

College of Management

Business Ethics

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PMG 750

Lecture 08



Chapter 8: DEVELOPING AN EFFECTIVE ETHICS PROGRAM

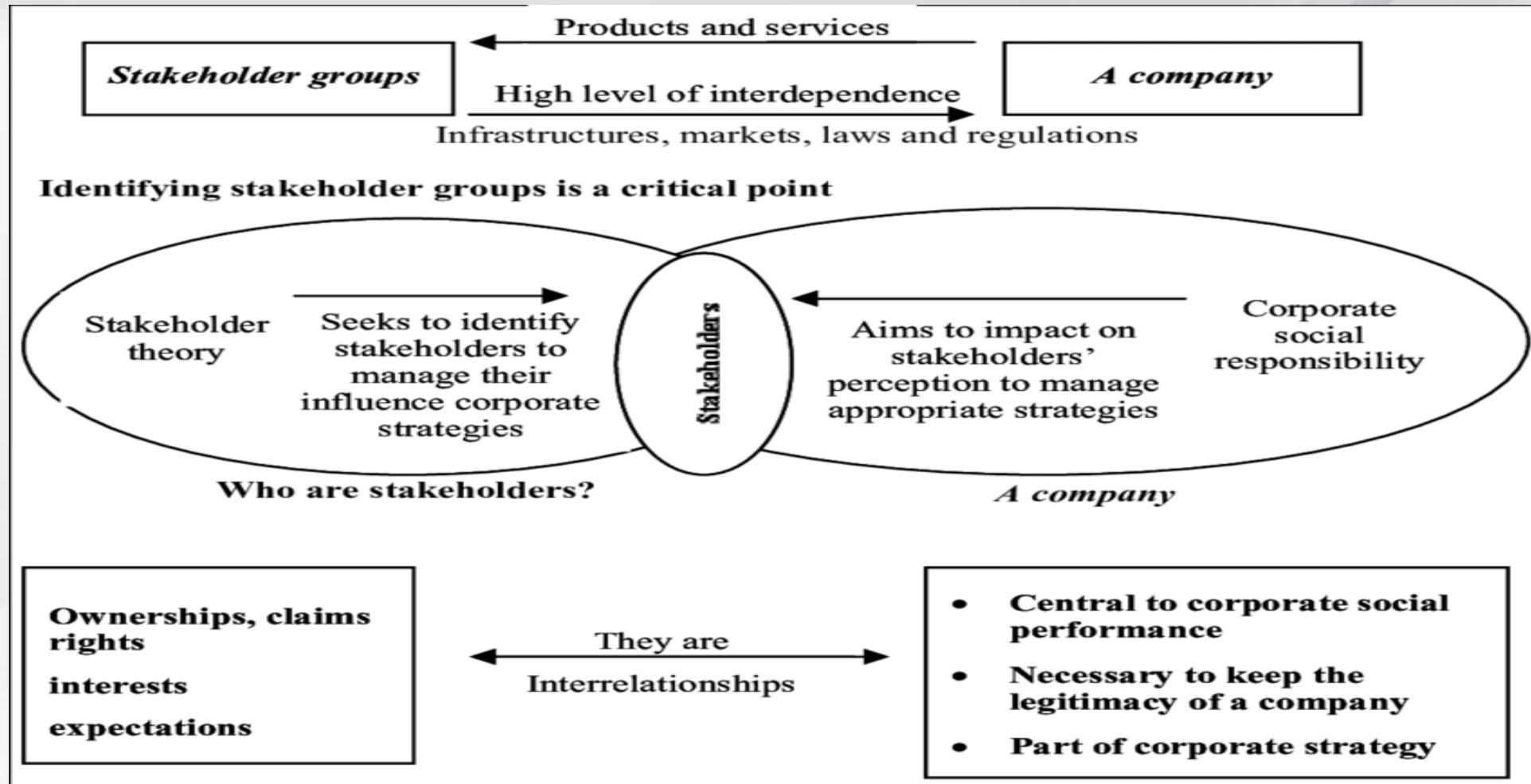
CHAPTER OBJECTIVES:

- **Understand** the responsibility of the corporation to stakeholders.
- **Understand** why businesses need ethics programs.
- **List** the minimum requirements for an ethics program.
- **Describe** the role of codes of ethics in identifying key corporate risk areas.
- **Identify** factors in successful ethics training, program types, and goals.
- **Examine** the ways ethical standards are monitored, audited, and enforced.



