

MORE THAN RULES & PLATITUDES: USING A CODE OF CONDUCT TO GROW AN ETHICAL CULTURE



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ETHICS BY DESIGN



Build Trust
Assure Compliance
Prevent Fraud & Misconduct

An ETHICS BY DESIGN On-Line Course for Business Leaders

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Introduction and Overview

Purposes of Course

This course has been designed to achieve two fundamental purposes:

1. To provide a basic understanding of the role of policies and procedures in creating an ethical cultures in organizations
2. To provide tools and resources that participants can use to create a code of conduct and other ethics policies for their companies

What this Course Covers

The course has the following 8 sections, consisting of lectures, readings, supplemental materials:

1. Introduction to corporate ethics
 - Ethics is about paying attention to the legitimate interests of others
 - Reciprocity: The Basis for Corporate Responsibility
 - Three levels of corporate ethics
 - Corporate Integrity
 - Multiple levels of ethical competence
 - Stewardship of the Professional Manager
 - Translation into Corporate Setting: The 8 P's of the Good Corporation
 - Growing the ethical culture systematically and organically
 - Measuring Goodness: Moral Accounting in the Corporate Context
2. The Business Case for a Corporate Ethics Program
 - Making the Business Case and Getting the Leadership on Board
 - From Bankruptcy to Industry Leader: Herb Taylor and the 4-Way Test
 - Robert Wood Johnson and the Johnson & Johnson *Credo*
3. Sarbanes Oxley, The Sentencing Guidelines, and Ethics Policies

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- The Ethics Provisions of Sarbanes Oxley
 - The Sentencing Guidelines Apply to Public and Private Corporations
 - 4. Professional Ethics & the Professional Manager
 - The Professional Challenge
 - Of Principles and Principals
 - The Trust Economy
 - Discretion and Fiduciary Duty
 - 5. Codes of Conduct and Other Ethics Policies
 - The nature of ethics the purposes of a code of conduct
 - The well-built and will-run business
 - Why we need rules and why rules are not enough
 - General Electric's *The Spirit and the Letter*
 - American Flatbread's *Philosophy*
 - Johnson & Johnson's *Credo*
 - 6. The Project Management Template for Creating a Code of Conduct and Other Ethics Policies
 - Lateral Leadership
 - Project Management Tools & Techniques
 - An Annotated Outline of Phases and Tasks in a Model Code of Conduct Project
 - The Code of Conduct Project Management Template
 - A *Project Kickstart* Template for a Code of Conduct Project
 - 7. Writing the Code of Conduct: The Content
 - Determine the Purposes and Goals You Want to Address With the Ethics Policy

Determine the Type of Policy You Want to Use (Rules, Aspirational Expectations, Statement of Principles, Ethical Constitution, Mixture)

Three Levels of Possible Content:

Basic content (ethics 101)

Mid-level problems

Creative ethical problem solving

Three Types of Moral Actors

Individual decisions and behavior

Group decisions and action

Corporate decisions and action

A Template for a Model Code of Conduct

8. Measuring Goodness: An Introduction

“You can’t manage what you don’t measure.”

Resources for assessing the corporation’s responsibility track record

Establishing metrics and data collection procedures for individual, group, and corporate goodness

How To Use the Resources of this Course

Listen to/Watch the Lectures

Much of the course is available in recorded audio-video format that you can watch or listen to on your computer or iPod.

Read the Texts of the Lectures and Supplemental Materials

All spoken lectures have been transcribed and are available in full-text format.

Additional texts are available that have not been recorded.

You can download and print written materials for your own use. The contents of this course are protected under U.S. copyright laws. Permission must be obtained before distributing any materials to others who have not registered for the course.

Visit the Websites

The Internet contains an abundance of highly valuable resources on general and corporate ethics. We have provided collections of links throughout the course to appropriate websites where you can obtain resources that will enhance and deepen your learning experience.

THE BASICS: AN INTRODUCTION TO CORPORATE ETHICS

Ethics is About Paying Attention to the Legitimate Interests of Others

Financial accounting is about money coming in and money going out and the balance between the two.

Ethics is about paying attention to the legitimate interests of others. Just as there is more to accounting than simply adding up income and expenses, there is more to ethics than this simple statement might suggest. However, in its essence, ethics is concerned with the impact of decisions and behavior on others – doing what’s appropriate and right.

As a rule, we are quite capable of looking out for our own interests. Paying attention to our conduct affects others comes less naturally. Much of ethics-- though certainly not all-- must be learned.

In this course, we will focus on aspects of ethics coming to play in a corporate context. Corporate or organizational ethics is distinct from ethics that we develop and apply to individuals alone. In what follows, we will be trying to make this distinction clear and to understand the implications of it for work within a corporation or other business organization.

Reciprocity: The Basis for Corporate Responsibility

The principle reciprocity is part of our ethical DNA. We were born with the need to return what others do to or for us. We repay kindnesses. But we also retaliate when harmed. Tit for tat is programmed into our genetic makeup.

The fundamental bargain that society makes with corporations is based on the principle reciprocity: Investors who put money into a corporation are shielded from personal liability with respect to claims made against the corporation itself. They may lose their investment, but that is all they couldn't risk. Thus, when a major oil company causes an environmental disaster of global proportions, the shares of stock might become worthless if the company goes bankrupt. But individual shareholders cannot be held liable for.

The principle reciprocity says there is no free lunch. If society puts up a wall between the corporation’s shareholders and its creditors, does not society have the right to expect something in return? Of course it does. That “something” is a contribution to the well-being of his society as a whole. In exchange for all the benefits that society provides two corporations in the form of limited liability, a legal system, physical infrastructure, fundamental research, education of prospective employees, and more, we expect corporations to provide good and services and to be good corporate citizens.

Reciprocity with stakeholders. A corporation does not and cannot exist or function without the coordinated cooperation of stakeholders. If you doubt this statement, spend a few days in bankruptcy court observing what is left of companies when the customers, employees, suppliers, lenders, and shareholders are gone. The remains are slim indeed. Most often someone else must clean up the mess that is left.

The simple truth is that corporations need their stakeholders and vice versa. Awareness is growing that a company's people are its most important asset. Alas, this language makes it sound as if the human beings in question were like a truck or building—something to be bought or sold, used or disposed of at will. We need better language to express the fundamental thought, which is that without the cooperation and contributions of knowledgeable, capable people—employees—a corporation has little value.

Because the corporation cannot exist without its stakeholders—most importantly, the employees—it must respect them as they must respect each other. The stakeholder theory of the corporation implies moral responsibility no less than membership in any group requires respect for the norms of the group.

Three Levels of Corporate Ethics

Moral responsibility exists at three levels in any corporation: individual, group, and the organization itself. Frequently, when people talk about business ethics, they are thinking solely of individual responsibility. But the acts of the corporation itself have an ethical dimension that is distinct from the responsibilities of the individuals and groups working within it. Long ago, the legal system recognizes that the corporation itself must be held responsible for what it does or what is done on its behalf.

Individual responsibility. Consciousness—and conscience—reside in the brains of individual humans. They are able to think, which is why we naturally look to them as the repositories of moral thought, of social responsibility. Any corporate ethics program must, therefore, focus both on the behavior of individuals in their own right and on their thinking and decision making as agents of the corporation. The first aspect concerns the interactions of individuals within the corporation on their own behalf—good manners, avoiding harassment or abuse of power, not stealing or engaging in other immoral acts. The second aspect concerns the exercise of official authority as stewards of the corporate interests. It covers a wide range of ethical issues from taking or accepting bribes to hiring and firing decisions to product design (Ford Pinto!) to decisions about plant closings to the use of corporate resources in community projects. This second side of individual responsibility is even more important than the purely personal domain and more difficult to understand and manage.

Group responsibility. People gather and communicate in committees and working groups. Such groups are key parts of the coordinated cooperation that constitutes

corporate activity. Often decisions seem to emerge from a group process by consensus or default. In such cases, there is no explicit decision maker, no vote taken, no one person responsible. Indeed, corporate consensus can grow across and out of the interaction of several groups. No one knows or can know who made the decision. True responsibility is diffused. The buck is homeless.

This feature of group communication and decision making creates a challenge for corporate ethics. How can we create a system of moral responsibility for processes that seem to have no moral center? One solution, of course, is to name one individual (say, a vice president of a division or director of a department) whom we hold responsible. But that is only partially effective. We need to find ways in which responsibility is integrated into the group process itself. We will return to this subject in later parts of the course.

Responsibility of the organization. The third level of corporate ethics concerns the corporation itself. What responsibilities does it have and how can we assure that it lives up to them? In some ways, this level of corporate ethics is less challenging than group responsibility. Unlike most committees and groups, the corporation as a whole has a governing body (the board of directors) that can adopt policies and approve procedures that control the exercise of corporate power. The challenge is more that of getting people to think of the corporation itself as a moral agent, something that appears to elude some of us.

The legal system has long held corporations liable for the acts committed on their behalf. The courts are merely reflecting moral intuition in this regard. To discharge a corporation's responsibilities to their various stakeholders, corporate leaders (board members and senior officers) must develop an awareness of those responsibilities together with procedures for determining the policies and procedures the corporation will use to assure compliance.

What Should We Mean by the Phrase "Corporate Integrity?"

Corporate integrity is closely related to corporate responsibility. But it is a deeper and more comprehensive concept. The word "integrity" comes from "integer," meaning wholeness or unity. It connotes soundness, the state of being unimpaired. A lack of integrity means that something corrupts or impedes appropriate behavior.

When we speak of corporate integrity, therefore, we are concerned with consistency of behavior throughout the organization coupled with authenticity – i.e., being in fact what the corporation appears to be.

