, is gone. Pitt and Herdman broke no laws when they failed to tell fellow SEC commissioners the full background of William Webster, their choice to be the chairman of the new accounting oversight panel mandated by SOX. Nonetheless, the commissioners felt betrayed.

Full disclosure involves ethics as well as laws—it's impossible to contemplate a law or regulation that could prevent every bad action. Without ethical concerns, creative minds will find a way to circumvent the spirit of any law. "You don't legislate morality," said David A. Nadler, the chairman of Mercer Delta Consulting in New York. "What we should be doing is expecting leaders of our companies to take responsibility for it."

The "soft controls" in an organization are most important in assuring that the organization accomplishes:

- Compliance with society's legal and regulatory rules;
- Satisfaction with generally accepted business norms, ethical precepts, and social expectations of society;
- Provision of overall benefit to society with enhancement of the interests of its stakeholders in both the long and short term; and
- Full and truthful accountability to its owners and other stakeholders.

When an outsider is being considered for a leadership position, those making the employment decision should learn as much as possible about how that person has behaved in the past because past behavior has been shown to be a good indicator of future behavior. Chairman Pitt had information that the other SEC commissioners might have found useful in making a judgment about nominee Webster's ability to lead. Serving on an audit committee of a company under investigation for fraud doesn't automatically indict Webster's leadership ability. Pitt's decision not to disclose this critical piece of information was a behavioral and, arguably, an ethical lapse that should have been easy to avoid.

Some would say it's impossible to discern the ethical climate of an organization. But Jim Collins, the author of *Good to Great: Why Some Companies Make the Leap…and Others Don't* (HarperCollins, 2001), doesn't believe it's all that hard to do, at least from the inside. "You need to look inside the company," Collins said. If you don't know if somebody has integrity after you've worked with them for 10 or 20 years, then you must not be very smart." The challenge is to make it easier for outsiders to come to similar conclusions.

The stock exchange requirements for all listed companies to adopt and disclose a code of conduct and ethics applicable to all directors, officers, and employees will provide at least a limited opportunity for outsiders to learn what values a company considers important. Each listed company's annual report to the SEC on Form 10-K must state where this information is available on the company's website.

The comments to New York Stock Exchange Rule 303A.10 are illustrative. They note that, although "no code can replace thoughtful behavior,…such a code can focus the board and management on areas of ethical risk, provide guidance to personnel to help them recognize and deal with ethical issues, provide mechanisms to report unethical conduct, and help to foster a culture of honesty and accountability" (from the *NYSE Listed Company Manual*, available on www.nyse.com).

According to the NYSE rule, the subject matter of the required code should include:

- Conflicts of interest. Even the appearance of the inability to separate personal from corporate priorities must be avoided.
- Corporate opportunities. Corporate resources must be used entirely for corporate—not personal—gain.
- Confidentiality. Disclosure of information they have that could be harmful to the company or useful to competitors must be made only when authorized or legally mandated.
- Fair dealing. Employees, officers, and directors should attempt to deal fairly with customers, suppliers, competitors, and employees.
- Protection and proper use of company assets. Company assets should only be used for legitimate business purposes. Theft, carelessness, and waste adversely affects profitability.
- Compliance with laws, rules, and regulations (including insider-trading laws). Compliance should be proactively promoted.
- Encouraging the reporting of any illegal or unethical behavior. The company should proactively promote ethical behavior.

The Nasdaq has adopted similar rules.

It's very encouraging that the NYSE rules suggest an ethical or values-based approach that includes fair dealing as an objective and not a highly legalistic approach. Proactively promoting ethical behavior and requiring the code to cover the need to deal fairly with stakeholders, including customers, suppliers, competitors, and employees, should go a long way toward achieving a goal of corporate responsibility. It will no longer be appropriate for companies to maintain a total focus on maximizing economic advantage for shareholders without considering the needs of other stakeholders in critical decisions.

It will remain to be seen, however, how well the boards and audit committees of listed companies actually implement the ethical spirit contained in these rules. Analysis of a few company filings indicates that some have chosen to adopt a separate ethics code for just their senior financial executives. This is a specific requirement of Section 406 of Sarbanes-Oxley. Apparently, the legal counsels of such firms believe in following the literal language of each requirement separately rather than following the philosophy of emphasizing the disclosure of ethical guidelines for the culture of the entire organization.

Since there's no specific requirement to set forth the core values of a corporation, legalistically oriented minds no doubt will prevail at some companies and suppress their publication. It also appears that some companies have put a link to their ethics code on their main website, making it very easy to find. Others have chosen to put their code on a separate website, with no apparent link from their home page. Why would any company want to hide the values and ethical principles it uses to manage its business? Fortunately, there are many companies that are proud to display the values they employ.

Analysis of the different choices made by companies will make for interesting reading in the future. ■

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