DEVELOPING AN EFFECTIVE ETHICS PROGRAM

THE RESPONSIBILITY OF THE CORPORATION TO STAKEHOLDERS



DEVELOPING AN EFFECTIVE ETHICS PROGRAM

The Responsibility of the Corporation to Stakeholders

- Increasingly, corporations are viewed not merely as profit-making entities but also as moral agents accountable for their conduct to their stakeholders, including employees, investors, suppliers, governments, and customers.

Companies are more than the sum of their parts or participants.

- Because corporations are chartered as citizens of a state and/or nation, they generally have the same rights and responsibilities as individuals.

Through legislation and court precedents, society holds companies accountable for the conduct of their employees as well as for their decisions and the consequences of those decisions.

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The Responsibility of the Corporation to Stakeholders

- Coverage in the news media of specific issues such as employee benefits, executive compensation, defective products, competitive practices, and financial reporting contributes to a firm's reputation as a moral agent.

As moral agents, companies are required to obey the laws and regulations that define acceptable business conduct.

- However, it is important to acknowledge that they are not human beings who can think through moral issues. Because companies are not human, laws and regulations are necessary to provide formal structural restraints and guidance.
- Employees have an ethical obligation to responsibly think through complex ethical issues to contribute to the ethical conduct of the corporation as a whole.

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The Responsibility of the Corporation to Stakeholders

- Though not a person, a corporation can be considered a moral agent in society, created to perform specific social functions.
- **It is therefore responsible to society for its actions.**

Because corporations have characteristics of agents, responsibility for ethical behavior is assigned to them as legal entities, as well as to individuals or work groups they employ.

- A corporate culture without values and appropriate communication about ethics can facilitate individual misconduct.

DEVELOPING AN EFFECTIVE ETHICS PROGRAM

THE NEED FOR ORGANIZATIONAL ETHICS PROGRAMS



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The Need For Organizational Ethics Programs

To understand why companies need to develop ethics programs, judge whether each of the following actions is unethical versus illegal:

- You want to skip work to go to a baseball game, but you need a doctor's excuse. You make up symptoms so that your insurance company pays for the doctor's visit. (unethical, illegal).
- While having a latte at a local cafe, you run into an acquaintance who works as a salesperson for a competing firm. You wind up chatting about future product prices. When you get back to your office, you tell your supervisor what you heard. (unethical, illegal).

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The Need For Organizational Ethics Programs

To understand why companies need to develop ethics programs, judge whether each of the following actions is unethical versus illegal:

- You are fired from your company, but before leaving for a position with another company, you copy a confidential list of client names and telephone numbers you compiled for your former employer. (unethical, illegal)
- You receive a loan from your parents to make the down payment on your first home, but when describing the source of the down payment on the mortgage application, you characterize it as a gift. (unethical, illegal).
- Your manager asks you to book some sales revenue from the next quarter into this quarter's sales report to help the firm reach target sales figures. You agree to do so. (unethical, illegal).

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The Need For Organizational Ethics Programs

- To promote legal and ethical conduct, an organization should develop a **program** by establishing, communicating, and monitoring the ethical values and legal requirements that characterize its history, culture, industry, and operating environment.
- Without such programs, uniform standards, and policies of conduct, it is difficult for employees to determine what behaviors are acceptable within a company.

Although there are no universal standards that can be applied to organizational ethics programs, most companies develop codes, values, or policies to provide guidance on business conduct.

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The Need For Organizational Ethics Programs