Thus, corporate integrity has several nuances:

Wholeness. The various divisions and departments of a corporation with integrity make up a whole that hangs together. In this respect a corporation lacking in integrity will have different parts that are at odds with each other. This notion extends to the behavior of individual executives and managers. If they are fighting with or trying to undermine each other, the corporation lacks integrity.

Consistency. Closely related to the notion of wholeness is that of consistency. A corporation with integrity does not play favorites or otherwise change its behavior arbitrarily from circumstance to circumstance. Rather, stakeholders can rely on it to maintain consistent standards – to be dependable – in its dealings with all people and entities.

Authenticity. To have integrity implies that the face the corporation presents to the world is genuine. Corporate integrity cannot abide fakery and fraud. If we aspire to have a reputation for integrity, we must be transparent about who we really are. We cannot pretend to be something we are not. At its core, integrity implies honesty.

Congruity. This aspect of integrity refers to a good fit between words and deeds but also to a good alignment of values and decisions and actions among all parts of the corporation. If the public relations department is talking about the company's commitment to environmental values while a manufacturing division is dumping toxic waste into adjacent rivers or streams, the corporation lacks integrity. Its internal structure and behavior is incongruous. It does not fit together well.

Baseline Goodness

When we encounter ethical dilemmas (for example, whether to close a plant or reduce hours at all facilities), it can be difficult to discern the right course of action because right is pitted against right. The legitimate interests of two or more stakeholder groups are in conflict. In such cases, the challenge is to discover which of the two is “even more right,” as one 6th grade boy put it. Which stakeholder group has the better claim?

But most of the time, there is little question about what is the right thing to do. (Doing it is another matter.) I call this level of ethics – the level about which there is almost no disagreement – baseline goodness. The key requirements of baseline goodness include the following list:

Do good work. Fundamental to business ethics is providing good value in exchange for value received. This elementary feature of corporate ethics grows out of the principle of reciprocity. To give less than you get in return when the other party is unable to evaluate the quality is a form of cheating. Doing good work is also about maintaining a level of self-respect and pride that is an important part of internalizing ethical values.

Tell the truth. The temptation to deceive never goes away. Other animals engage in deception to get what they want. But deception destroys trust. And without trust, business either will not occur or will be unnecessarily costly (lawyers, written contracts, third party enforcers, etc.). Honesty remains the best policy. Cultivate habits of honesty by individuals and develop policies and procedures that assure the corporation itself tells the truth.

Keep your word. Every business and every person within a business should strive to keep promises. This implies that we should not make commitments we will have difficulty keeping. Like the other topics of baseline goodness, the injunction to do what you say applies in both small and great matters. Customers and other stakeholders come to trust the reliable company and reward it with repeat business.

Play fair. The principle of reciprocity returns in a different form. We all have a general sense of what is fair. The responsible corporation will have policies and procedures that assure that the right thing is understood as the fair thing as well. Decisions about compensation, hiring, firing, promotions, customer complaints, and other aspects of doing business should be infused with fairness. Give others what they are due. When they are accused, let them be heard.

Respect. In many ways, respect is the foundation of all morality and at the center of baseline goodness. At its core respect is about seeing the other person (or entity) as a subject and not merely as an object, as an end and not merely as a means. The Golden Rule (do to others what you would want them to do to you) encapsulates respect. The corporation that grows a culture of respect will be well on its way to fulfilling its moral responsibilities.

Mind your manners. I find that too many businesses take this aspect of baseline goodness for granted. Yet rude or inconsiderate behavior in the office is one of the leading causes of employee discontent. No one has said it better than Edmund Burke, writing in the 18th Century: “Manners are of more importance than laws. . . . Manners are what vex or soothe, corrupt or purify, exalt or debase, barbarize or refine us, by a constant, steady, uniform, insensible operation, like that of the air we breathe in.”

Do no harm. This ancient command of the Hippocratic Oath for Physicians applies to everything a corporation does – its relations with employees, the community, suppliers, creditors, and, of course, the Earth and the ecosystems it affects. The whole purpose of granting corporate charters (with limited liability) to groups of shareholders is to entice them to do something worthwhile for society. Whatever else they do, at the very least they must do no harm.

Multiple levels of ethical competence

Ethical competence consists of the knowledge and skills needed to respect the legitimate interests of others in social and business settings. In other words, it is about being able to act appropriately and to make morally responsible decisions. (As philosophers have remarked for thousands of years, however, knowing the right thing to do does not mean that you will do it.)

Developing ethical competence is similar to acquiring and honing any other skill. We all start with some native talent, which can be improved and enhanced through study, training, and practice. Of the multiple levels of ethical competence, three deserve particular attention:

Baseline goodness: Ethics 101. This is an amalgam of the universal law of morality (don't murder, tell the truth, play fairly, etc.), which people in every culture throughout time have acknowledged, and the cultural variations on it, largely in the form of etiquette and protocol. If you cross your legs showing the bottom of your shoe to someone from an Arab land, you have shown deep disrespect. In Japan people bow when they meet; in Germany they shake hands. We tend to assume that baseline goodness is a no-brainer that everyone in the office will know and observe. Alas, this is not the case.

Rules (encapsulated judgments). Certain types of ethical questions come up again and again in different settings. A salesperson wants to entertain a prospect in order to land an order. Are there any limits to what she may spend? Is it ethically appropriate to give the sales prospect season tickets to the games of a professional football team? If we know a particular kind of problem arises repeatedly, it helps to make a judgment about the correct response and reduce that judgment to a rule. Rules are, in effect, prepackaged judgments that can be unpacked when needed. They save time and brain power. And they lead to consistency of behavior throughout the organization. Taking the time to work through recurring ethical issues and to devise policies (rules) in response is ounce-of-prevention thinking.

Post-conventional thinking. Received wisdom, established norms and rules, and common practices are all conventional. But the norms and rules do not cover every circumstance. They are particularly inadequate in the face of moral dilemmas, quandaries in which no rule applies and which present a choice between two right or two wrong courses of action. Such dilemmas require creative moral thought, sometimes called post-conventional thinking. Two types of such moral dilemmas pop up repeatedly in corporate settings:

Conflicts among the legitimate interests of stakeholders (a/k/a The Dirty Hands dilemma). Suppose your company has discovered the formula for the morning after pill but the CEO of your company's largest shareholder thinks using such a pill is

tantamount to abortion, a sin. Is the correct decision to develop and market the pill, thereby satisfying the interests of some of the customers of the company? Or should the company deep-six the invention, bending to the wishes of the majority shareholder? Or suppose the company's sales have dipped so dramatically that you think one of the production plants needs to be closed. But closing it will not only put 230 people out of work; it will also devastate the community and hurt the company brand. How should this conflict between the interests of shareholders (profitability) and employees be resolved?

The Homeless Buck (a/k/a The Many Hands Dilemma). Much corporate decision making is characterized by the law and input from many people, some of whom may not even be in place of the corporation. It often happens that no single person or even a group "makes" the decision in the same sense that individuals make decisions. For example, the decision to launch Challenger in 1980 involved more than 50 people from three different organizations, all communicating by conference call. No doubt the "decision" by Toyota not to recall cars with defective braking systems came about in similar ways. In such circumstances, responsibility is diffused; there is no one to ask for an accounting.

Professionalism, Professional Ethics, and the Professional Manager

Executive officers and managers of corporations are professionals. By that I mean that their employment relationship with the corporation is one of agent-principal. That kind of relationship gives rise to particular legal and ethical obligations that are distinct from those of the entrepreneur or the traditional laborer.

The traditional laborer receives orders from a boss and is expected to do precisely as he is told. Frederick Winslow Taylor, the originator of scientific management, perfected the practice of determining how a human most efficiently performed specific tasks and then standardizing that process for everyone performing the job. This worked tolerably well when humans were integrated into the production process as part of the overall machinery.

On the other end of the spectrum, entrepreneurs are completely self-directed and accountable solely to themselves – at least at the outset. They determine what they will do, when they will do it, how much they will charge to customers, and so on.

Professional managers fall somewhere in the middle of these two extremes. They answer to a principal (the corporation as represented by the board or more senior officers); but no one micromanages what they do. To the contrary, the very nature of the professional relationship requires the professional to use her knowledge and skill – her expertise – on behalf of but not at the direction of the principal. If the relationship works properly, a supervisor sets goals and expectations; the professional determines how best to meet them.

The nature of the professional relationship gives rise to a particular kind of moral responsibility that we do not see either with the micromanaged laborer or with the entrepreneur. We call this moral responsibility a **fiduciary duty** and the relationship a fiduciary relationship.

A fiduciary duty requires the agent to subordinate her own interests to the principal's interests with respect to the subject of the professional relationship. It is a relationship of trust. The principal trusts the fiduciary (agent) to exercise her expertise on behalf of the principal—i.e., to do what the principal would do if he/it knew how or was physically present.

Thus, a babysitter has a fiduciary relationship with the parents of the child. The babysitter should look after the child just as the parents would were they home to do so. The babysitter may not, consistent with her fiduciary responsibilities, take advantage of the trust she has been given to further her own interests (e.g., by drinking a bottle of wine belonging to the parents).

A professional manager in a corporation should likewise exercise the power and authority entrusted to her for the benefit of the corporation and not her own. She is, of course, entitled to appropriate compensation for taking on the responsibility; but she may not use her access to the corporate checking account to augment her salary (embezzlement) or use her authority over subordinates to have them pick up her laundry or use her knowledge of corporate decisions to purchase stock that will shortly appreciate in value.