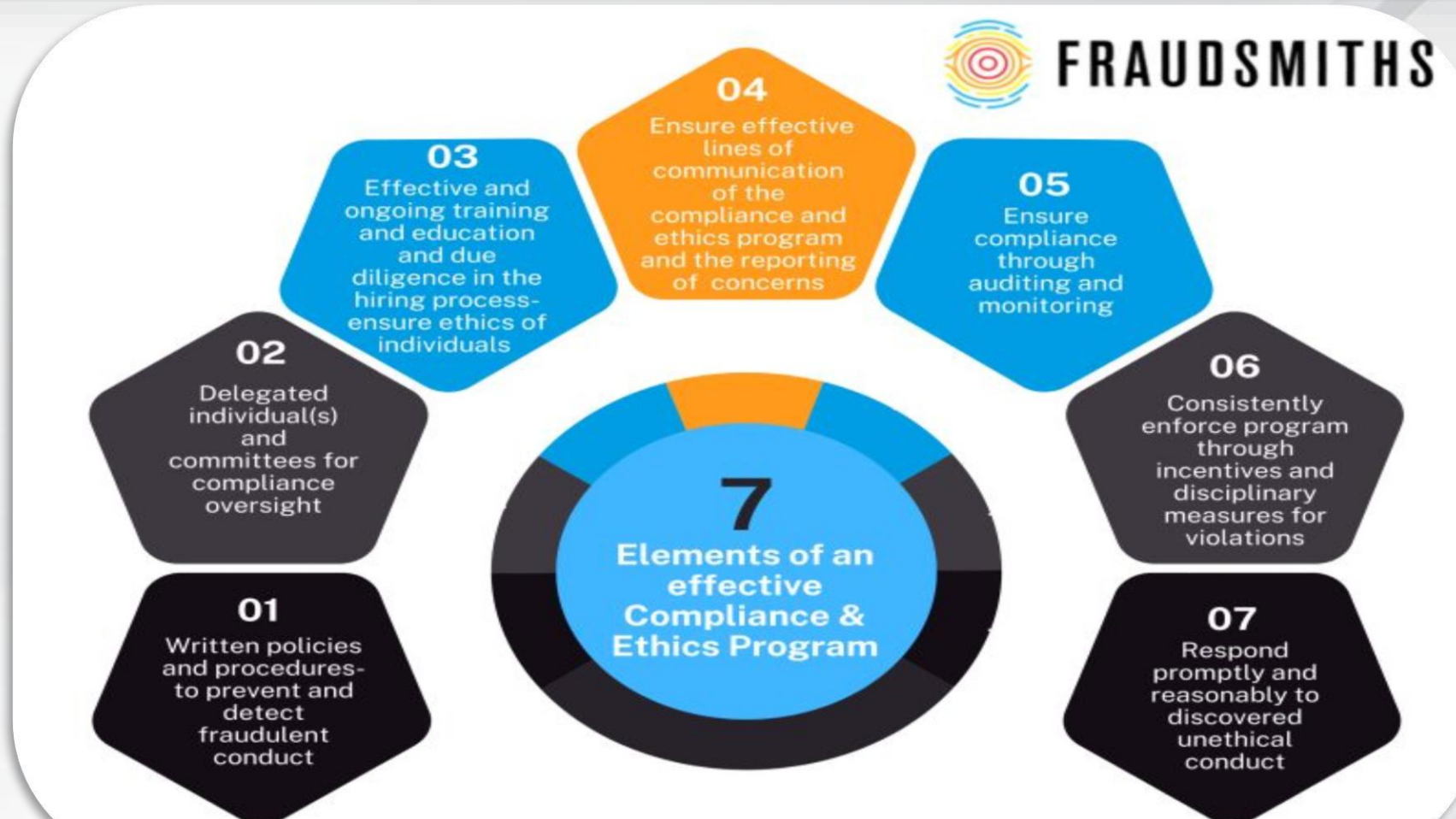
- If a company's leadership fails to provide the vision and support needed for ethical conduct, then an ethics program will not be effective.

Ethical responsibility is not something to be delegated to lower-level employees.

- To satisfy the public's escalating demands for ethical decision making, companies need to develop **plans** and **structures** for addressing ethical considerations.
- Some directions for improving ethics are mandated through regulations, but companies must be willing to put in place a system for implementing values and ethics that exceeds the minimum requirements.

DEVELOPING AN EFFECTIVE ETHICS PROGRAM

AN EFFECTIVE ETHICS PROGRAM



DEVELOPING AN EFFECTIVE ETHICS PROGRAM

An Effective Ethics Program

- A company must have an effective ethics program to ensure all employees understand its values and comply with the policies and codes of conduct.

If the culture encourages unethical conduct, then misconduct is likely to occur even if the company has ethical guidelines in place.

- Because we come from diverse business, educational, and family backgrounds, it cannot be assumed that we know how to behave appropriately when we enter a new organization or job.

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An Effective Ethics Program

An Ethics Program Can Help Avoid Legal Problems

- Some corporate cultures provide opportunities for or reward unethical conduct because management is not sufficiently concerned about ethics or the company has failed to comply with the minimum requirements of the Federal Sentencing Guidelines for Organizations (FSGO; Table 8-1).

Companies may face penalties and the loss of public confidence if one of their employees breaks the law.