The 8 P's of the Good Corporation

We should never consider corporate ethics as something added on to the rest of the corporation. Ethics is a build-in, not an add-on. Individuals do not have a separate compartment from which they take out their moral responsibility on special occasions. Moral responsibility is part of who we are; it is wrapped up in our habits, our character. The same holds true for corporations. Thus, we must think of ethics within the context of all other aspects of the corporation:

Purpose (mission). At the core of corporate ethics is the purpose of the business—its mission. A corporation must *be* something, *stand* for something, be designed to *accomplish* something. And that something must be worthwhile—providing food at reasonable prices to people in the neighborhood or making communication possible between people at far ends of the country or world. Business is people doing things for each other. Unless the business has a clear purpose that is clearly communicated to the people who work in it, how can it possibly act with integrity or do the right thing?

People (stakeholders). It has become commonplace for PR departments and corporate flacks to mouth the cliché that “our people are our most important asset.” But for many

companies the cliché is true. And for all it should be. People do the work; and people ultimately benefit from the fact that the corporation exists.

(moral) **Principles.** Ethics cannot be reduced solely to first principles – honesty, fairness, etc. But unless the corporation is grounded in solid moral principles that provide guidance for most decisions most of the time, it will swing wildly with the prevailing fashions and be vulnerable to the infirmities of the occasional executive who is more enthralled with himself and what he wants than with his responsibilities to the corporation and its stakeholders. Principles are as important to the sustainable business as purpose. Indeed, the two go hand in hand.

Policies. Humans have consciousness and memory. Corporations have neither except in the form of written policies and cultural norms. But written policies are more important even than cultural norms because the latter can change imperceptibly with personnel changes. Once the board adopts written policies, they stay in place until changed, which requires a conscious, affirmative decision. Some policies are constitutional in nature and help define the very nature of the corporation.

Procedures. Procedures regulate how a corporation gets things done, how it puts policies into practice. Often they develop through trial and error; but here again the institutional memory needs some record of what the best procedures are. Nowhere is this more important than with decision making. The corporation is its procedures as much as it is its policies, principles, and people.

Passion. Who wants to work for a company in which people come to work counting the minutes until they can leave or dreading to show up at all? A good corporation inspires and supports the fervent engagement of employees, suppliers, and other stakeholders in the effort to accomplish its basic purposes. If the level of engagement is low, there is something wrong with the corporation that needs to be addressed immediately.

Performance. The good corporation does good work as do the people who contribute to its success. The principles, policies, and procedures contribute to this result. None of those are worth anything without passionate, engaged people. But ultimately, the customers of the company will say all is for naught if its goods and services are mediocre or worse. Customers have a moral right to expect and receive good work for good money.

Profitability. No corporation is any good in bankruptcy court. As David Packard put it, profit, though not the proper end of management, is what makes all the proper ends and aims possible. A morally responsible corporation will be managed in a fiscally responsible way. To do less is to put everything else – the goods and services made available to customers, the jobs of employees, the viability of suppliers, and the contributions to community welfare – in jeopardy. That said, profit is the means of goodness, not the end.

Growing the Ethical Culture Systematically and Organically

An ethical culture is not the product of written policies signed by all employees. Such policies may establish a framework within which to work but they do not cause individuals, groups, or the corporation to behave responsibly. A corporate culture imbued with ethical awareness and ethical competence is the product of continual, intentional effort.

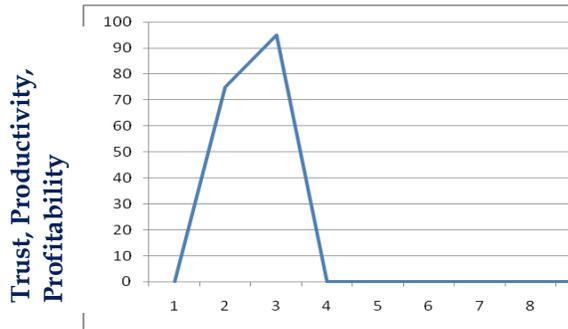
Like large oaks good corporations start with small seeds. So it is with an ethical culture. A tribe of 75-150 people develops unwritten norms which suffice because the tribe is largely self-sufficient. A small business with 2-5 employees needs little in the form of written ethics policies. But it does need some explicit commitment, some guide. The power of a charismatic leader with strong ethical bearings will dim as the corporation grows from 5 to 20 and then to 100 or 200. Better to find some short text that acts like a compass in the day-to-day uncertainties and temptations.

For this purpose, a fledgling company would do well to adopt the 4-Way Test devised by Herbert Taylor in the 1920's, which is discussed at length in section 2 of this course. The 26 words of Taylor's code of conduct cover many situations and contribute to the growth of a culture in which everyone learns to conduct business in accordance with baseline goodness: 1. Is it the truth? 2. Is it fair to all concerned? 3. Will it build good will and better friendships? 4. Is it beneficial to all concerned?

As the company grows, it will need to add layers of sophistication and ethical proficiency to meet the challenges of complex business relationships both within and outside the corporation. For example, larger companies need a code of conduct and other ethical policies to address special industry-related problems and to help managers and executive officers improve their abilities to make ethically sound decisions. An ethics hotline, coaching and mentoring, periodic training, some form of due process for those accused of misconduct, and an incentive structure that rewards employees for making tough decisions that keep the corporation on the straight and narrow path despite temptations to take expedient short cuts – all are features that a company might consider adding to reinforce a strong ethical culture.

Making the Business Case for a Business Ethics Program

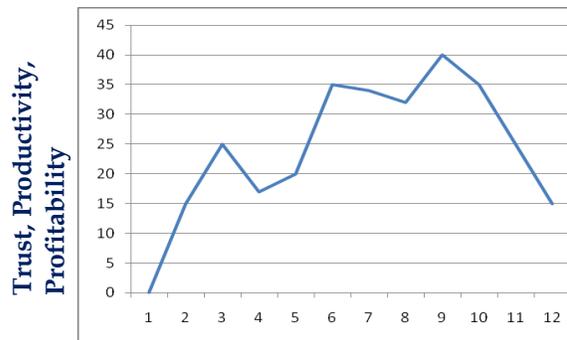
The Argument in a Nutshell:



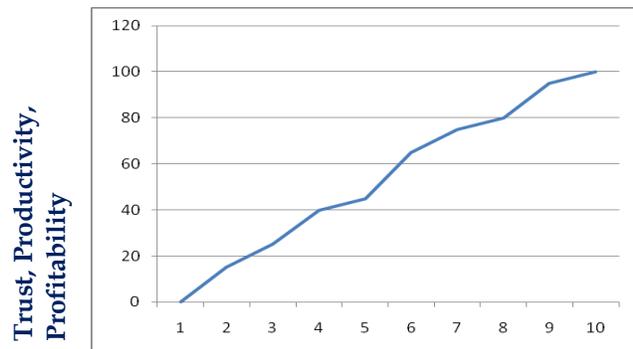
Bad Ethics



Really Bad Ethics



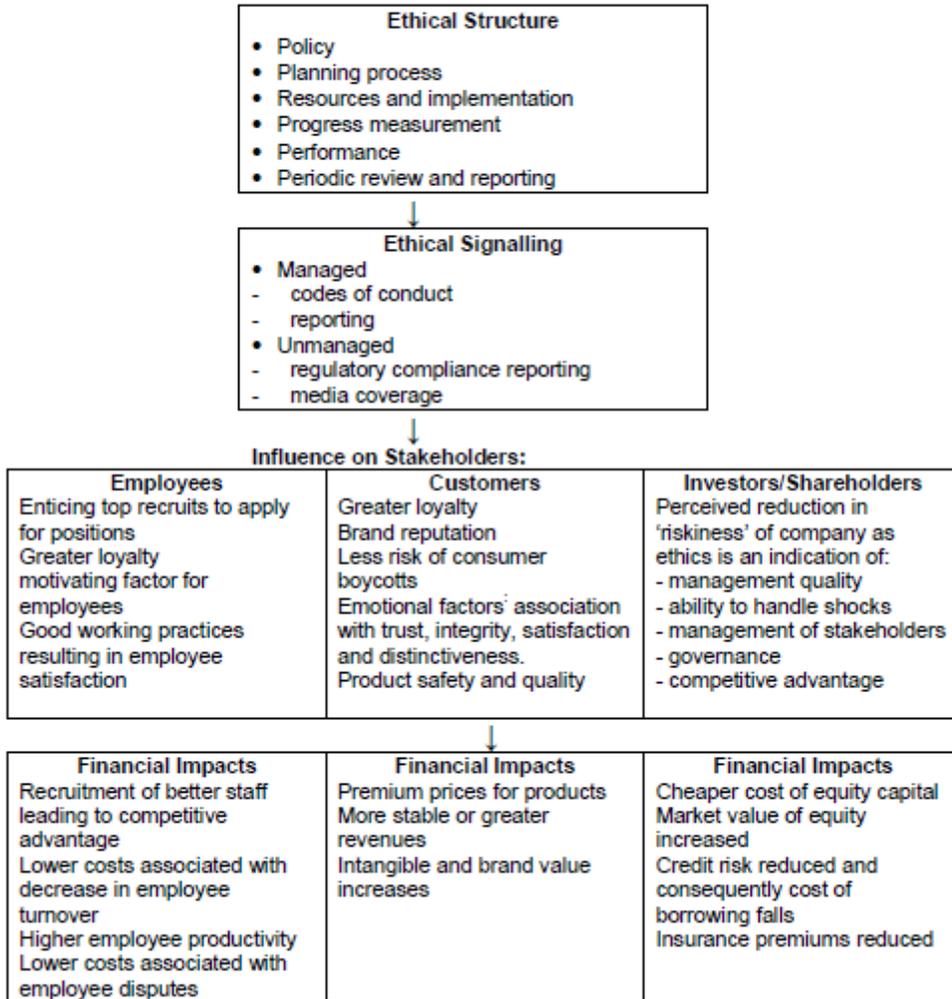
Mediocre



Good Ethics

The following chart summarizes the findings of a study in England showing how attention to ethics translates into corporate financial performance.¹

Summary Chart of the Relations of Ethics Policy on Financial Performance



Inattention to Ethics Increases the Level of Risk

Misconduct weakens and destroys businesses – both large and small. One study concludes that the main cause of failure of a majority of small business failures is fraud.² “White collar crime may be the most serious and yet the most under-recognized problem in the United States today, especially for small businesses.”³ According to a study conducted for the U.S. Department of Commerce in 1995, employee fraud and theft account for a whopping 30% of all business failures in the United States.