- Table 8-2 shows the percentage of CFOs and other financial people who would justify unethical and illegal behavior.
- Table 8-3 reports on the specific actions these individuals would take.

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TABLE 8-1 Minimum Requirements for Ethics and Compliance Programs

1. Establish standards and procedures to prevent and detect criminal conduct.
2. Ensure the firm's board, top management, and high-level personnel exercise reasonable oversight of those standards and procedures.
3. Make reasonable efforts to keep individuals whom organizations knew or should have known to have engaged in illegal activities out of key positions.
4. Communicate standards and procedures by training directors, employees, and appropriate agents.
5. Monitor and audit the program to detect criminal conduct, evaluate the program periodically, and have a system for reporting suspected violations.
6. Promote and consistently enforce the program through appropriate incentives and appropriate discipline.
7. After criminal conduct is detected, take reasonable steps to respond appropriately and prevent further similar criminal conduct, including necessary modifications to the ethics and compliance program.

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TABLE 8-2 **Justifications for Unethical or Illegal Behavior**

	CFO/FD	Other Finance
Survive an economic downturn	36%	46%
Meet financial targets	42%	N/A*
Improve financial performance	36%	46%

*N/A denotes not available.

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TABLE 8-3 **Unethical and Illegal Actions CFOs and Other Financial Managers Would Justify**

	CFO	Other Finance
Offering entertainment	24%	32%
Change assumptions: valuations/reserves	18%	20%
Cash payments	13%	16%
Personal gifts or services	13%	15%
Backdate contracts	9%	8%
Extend monthly reporting period	9%	14%
Book revenues earlier than they should	7%	11%
Misstating financial performance	3%	7%
At least one of these	36%	46%

DEVELOPING AN EFFECTIVE ETHICS PROGRAM

An Effective Ethics Program

Values versus Compliance Programs

- No matter what their goals, ethics programs are developed as organizational control systems, with the aim of creating predictability in employee behavior.

Two types of control systems can be created.

1. **A compliance orientation** creates order by requiring employees to identify with and commit to specific required conduct. It uses legal terms, statutes, and contracts that teach employees the rules and penalties for noncompliance.
2. **A values orientation** strives to develop shared values.

Although penalties are attached, the focus is more on an abstract core of ideals such as accountability and commitment.

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An Effective Ethics Program

Values versus Compliance Programs

The advantage of a value's orientation is that it gives employees a clearly defined basis on which to make decisions, one in which fairness, compassion, respect, and transparency are paramount.

- At the same time, diversity in employees' experience and personal values requires explicit communication and training on subject matter areas such as financial reporting, use of company resources, and intellectual property.
- Establishing compliance standards helps employees understand the rules of conduct when there are identified risks.

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An Effective Ethics Program

Values versus Compliance Programs

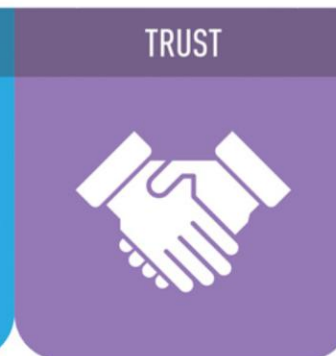
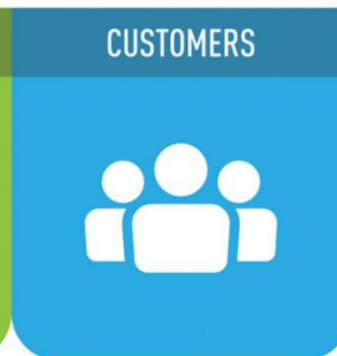
- Research into compliance- and values-based approaches reveals **both types** of programs can interact or work toward the same end, but a values orientation has the added benefit of sparking ethical reasoning among employees.
- **Values-based programs** increase employees' awareness of **ethics** at work, **integrity**, **willingness** to deliver information to supervisors, use of **reporting** mechanisms, and perception that **ethical decisions** are being made.
- **Compliance-based programs** are linked to employees' awareness of **ethical risks** at work and a clear **understanding of rules** and expectations that facilitate **decision making**.

DEVELOPING AN EFFECTIVE ETHICS PROGRAM

CODES OF CONDUCT



CODE OF CONDUCT



DEVELOPING AN EFFECTIVE ETHICS PROGRAM

Codes of Conduct

- The perception of business accountability has changed over the years; expectations for organizational codes of ethics have grown.