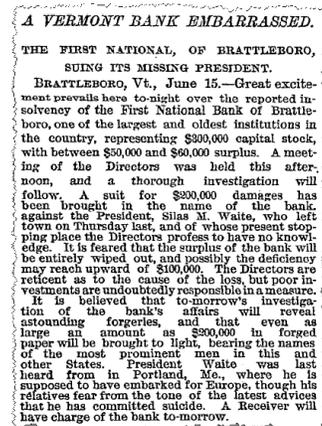
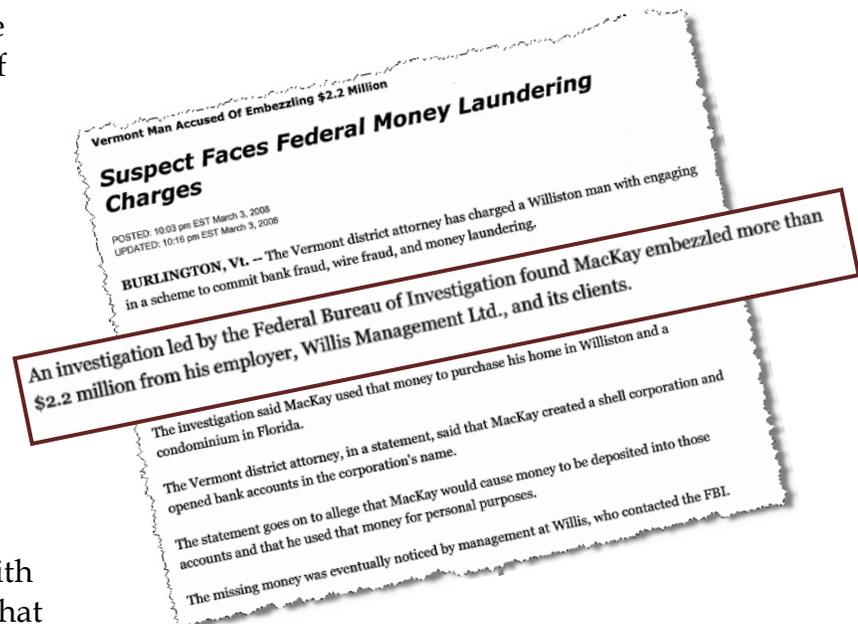
In my own legal practice, one client with only 12 employees lost over \$700,000 that a trusted bookkeeper embezzled over 6 years, and another suffered personal bankruptcy when an employee stole all the capital he had saved for his start-up dream company.

Experts estimate that American businesses lose around \$40 billion a year from fraud and theft, about 40% of which is internal, which means it is preventable.⁴ Fraud and

At least four of the top ten warning signs for fraud are related to

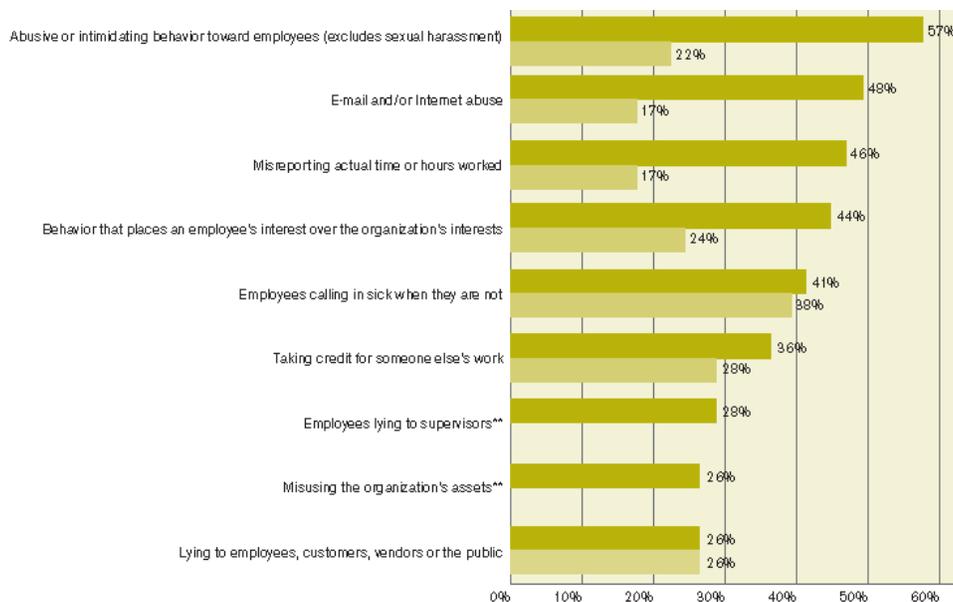
theft cost businesses of all sizes an average of 6% of gross revenues each year and about two of three employees in America are stealing at least something from their employers.⁵ “Of the top 10 warning signs for fraud, at least four are related to ethics.”⁶

But fraud and theft are not the only forms of misconduct that drain business resources. A study by Fulbright & Jaworski published in 2009, reveals that 45% of all business litigation revolved around labor and employment issues.⁷ Abusive bosses and co-workers chase away the best and most productive employees, leaving behind those who have trouble finding another job. Sexual harassment is still a big problem in all kinds of business settings, and the number of lawsuits filed by victims continues to rise every year.⁸ In 1994, businesses spent an average of \$600,000 to defend and resolve sexual harassment claims, a number that has surely grown since.⁹



A survey of Human Resource managers conducted in 2008 shows that five of the nine most common types of misconduct on the job involve lying, fraud, or other forms of deception:¹⁰

- Misreporting actual time or hours worked,
- Employees calling in sick when they are not,
- Taking credit for someone else's work,
- Employees lying to supervisors, and
- Lying to employees, customers, vendors or the public.



The Three Main Purposes of a Code of Conduct Program

Prevent Misconduct

Build Trust

Prioritize Values and Interests

Preventing Misconduct. As noted, embezzlement, fraud, pilfering, bribery, sexual harassment, and other forms of misconduct can cripple or even destroy a business — as a lawyer, I've seen it happen. Part of the problem is that not everyone agrees where the lines are to be drawn. That might astonish you, but it's true.

But it's not just misconduct for immediate personal gain that is a problem. Surprisingly often employees commit fraud or cover up product defects or suppress unwelcome information – all for the supposed purpose of benefitting the company. For example, senior officers in a pharmaceutical chain engaged in Medicaid fraud in order to compensate for disallowed claims that had been submitted too late.¹¹ Officers at another company deliberately kept the lid on information about defective medical devices, leading to the deaths of people whose lives might have been saved had their physicians been notified.¹²

A code of conduct program may be the least expensive and most effective insurance against fraud, theft, and other misconduct that you can put in place.

A code of conduct draws the lines. A good ethics program makes sure that everyone in the company knows where the lines are and abides by them. It is a very cost-effective means of protecting the business from misconduct.

Building Trust. Assuring an alignment of moral values and conduct among all employees and representatives of the business is an important means for building the trust that is essential to an efficiently run and profitable operation. When employees consistently treat customers, suppliers, and other stakeholders with respect, adhering to baseline precepts of goodness, stakeholders and business partners respond with **greater levels of trust**. A code of conduct program helps bring about that kind of consistent conduct throughout the business.



Prioritize Values and Interests. In an organization of any size, values and interests will sooner or later come into conflict. It is not prudent to leave the determination of which is more important than others to the personal opinion of whoever happens to be making the decision at any given moment.



A good code of conduct will make clear, for example, that obeying the law always comes first and trumps all other considerations. It will also indicate whether and when the interests of customers win if there is a conflict between customers and employees or shareholders.

And a good ethics program will help managers become ethically savvy, developing creative judgment for cases when the rules are inadequate and the conflict is between doing one right thing or doing another right thing.

In some ways, a business is like a car or truck, which must be designed and constructed well and operated responsibly. A code of conduct program is like the steering mechanism, the braking system, the oil filter, the seat belts, the airbags, and a GPS device. A code of conduct provides a measure of protection against risks as well as guidance on achieving the company's mission in a responsible way. If we forget to change the oil and filter, the engine will wear out more quickly and may grind to a stop. If we have faulty brakes, the car crashes. And a poor steering mechanism leads to collisions and inefficient progress.



You can pay me
now

Or we can think of a code of conduct program as a kind of moral compass that helps solidify a culture of integrity.

Whatever analogy we use, building ethical intelligence and competence into the structure of the business is a key to high-level success.

How a Code of Conduct Lowers Costs and Improves Chances of Success

A poor ethical culture adds a cascading array of direct costs through:¹³

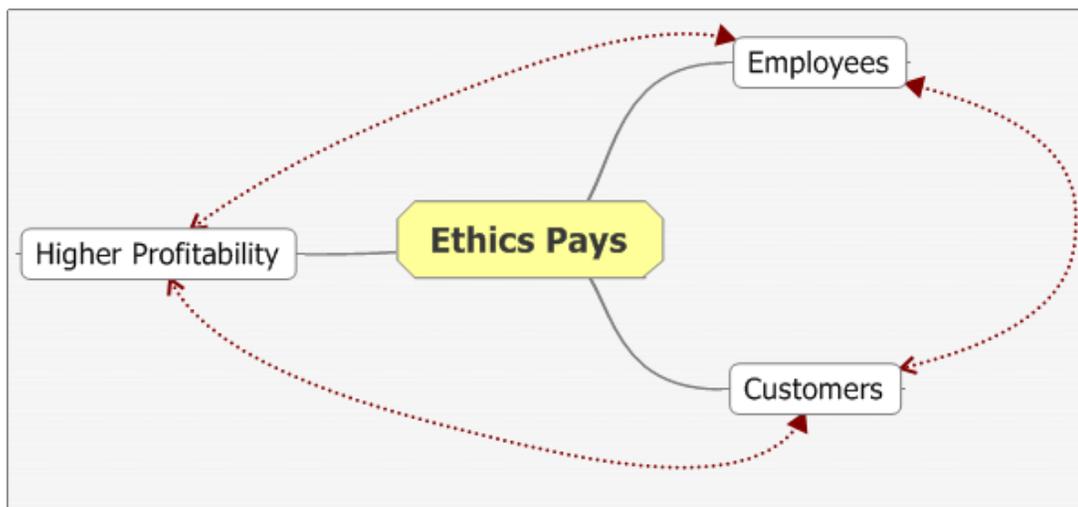
- Increased turnover
- Greater absenteeism
- Losses caused by fraud
- Losses caused by theft
- Lower productivity
- Increased litigation
- Civil damage awards
- Loss of customers
- Legal fines or sanctions
- Higher insurance fees

I have one "manager" who makes it as difficult as possible for people to take a day off. Her people actually dread to even speak to her. . . . Her people never get things done on time and take all the days off that they're entitled to. Critical project due soon? Sorry, it's 5pm, time to leave. I let my people take any time off they like, as long as the work is done. . . . They found it in their best interest to cross-train each other. And when critical work on a tight deadline needed to be done? They worked nights and weekends.
Shirking Working, *Business Week*

A strong ethical culture, on the other hand, pays rich dividends:

Numerous studies conclude that people who are treated well are

- more engaged in their work,
- more cooperative,
- more helpful to their colleagues,
- more punctual and time-efficient,
- absent from work less, and
- stay with the company longer.



Employees at good companies bond with each other more and make better contributions to the mission of the company.

Ethically aligned companies – where 360° respect is the norm – tend to have highly motivated employees who have high levels of productivity.

As Paul Millman says of his company, “Chroma Technology is a place where people can smart-up instead of dumb-down. We encourage people to bring their creativity, problem solving ability and smarts to the workplace.”

Employees in respectful workplaces are less likely to steal or engage in fraud or other kinds of misconduct.

Disrespect creates disgruntled employees who leave – and sometimes take stuff with them.

Respectful workplaces also experience lower rates of absenteeism and turnover.

And it costs money to recruit and train a replacement.

The 52nd employee hired by Google was the cook. He's now worth over \$24 million. But he's still the cook at Google.

A well-paid lawyer in a government office told me he left because he could no longer stand the backstabbing, bickering, sniping, and poisonous atmosphere of his workplace. His story is not unusual.

Good companies achieve higher levels of productivity.

There is a direct link between respectful workplaces and increased levels of productivity.

It's common sense. Employees who are more fulfilled and who find their work rewarding are likely to do it better and to do more of it.

One study projected that the increased productivity of employees in a morally responsible business could mean additional revenue of \$960,000 per 100-person business unit per year.¹⁴

Good companies keep loyal customers and suppliers.

Customers like to buy from ethical companies. We develop brand loyalty, not just because we like the product or service, but because we like the company itself.

The opposite can also be true. When I returned to America after living abroad for 10 years, I needed to drive from Alexandria, Virginia to Baltimore to pick up the car we had shipped. When attempting to rent a car to make the drive, I ran into an intransigent sales manager who insisted I must pay with a credit card, even though I was willing to leave a \$6,000 cash deposit because I had no card. I reminded him of the company's slogan – We Try Harder – all to no avail. Somehow, in the past 30 years, I've never gone back to Avis.

Customers support those companies they feel good about.

"How a company treats its employees and how it is perceived as an ethical and honest company are still the two most critical factors when consumers judge a company's performance as a good corporate citizen."¹⁵

At King Arthur Flour, a Vermont company that has grown from 5 employees to well over a hundred, customer loyalty is off the charts. Customers are constantly

sending in glowing letters praising the company. As one King Arthur Flower employee-owner put it, "People like doing business with the kind of business we are."

And happy customers feel good about telling other people about good companies like King Arthur Flour.



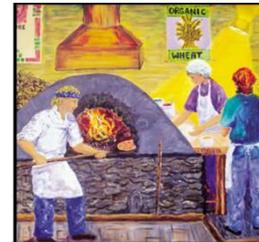
Acting responsibly toward suppliers translates into better deals.

There are many examples of suppliers who went the extra mile because they have been treated well by the customer.

The opposite is also true. Vendors tend to avoid abusive customers. For example, Wal-Mart tends to squeeze its suppliers so hard that some, like Rubbermaid, have gone out of business.¹⁶ As a result, some suppliers and professionals avoid Wal-Mart altogether.

Loyal customers and suppliers can save a company from failure at a time of crisis.

In 1998, American Flatbread's bakery was shut down by a major flood. Everything touched by water had to be replaced. 100 people immediately volunteered to help American Flatbread dig out and rebuild. A customer from Florida called and had two tons of kiln-dried wood delivered. Instead of being closed for a month, which might have ruined the company, American Flatbread was back up in a week. Founder George Schenk attributes that help directly to the good will the company amassed through its community outreach programs.



Good companies have fewer lawsuits and manage disputes better.

The more responsibly a company behaves – toward employees, suppliers, customers, and other stakeholders – the less likely it is to be faced with litigation and other costly conflicts. This is almost axiomatic.

When senior executives at Guidant discovered that their implantable cardioverter defibrillator had a defect that could cause it to short out, they initially considered notifying the patients and doctors but then decided to hush it up and keep delivering the defective ICD's already in stock.

Most people believe it would have been the right and necessary thing to inform physicians and patients about the problem when it was discovered. Yes, it would have been costly. But it would have enhanced Guidant's reputation for integrity and responsibility. Having failed this crucial test, Guidant must now absorb the costs of the massive recall *and* the legal fees for litigation (which will run into the

tens of millions) *and* the costs for the settlements and damage awards that are coming its way *and* the damage to its brand. (When Boston Scientific purchased Guidant, it retired the brand altogether.)

There are thousands of cases in which an ethical breakdown led to massive, even company-fatal litigation. The Ford Pinto cases, the asbestos cases (Johns Manville filing bankruptcy), numerous gender and racial discrimination cases such as the class action suit against Denny's, sexual harassment cases, and on and on.

Ethically strong companies do not avoid litigation altogether, but they have less of it and what they have is less costly. This is particularly true with respect to employment-related lawsuits.¹⁷

By growing trust good companies reduce risk and transaction costs.

Dotty Schnure of Green Mountain Power puts it like this:

"If our customers don't trust us, they are more likely to call regulators and complain. If we are open and transparent, that makes the regulatory process easier. If there is no trust, then the regulatory process is much more expensive."¹⁸



The less trusting we feel toward each other, the higher the transactional costs are going to be. The more trust, the greater the benefit. The relationship between articulated values and risk management is real and has an impact on financial success.

Good companies have better access to capital at less cost.

When American Flatbread ran out of space in 1992, they sought to expand on their landlord's farm. But the landlord's borrowing capacity was tapped out. At that time, American Flatbread did not satisfy standard loan criteria. But they got the loan anyway. When the loan committee said they weren't credit worthy, the loan officer pointed out that he was an American Flatbread customer. He said, "Their work is excellent, and the place is clean and I recommend that you make the loan."

That began a long, on-going relationship with the Chittenden Bank, which stemmed from the way American Flatbread treats its employees and its customers, from the quality of its products, and from its general reputation in the community as a good corporate citizen.

As George Schenk tells it, all these things translated into a benefit to the company in ways that he did not understand at the time. "The content of our character factors into our business decisions."

And now the Chittenden Bank features American Flatbread in its advertising series on model businesses.

Don't Oversell the Proposition

Crime pays. Unethical, sleazy, and criminal business practices would not be so wide spread if they did not provide some immediate benefit. The bad guys don't always get caught – or lose. As the graph at the top of this chapter indicates, an immediate spike in financial success can occur despite or even as a result of bad ethics – but not for long and mostly in the nether regions of society.

The business case for good ethics is not just that it's the right thing to do – although it is. Rather, the business case is twofold: (a) An unethical business is not sustainable. (b) An ethically built and operated business will outperform similar businesses that pay no attention to ethics. Individuals may well live most or all of their lives violating the law and get away with it. A business entity is a horse of a different color; in fact, it's a different animal altogether.

That said, in making the case to the leadership of your firm, it is unwise to pretend that the *financial* returns on an investment in a sound ethics program are immediate. They are not likely to be. The social benefits – improved morale, greater engagement, increased firm loyalty, better understanding of the company mission, higher productivity, better customer satisfaction – will show up soon, however. And they will lead to the financial return.

Choosing to build ethics into the structure of the business is a strategic decision.

When making the case that a company will be better off investing time and resources in the creation of a strong ethics program, it is important to stress that this is a strategic decision, not one of tactical expediency. The decision concerns what kind of company we want to be. Do we want to be a roman candle like Enron, crashing and burning after a glittering romp on the stage, or do we want to be a steady performer like Johnson & Johnson, consistently generating above-average returns on investment in both income and growth? If senior management wants to pursue the latter, then the remainder of this course can help.