Today, society expects to see employees adhere to ethical principles and standards specified through company ethics programs.

- Most companies begin the process of establishing organizational ethics programs by developing **codes of conduct** or formal statements that describe what an organization expects of its employees.
- Such statements may take three different forms: 1. **a code of ethics**, 2. **a code of conduct**, and 3. **a statement of values**.

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1. Code of ethics

- **A code of ethics** is the most comprehensive and consists of general statements, sometimes altruistic or inspirational, that serve as principles and as the basis for rules of conduct.
- A code of ethics generally specifies methods for reporting violations, disciplinary action for violations, and a structure of due process.
- **Table 8-4** describes some benefits of having a comprehensive code of ethics.

A code of conduct is a written document that may contain some inspirational statements but mainly specifies acceptable and unacceptable types of behavior.

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TABLE 8–4 **Benefits of Having an Ethics Code**

A Comprehensive Code of Conduct Can...	
1.	Guide employees in situations where the ethical course of action is not immediately obvious.
2.	Help the company reinforce—and acquaint new employees with—its culture and values. A code can help create a climate of integrity and excellence.
3.	Help the company communicate its expectations for its staff to suppliers, vendors, and customers.
4.	Minimize subjective and inconsistent management standards.
5.	Help a company remain in compliance with complex government regulations.
6.	Build public trust and enhance business reputations.
7.	Offer protection in preempting or defending against lawsuits.
8.	Enhance morale, employee pride, loyalty, and the recruitment of outstanding employees.
9.	Promote constructive social change by raising awareness of the community's needs and encouraging employees and other stakeholders to help.
10.	Promote market efficiency, especially in areas where laws are weak or inefficient, by rewarding the best and most ethical producers of goods and services.

DEVELOPING AN EFFECTIVE ETHICS PROGRAM

1. Code of ethics

Some of the key reasons that codes of ethics fail:

- **(1)** Top code is not promoted, and employees do not read it;
- **(2)** Top code is not easily accessible;
- **(3)** Top code is written too legally and therefore is not understandable by average employees;
- **(4)** Top code is written too vaguely, providing no accurate direction; and
- **(5)** Top management never refers to the code in body or spirit.

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3. Statement of values

- The final type of ethical statement is a **statement of values** that serves the general public and also addresses distinct groups, such as stakeholders.

Value statements are conceived by management and are fully developed with input from all stakeholders.

- Despite the distinction made in this book between a code of ethics and a values statement, it is important to recognize that these terms are often used **interchangeably**.
- **Table 8-5** shows factors to consider when developing and implementing a code of ethics.

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TABLE 8–5 Developing and Implementing a Code of Ethics

1. Consider areas of risk and state the values as well as conduct necessary to comply with laws and regulations. Values are an important buffer in preventing serious misconduct.
2. Identify values that specifically address current ethical issues.
3. Consider values that link the organization to a stakeholder orientation. Attempt to find overlaps in organizational and stakeholder values.
4. Make the code understandable by providing examples that reflect values.
5. Communicate the code frequently and in language that employees can understand.
6. Revise the code every year with input from organizational members and stakeholders.

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Codes of Conduct

- Codes of ethics may address a variety of situations, from internal operations to sales presentations and financial disclosure practices.

Research found that corporate codes of ethics often contain about six core values or principles in addition to more detailed descriptions and examples of appropriate conduct. The six values are:

- (1) trustworthiness,
- (2) respect,
- (3) responsibility,
- (4) fairness,
- (5) caring, and
- (6) citizenship

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ETHICS OFFICERS



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Ethics Officers

- Organizational ethics programs must have oversight by high-ranking persons known to respect legal and ethical standards.
- These individuals—often referred to as **ethics officers**— are responsible for managing their organizations' ethics and legal compliance programs.
- Ethics officers are also responsible for knowing thousands of pages of relevant regulations as well as communicating and reinforcing values that build an ethical corporate culture.

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Ethics Officers

Ethics officers are usually responsible for:

1. **Assessing** the needs and risks an organization-wide ethics program must address
2. **Developing** and distributing a code of conduct or ethics.
3. **Conducting** training programs for employees.
4. **Establishing** and maintaining a confidential service to answer employees' questions about ethical issues.
5. **Making** sure the company is in compliance with government regulations.
6. **Monitoring** and auditing ethical conduct.
7. **Taking** action on possible violations of the company's code, and
8. **Reviewing** and updating the code.

DEVELOPING AN EFFECTIVE ETHICS PROGRAM

ETHICS TRAINING AND COMMUNICATION



DEVELOPING AN EFFECTIVE ETHICS PROGRAM

Ethics Training and Communication

- A major step in developing an effective ethics program is implementing a training program and communication system to educate employees about the firm's ethical standards.
- Training programs can also make employees aware of available resources, support systems, and designated personnel who can assist them with ethical and legal advice.

Training can empower employees to ask tough questions and make ethical decisions.

- Many organizations are now incorporating ethics training into their employee and management development training efforts

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Ethics Training and Communication

- Training and communication initiatives should reflect the unique characteristics of an organization: its size, culture, values, management style, and employee base. **To be successful, business ethics programs should educate employees about formal ethical frameworks and models for analyzing business ethics issues.**
- Then, employees can base ethical decisions on their knowledge of choices rather than on emotions.
- A key component of managing an effective and efficient ethics and compliance program is a firm grasp of techniques that clearly 1. **communicate** the company's values, culture, and policies for dealing with ethical issues to employees.

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Ethics Training and Communication

- Another training device is the 2. **behavioral simulation**, which gives participants a short, hypothetical ethical issue situation to review.
- Each participant is assigned a role within a hypothetical organization and provided with varying levels of information about the scenario. Participants must then interact to develop recommended courses of action representing short-, mid-, and long-term considerations.

These exercises help participants **gain awareness** of the ethical, legal, and social dimensions of business decision making; **develop analytical skills** for resolving ethical issues; and **gain exposure** to the complexity of ethical decision making in organizations. **Table 8-6** lists the goals for successful ethics training.

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TABLE 8-6 Key Goals of Successful Ethics Training Programs

1. Identify key risk areas employees will face.
2. Provide experience in dealing with hypothetical or disguised ethical issues within the industry through mini-cases, online challenges, DVDs, or other experiential learning opportunities.
3. Let employees know wrongdoing will never be supported in the organization and employee evaluations will take their conduct in this area into consideration.
4. Let employees know they are individually accountable for their behavior.
5. Align employee conduct with organizational reputation and branding.
6. Provide ongoing feedback to employees about how they are handling ethical issues.
7. Allow a mechanism for employees to voice their concern that is anonymous but provides answers to key questions (24-hour hotlines).
8. Provide a hierarchy of leadership for employees to contact when they are faced with an ethical dilemma they do not know how to resolve.

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Ethics Training and Communication

- When measuring the effectiveness of an ethics program, it is important to get input from employees.

Employee surveys and the incorporation of ethics measurements in performance appraisal systems are two ways to help determine the effectiveness of a firm's ethics training.

- If ethical performance is not a part of regular performance appraisals, employees get the message that ethics is not an important component of decision-making in their company.
- For ethics training to make a difference, employees must understand why it is conducted, how it fits into the organization, and what their own role in implementing it is.

DEVELOPING AN EFFECTIVE ETHICS PROGRAM

COMMON MISTAKES IN DESIGNING AND IMPLEMENTING AN ETHICS PROGRAM



DEVELOPING AN EFFECTIVE ETHICS PROGRAM

Common Mistakes In Designing And Implementing An Ethics Program

Common Mistakes In Designing And Implementing An Ethics Program:

- **Lack of Clear Goals:** Many companies fail to define the objectives of their ethics programs, such as preventing unethical behavior, improving stakeholder relationships, and fostering a unified corporate culture.
- **Unrealistic or Non-Measurable Objectives:** Programs often lack measurable goals or employee input, making it difficult to assess effectiveness.
- **Lack of Senior Management Commitment:** Without top-level leadership support and board oversight, maintaining an ethical culture is challenging.

DEVELOPING AN EFFECTIVE ETHICS PROGRAM

Common Mistakes In Designing And Implementing An Ethics Program

Common Mistakes In Designing And Implementing An Ethics Program:

- **Complex and Legalistic Program Materials:** Ethics materials written mainly by lawyers can be confusing; employee-friendly content with practical tools is essential.
- **Failure to Adapt Internationally:** Using a U.S.-centric program globally can cause misunderstandings; involving local personnel early ensures alignment with international standards.
- **Overly Lecture-Based Training:** Passive lectures are ineffective; interactive methods such as case studies and group exercises improve retention.



Thank You