From the perspective of the company's mission and financial well-being, the decision to build a code of conduct program as a tool for developing a strong ethical culture is a risk management decision. As fiduciaries responsible to the ultimate shareholder – the one left holding the bag when the music stops and the company collapses as a result of imprudent decisions or, alternatively, pocketing a premium when the company is sold or goes public – the leaders of a company must determine whether investing in ethics is wise. The evidence leads to the conclusion not only that it is, but also that a failure to attend to the ethical dimension of a company appropriately could be considered a violation of management's fiduciary duty.¹⁹

From Bankruptcy to Industry Leader: Herb Taylor, Club Aluminum, and The Four-Way Test

Herb Taylor had a problem. The Continental National Bank of Chicago had asked him to take on the leadership of Club Aluminum Products Company in an effort to salvage something for the creditors. Formed in 1923, the maker of waterless cookware had grown rapidly during the 1920's, but its debt had outstripped its growth. When the Continental National Bank asked Taylor to take over in 1930, Club Aluminum's balance sheet was in the red by more than \$400,000, an enormous sum at the time. 250 jobs were at stake at the company headquarters in Chicago alone, not counting the



hundreds of salesmen throughout the country who would join the growing ranks of people unable to find work if, as seemed almost certain, the company went down for the count.

Salesmen demonstrated Club Aluminum's waterless cookware through home parties, at which they showed special features. A set of Club Aluminum was expensive but worth the price if you nutritional meals with the flavor and vitamins locked in – and afford it, which fewer and fewer people could, as the buying consumers rapidly shrank.



off its cookware valued if you could power of

What would you do if a company's largest secured creditor had asked you to take over the fortunes of an insolvent company in the midst of the worst depression ever? Some, like Al "Chainsaw" Dunlap,²⁰ would start firing people and cutting operations right and left, extracting salary concessions from the temporarily spared employees and beginning the search for buyers of the choice assets in preparation for liquidating the company. Herb Taylor, in contrast, sought moral guidance:

The first job . . . was to set policies for the company that would reflect the high ethics and morals God would want in any business. If the people who worked for Club Aluminum were to think right, I knew they would do right. What we needed was a simple, easily remembered guide to right conduct—a sort of ethical yardstick—which all of us in the company could memorize and apply to what we thought, said and did in our relations with others.²¹

Although he was active in his church, Taylor was not aware of any religious teachings that specifically applied to the business world. Taylor tried the Chicago Public Library but found nothing that would serve as a concise code of conduct for Club Aluminum. He prayed and fretted. Finally, one day he went into his office, shut the door, put his head down on his desk, and, after about 20 minutes, was inspired to write The Four-Way Test:



The Four-Way Test of All We Think, Say, and Do

1. Is it the truth?
2. Is it fair to all concerned?
3. Will it build goodwill and better friendships?
4. Will it be beneficial to all concerned?

Taylor was not sure this little code of conduct would actually work for Club Aluminum. Having had a successful career as a high-level executive in the Jewel Tea Company, he had first-hand knowledge of the norms and practices of business people – especially traveling salesmen – in the early part of the 20th Century. For many, business was a dog-eat-dog world, in which only cursory thought was given to the interests of others, if that.

Still, Taylor felt he should give the test a try. So, for 30 days, without telling anyone else, Taylor tried to conform his own behavior to the implicit mandates of The Four-Way Test. He found to his amazement that it sharpened his ethical awareness and strengthened his resolve. Although he was a religious man who led a Sunday school class and considered himself to be above reproach in ethical matters, this little collection of four questions totaling 26 words helped him improve his thinking and behavior when dealing with others.

Following his own positive experience with The Four-Way Test, Taylor introduced it to the senior executives of Club Aluminum, asking them to give it the same tryout. At the end of the 30 days, these top-level managers reported that The Four-Way Test should be distributed throughout the company.

And so everyone in Club Aluminum came to have wallet-sized cards reminding them of The Four-Way Test whenever they were working on behalf of the company:

Not only did we put the four-way test into practice with our salesmen, we printed The Four-Way Test on the backs of our calling cards. Our salesmen were instructed to say something like this: “Of course, I can’t live up to this perfectly, but I’d appreciate your help. Whenever you find I’m not living up to it, let me know, and I’ll do my best to change.”²²

Taylor credits The Four-Way Test with having played a major part in rescuing Club Aluminum from bankruptcy and making it a highly successful company, one that was so financially prosperous that Taylor was able to go into semi-retirement in order to pursue his lifelong ambition of working with young people around the world. As he put it, “These words are not only responsible, to a great degree, for the success of the Club Aluminum Products Company, but they are also credited with changing the lives of hundreds of thousands of people all over the world.”²³

In writing about the Club Aluminum experience with The Four-Way Test, Taylor states:

Anyone who checks his thoughts, his words and deeds against The Four-Way Test before he expresses himself or takes action is almost certain to do the right thing. People go through life following their strongest thoughts so the challenge is to direct thoughts in the right path.

* * *

It has been called an implementation of the Golden rule. After all, what would you have others do with you but be sincere? To be fair and just, kind and thoughtful and helpful when you need help?²⁴

Respect Pays Off

Taylor reported that the test “worked wonders.” Rather than using their skills to talk dealers into taking more cookware than they needed, salesmen worked with them to determine what they could reasonably expect to sell, giving them advice and supporting materials to help them succeed. “[W]e began winning renewed confidence from our dealers. This feeling was passed along by the dealers to the eventual customers, and sales began to climb steadily.”²⁵



These glowing words should not be taken to mean that The Four-Way Test always led to a decision likely to boost the bottom line in the immediate quarter. Quite the contrary. And there were temptations to exit the lofty high road for more expedient byways:

At times The Four-Way Test was hard to live up to—considering that we had very little cash; the company was still bankrupt and we were in the midst of the national depression. One of our top salesman came in one day—a man whose judgment I respected—and said that The Four Way Test was going to play havoc with our sales.

“Our procedure” he said, “has always been to sell a dealer as much as we can, even if we load him down with our product.” The dealer usually bought more than was good for them, carrying a larger inventory that he needed and, as a result, he was forced to push our products to customers who might not want or need them.

“Your procedure doesn’t agree with point number three in the four-way test as far as I can see,” I told the salesman. “It won’t build goodwill with either the dealer or the final customer. And it certainly doesn’t agree with point number four, “Will it be beneficial to all concerned?”

Then I told him to try selling according to The Four-Way Test. I suggested it would be more profitable in the long run.²⁶

It's Not Always Easy to Do the Right Thing

Not long after Taylor began making changes, the company's sales manager excitedly announced a possible order for more than 50,000 utensils. The looming bonanza came when Club Aluminum was still insolvent and during the slow season of the year. It must have looked like manna from heaven. The company desperately needed this business deal.

But "there was a hitch." The potential customer intended to sell the products at a substantial discount, which would undercut the regular dealers who had invested time and money promoting the products at a set, fair price. Accepting the order would not be fair or beneficial to them.

"We turned the order down," Taylor writes, "probably the most difficult thing we had to do in those early bankrupt days. But there was no question that this particular business transaction would've made a mockery out of The Four-Way Test principles we lived by."²⁷

On another occasion, a printer won a print job from Club Aluminum because his was the low bid by \$500, not pocket change in the 30's. But when he delivered the materials, the printer confessed that he had made a \$500 mistake in his estimate and asked whether Club Aluminum would be willing to make up his loss.



It would have been standard operating procedure in most of the business world at the time (and probably now) to tell the printer that a deal is a deal. Indeed, the executives at Club Aluminum had much the same reaction when they conferred about the matter, one of them saying, "We acted in good faith—let the printer take his loss." Another man, however, pointed out, "But that may not agree with point number two in The Four-Way Test. If the printer made an honest mistake, then it will not be *fair to all concerned* if we penalize him. Let's find out, first, if it *was* an honest mistake."²⁸ After confirming that the printer had not deliberately misbid, the executives added \$500 to the payment. Taylor adds, "Without The Four-Way Test, I doubt that we would have."²⁹

The Four-Way Test Becomes Part of the Aluminum Club Culture

Taylor reflected on why The Four-Way Test was so effective: "A man who trusts you will do business with you. . . . The Four-Way Test, for example, gives a man self-respect when he carries it out. No matter what other people may think of him, *he* knows what he is inside; following The Four-Way Test erases self-doubts and anxieties. He is stronger for it. . . . In time—without fail—anyone who follows The Four-Way Test faithfully will notice that others think more highly of him also."³⁰

By making an effort to practice The Four-Way Test as faithfully as possible, employees of Club Aluminum built a storehouse of goodwill and trust not only among its dealers and ultimate consumers but also with its competitors. Taylor believed that their practice of never saying anything derogatory about a competitor – even complimenting them when appropriate – helped the entire industry grow in the esteem of dealers and consumers alike, leading to more sales for all.³¹



Others testified to the effectiveness of The Four-Way Test: “It became a way of life when I was there,” said one executive. “We were very conscious of it. Just the fact that we enunciated it the way we did had a powerful impact on us and those with whom we did business.”³²

“Sometimes we were challenged on it,” another executive remembers, “but the top man believed in it and set the example. That’s what made it work. And it sunk down to all the employees. I think it’s one reason we had so little turnover. We were a close team.”³³

Taylor found The Four-Way Test had value in relations between production employees and management as well. He felt that strikes, lockouts and industrial strife in general “can be traced directly to selfishness, insincerity, unfair dealings, or fear or lack of friendship among the men concerned.”³⁴ Accordingly, Taylor made sure that The Four-Way Test was included in the contracts negotiated with union employees at Inland Glass Works, a company Club Aluminum purchased in 1951. Management representatives found it difficult to ignore the implications of the test when engaging in contract negotiations. And when Inland Glass was later shut down, Taylor made sure every employee found another job.³⁵

Success Does Not Come Without a Few Nay Sayers

Some executives and stockholders dissented from the view that The Four-Way Test was best for the company, believing that the test prevented Club Aluminum from maximizing profits, turning down opportunities less scrupulous firms would have seized eagerly.

And practicing what the company preached could be challenging at times. Dom Drumtra – who as merchandise manager received letters complaining about discoloration, wear and tear on the Teflon finish, and problems with handles, bushings, and knobs – felt that the company was “compounding some of our normal service problems by publicizing what really are our standards of business ethics and giving our customers an opportunity to measure us and our product by these rather than the actual performance of our product compared to others of its kind.”³⁶

As the man who had to read and respond to the letters, Drumtra did not particularly like the practice of including a copy of The Four-Way Test with every product sold along with a letter from the company president encouraging customers to write if they were not entirely satisfied with the product. "I'm sure they would forget their gripes if we were not so clear, all inclusive, and specific about who and where to write," Drumtra said.³⁷

The Proof of the Pudding

But most no doubt (perhaps even Drumtra) would agree with Taylor's assessment that The Four-Way Test played a key role in creating an ethical culture in the company that helped it perform at high levels – efficiently and profitably. After all, Club Aluminum paid off the entire \$400,000 debt – with interest – only five years after the Continental National Bank asked Taylor to save the sinking ship. When Taylor devised The Four-Way Test, the creditors would have been happy to get 10 cents on the dollar.³⁸

It could be argued that the people and the products, not ethical conduct, made the difference. Yes, they were important; but the company got into financial trouble with the same people and products – before the stock market crash and before the onset of the Great Depression.

It would be easy to characterize the experience of Herb Taylor and Club Aluminum with The Four-Way Test was an aberration from the normal way that businesses succeed in the United States. Some might even suggest that the success of Club Aluminum was due more to Herb Taylor's business acumen than it was to any quaint moral code – especially one as unrealistic as The Four-Way Test. After all, how far would we get by asking whether our thoughts and deeds were beneficial to our competitors? Well, as the saying goes, the proof of the pudding is in the eating. And the creditors, employees, and shareholders of Club Aluminum ate very well.

Over the next 15 years, Club Aluminum distributed over \$1 million in stock dividends and saw its net worth climb to over \$1.75 million, a turnaround within 20 years of over \$2.15 million. Not a bad result for 26 little words.

The Four-Way Test Goes Big Time

An active member of the Chicago Rotary Club for many years, Herb Taylor became its president in 1938. As more and more Rotarians learned about The Four-Way Test, some proposed that Rotary should take on the job of promoting it worldwide, an idea to which Taylor gave his whole-hearted consent in 1952. When he became President of Rotary International in 1954, he took advantage of the opportunity to carry The Four-Way Test with him on his visits to Rotary clubs around the world.



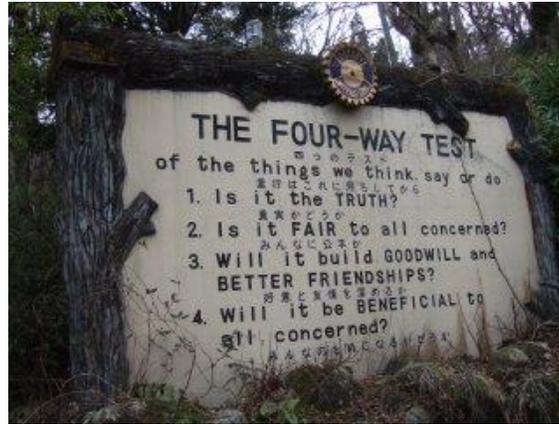
Today, every place that Rotary clubs meet there is likely to be a plaque or poster announcing The Four-Way Test. Hundreds of thousands of Rotarians display such posters in their offices and places of work. Rotary clubs and individuals around the world organize and sponsor essay writing contests and other activities to promote the test.

I remember seeing a framed poster of The Four-Way Test in my father's office when I was ten years old. I did not fully appreciate this list of questions at the time. They do, after all, require some thought. But over the years I have come to admire this little code as the embodiment in compact form of some of the soundest principles of business ethics.

Some Lessons to be Learned

Among the lessons to be drawn from the story of Herb Taylor and The Four-Way Test are the following:

1. Moral responsibility matters. It is a key ingredient in trust building, without which any on-going business is not possible.
2. It is important to have a written guide to which everyone within the organization can refer and which serves as a common orientation.
3. It is important to test actual decisions against the written guide. Part of the genius of The Four-Way Test is that it was composed not as commands but as questions, thereby serving the same kind of function as a thermometer or blood pressure machine, asking how are we doing with respect to our moral constitution.
4. It is important that top-level executives take the lead in implementation. Without the right tone at the top, any code of conduct will be worse than mere rules and platitudes. It will feed cynicism, resentment, and bitterness.



THE PROFESSIONAL CHALLENGE

Carol and Terrance Carpenter have asked 15-year old Joyce Howard to babysit their 4-year daughter, Cynthia, while they go out to a dinner/dance at the local country club. They seldom go out, and this is the first time in over two years that they have left Cynthia with someone else for an entire evening. "I'm sure she'll be fine with Joyce," Terrance reassures Carol. "Joyce comes from a good family and has a level head on her shoulders."



When Joyce arrives at 6:30, Cynthia has already eaten and is dressed for bed. Carol tells Joyce that she can play with Cynthia for awhile but would like Joyce to read her a story and put her to bed by 8:00. The Carpenters don't expect to get back until around 11:30. After the Carpenters leave, Joyce plays with Cynthia and around 8:00 puts her to bed.

As soon as Cynthia is snoozing, Joyce calls her boyfriend Brad, who comes over to the Carpenter house in about 15 minutes. Joyce and Brad settle in to watch a movie on the Carpenter's home entertainment system.



Around 9:00, they decide to raid the fridge, helping themselves to some beer and snacks. About 10:15, Joyce hears Cynthia crying in her room. Joyce tries to rock her back to sleep but is not having much luck.



Brad, eager to get back to the extracurricular activity he and Joyce have been enjoying, suggests that Joyce try an old home remedy he heard of: "Just give her a shot of vodka in a glass of orange juice." At first, Joyce is not sure this is a good idea, but seeing it as a way to get back to more fun on the Carpenter's couch, Joyce mixes a screwdriver for Cynthia who is back to sleep only a few minutes after drinking it.



By the time the Carpenter's return at 11:30, Brad is gone, all evidence of eating and drinking has been cleaned up, and Cynthia is . . . well, sleeping like a baby. Joyce reports that the evening was uneventful. Terrance drives her home and pays her \$50 for watching over Cynthia.

That was the story of Carol, Terrance, Cynthia, Joyce, and Brad. Now consider the story of Frederick Winslow Taylor and Schmidt:

While employed as a consultant for a steel mill in Pennsylvania, Taylor approached a group of workers who spent the day loading pig iron onto a train car from a yard where it was stacked onto the ground. As Taylor tells the story in his book, *The Principles of Scientific Management*, he called Schmidt, one of the workers, aside and had the following conversation with him:

"Schmidt, are you a high-priced man?"

"VeIl, I don't know vat you mean?"

"Oh yes, you do. What I want to know is whether you are a high-priced man or not."

"VeIl, I don't know vat you mean?"

"Oh, come now, you answer my questions. What I want to find out is whether you are a high-priced man or one of these cheap fellows here. What I want to find out is whether you want to earn \$1.85 a day or whether you are satisfied with \$1.15, just the same as all those cheap fellows are getting."

"Did I vant \$1.85 a day? Vas dot a high-priced man? Well, yes, I vas a high-priced man."

"Oh, you're aggravating me. Of course you want \$1.85 a day -- Everyone wants it! You know perfectly well that that has very little to do with your being a high-priced man. For goodness sake answer my questions, and don't waste any more of my time. Now come over here. You see that pile of pig-iron?"

"Yes."

"You see that car?"

"Yes."

"Well, if you are a high-priced man, you will load that pig-iron on that car tomorrow for \$1.85. Now so wake up and answer my question. Tell me whether you are a high-priced man or not."

"VeIl – did I got \$1.85 for loading dot pig iron on dot car tomorrow?"

"Yes, of course you do, and you get \$1.85 for loading a pile like that every day right through the year. That is what a high-priced man does, and you know it just as well as I do."

"VeIl, dot's all right. I could load dot pig-iron on the car tomorrow for \$1.85, and I get it every day, don't I?"

"Certainly you do -- certainly you do."

"VeIl, den, I vas a high-priced man."



"Now, hold on, hold on. You know just as well as I do that a high-priced man has to do exactly as he's told from morning till night. You have seen this man here before, haven't you? Well, if you are a high-priced man, you will do exactly as this man tells you tomorrow, from morning till night. When he tells you to pick up a pig and walk, you pick it up and you walk, and when he tells you to sit down and rest, you sit down. You do that right straight through the day. And what's more, no back talk. Now a high-priced man does just what he's told to do, and no back talk. Do you understand that? When this man tells you to walk, you walk; when he tells you to sit down, you sit down, and you don't talk back at him. Now you come on to work here tomorrow morning and I'll know before night whether you are really a high-priced man or not . . ."

Schmidt started to work, and all day long, and at regular intervals, was told by the man who stood over him with a watch, "Now pick up a pig and walk. Now sit down and rest. Now walk – now rest," etc. He worked when he was told to work, and rested when he was told to rest, and at half past five in the afternoon had his 47½ tons loaded on the car. And he practically never failed to work at this pace and do the task that was set him during the three years that the writer was at Bethlehem. And, throughout this time he



averaged a little more than \$1.85 per day, whereas before he had never received over \$1.15 per day, which was the ruling rate of wages at that time in Bethlehem. That is, he received 60 per cent higher wages than were paid to other men who were not working on task work. One man after another was picked out and trained to handle pig-iron at the rate of 47½ tons per day until all of the pig-iron was handled at this rate, and the men were receiving 60 per cent more wages than other workmen around them.³⁹

Consider one more story. One bright summer morning George decides to go into business for himself. He gets some wood, paint, nails, and poster board that have been lying around the basement of his parents' house and creates a lemonade stand. He then



takes some of the money he has saved from his allowance, buys a lemonade mix, and prepares a couple of gallons of iced lemonade. Once he has his product ready, he goes out to the street corner and opens up for business, charging 35 cents per glass. At the end of the day, George has sold 43 glasses of lemonade, generating a gross income of \$15.05. After deducting the \$8.25 he paid for the

lemonade mix, George has a net profit of \$6.80.

What makes Joyce – or any other babysitter – different from Schmidt and George? What is the *essential* difference in the work being done by these three people?

Let's start with George. Once George decides to go into business, every decision he makes is governed by his own interests alone. Whether to build a lemonade stand out of wood or some other material is up to him. What hours to operate, whether to serve lemonade or some other drink, how much to charge, whether to be polite or rude to his customers, and everything else is literally his business and no one else's. He is, as they say, his own boss. He is not working for anyone else. As a lemonade stand owner, George need not consider the interests of others – except, of course, as the general norms and rules of society require. Otherwise, however, he need answer to no one.

Schmidt, on the other hand, has no discretion whatsoever. Ostensibly, his job is to move pig-iron from one place to another. But after he agrees that he is a "high-priced man," his job becomes that of doing exactly what he is told to do, when he is told to do it – no more, no less. As a high-priced man, Schmidt has become a tool of another person's will. He is not asked to exercise any judgment about what is best to do. He must completely divest himself of any judgment at all.

Joyce has entered into a special kind of relationship. She is not completely free to do as she likes in pursuit of her own interests as is the case with George. Nor is she being micromanaged like Schmidt. Her situation is something of a hybrid between that of George and Schmidt.

What's the difference?

- George is his own boss.
- Schmidt has no discretion. Exercises no independent judgment. He is micromanaged.
- Joyce is entrusted with resources, power, and authority and expected to exercise independent judgment for the benefit of the Carpenters.

The Carpenters have lent Joyce resources, power, and authority that normally belong to them. Her commission is to watch over their daughter, Cynthia, while they are away. The Carpenters expect her to exercise independent judgment on their behalf for the benefit of Cynthia. To do that Joyce must respond to events as they happen, much like what the Carpenters would do if they were present. The Carpenters expect her to protect and further their interests. Certainly, if there is any conflict between what she wants and what is best for Cynthia, the Carpenters expect her to do what's best for Cynthia. Joyce's interests come second.

Employees of a corporation can have a professional relationship with the corporation. To the extent that they are entrusted with power and authority and expected to use their judgment to act in the interests of the corporation, they are professionals.



Elements of a Definition:

- Expertise
- Independent judgment
- For the benefit of a client
- Subordination of self-interest
- Responsible to client
- Responsible to larger society

Professionals and Ethics

Let's return to the Carpenters. They need to engage a babysitter. What concerns might they have? Can the person we are engaging do the work? Does she know how to feed, clothe, bathe, and properly play with the child? Will she know what to do if an emergency develops? Can we count on her to exercise good judgment? In short, is she **competent**?

A parent will also want to know that the prospective babysitter will not abuse the power and authority with which she is being entrusted. Can we be confident that she will not harm the child in any way – either willfully or negligently? Will she steal from us? If there is a choice between doing what's best for our daughter and pursuing her own pleasure or convenience, will she subordinate her own interests to ours and those of our daughter? In short, is she a person of good moral **character**?

The fundamental ethical concerns in the professional relationship revolve around competency and moral character.

Schmidt's boss need not have much concern about Schmidt's character or his competency. If Schmidt cannot do the job, the boss will know it immediately. George's customers certainly need to trust him not to adulterate the lemonade or to take advantage of them. But if the product is bad or they find they have been cheated, they can take action immediately by simply refusing to buy any more lemonade.

The clients of a professional are in a different position from that of Schmidt's boss or George's customers. Such clients often have little understanding of the special knowledge and skills that their lawyer, architect, physician, or engineer uses on their

behalf. They may not know, therefore, whether their lawyer is doing a competent job until it is too late to protect themselves. Clients often must trust professionals not only to be competent but also to be the source of information on what competency means in a particular setting.

We must also rely on professionals to use the power and authority with which we entrust them for the interests of their clients.

Suppose, for example, you are the shaman of your tribe. Shamans have special, often secret, knowledge. Your job as the tribal shaman is to communicate with various spirits. You have healing functions. You perform or lead rituals designed to make the land fertile, to induce rain, and generally to increase the prosperity of the group. A shaman often has magical powers with which he or she can cause good or bad things to happen to others.



As a shaman, is it morally permissible for you to use your office, your knowledge, and your special powers for purely personal purposes, say to take revenge on someone who has harmed you or to extort payments or favors from another member of the tribe?

Professionals perform much of their work when the client is not around. The Carpenters may never learn that Joyce and Brad gave Cynthia a screwdriver to get her back to sleep. They also may not notice the missing beer. It is precisely because clients cannot always check up on the professionals they engage that the professionals must strive to achieve the highest levels of integrity.

Professionals must also comply with the special responsibilities that grow out of the nature of the profession to which they belong. On occasion, the professional's responsibility to the client supersedes all other considerations – even those to society in general and other individuals. For example, if a friend confesses to you that she has murdered someone, you may be required by law to turn her in. If she confesses the same thing to her priest, the priest may be prohibited from telling anyone else, including the police or prosecutors. Such restrictions are not for the benefit of the individual client. In this case, the confidentiality of confessions to clergy is not there to protect murderers. Rather, it exists to encourage complete candor on the part of all communicants. The murderer just happens to be a coincidental beneficiary of a rule developed for other reasons.



Tensions can also arise when the client wants the professional to do or say something that contravenes the profession's ethical code. The client may want her lawyer to destroy incriminating documents, for example. But the ethical lawyer will refuse to do so, even if it means losing the client. Not only does the professional have a responsibility to society not to



be an accomplice in fraud; but a failure to draw strict lines in such cases would eventually destroy the profession itself and the benefit that might accrue to honest clients.

The trust necessary to the professional relationship places a premium on moral responsibility. The challenge to the professional is to subordinate her own interests to those of her client. But the challenge is also one of honoring the profession's responsibilities to society at large.



OF PRINCIPALS AND PRINCIPLES: THE PROFESSIONAL'S DILEMMA¹

In "The Professional Challenge," I discussed the basic professional relationship. The profession is an agent of the principal. That relationship gives rise to the notion of fiduciary duty. Faithfulness and loyalty are the overriding concepts. The professional manager's fiduciary duty implies subordination of the her interests to those of the principal – the corporation. The professional manager is entitled, of course, to reasonable compensation for her work. But she is not entitled to use her position as an agent of the corporation to advance her own interests.

This article focuses on the following question: In entering into the professional relationship, does the agent give up her identity as a moral agent? To what extent is this the case? To what extent not? In other words, does subordination of the manager's interests extend to subordination of the her moral conscience? And what does the larger society, in which both principal and the manager are possible, have to say about it?

There is a scene in the movie version of *The Remains of the Day* in which Lord Darlington tells Mr. Stevens to dismiss two Jewish maids. Darlington is conversing with Stevens in the study and inquires about any Jews on the house staff. Stevens replies that there are two Jewish housemaids, whereupon Lord Darlington tells Stevens, "Of course, you'll have to let them go." Stevens, in his typical understated way, communicates slight surprise, "I'm sorry, Sir," as if he hadn't heard correctly. Lord Darlington continues: "It's regrettable, Stevens, but we have no choice. There's the safety and well-being of my guests to consider. Let me assure you, I've looked into this matter and thought it through thoroughly. It's in all our best interests." Stevens accepts the decision without further discussion and leaves.



Later that evening, at his routine meeting with Miss Kenton for cocoa, Stevens informs the housekeeper of His Lordship's decision to dismiss the maids. Because Miss Kenton supervises their work, Stevens apparently wants to give her the chance to have a word with them before he tells them they've been sacked.

Miss Kenton is incensed by the injustice of the decision. They were taken in as refugees from Nazi Germany in the first place. If they are sent packing, there is the substantial risk that they will be expelled to Nazi Germany and certain persecution, perhaps death, in that totalitarian state. She is flabbergasted that Stevens could go along with and become the instrument of Darlington's order. "Does it not occur to you, Mr. Stevens," she says, "that to dismiss Ruth and Sarah on these grounds would be simply--wrong? I will not stand for such things." She later declares it a "sin as any sin ever was one."

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Expressing her moral outrage as firmly as she can, Miss Kenton declares that she will leave as well, if the Jewish maids are in fact dismissed.

What should we think about this? Is there a moral problem here? If so, what is it?

How should Stevens think about this? What should he do? What responsibility does he have?

What does Miss Kenton think about it? What should she think? What should she do?

Fundamentally, is there any circumstance in which the professional, as agent of the principal, is not only permitted but even compelled to refuse to follow the dictates of her principal? If so, how can we recognize such circumstances?

In this case, Mr. Stevens takes the view that all responsibility lies with His Lordship, who is better educated and informed than the likes of Stevens or Kenton. He is a man with international experience and the judgment necessary to make such decisions. If Darlington has concluded that the Jewish maids must go, who is he, a mere butler, to resist or even criticize that decision? Perhaps he sees himself as a mere instrument, having no independent moral responsibility other than to comply with his Lordship's wishes. Does Lord Darlington's decision absolve Stevens of responsibility?

It is easy to punch holes in Stevens' presumed argument as a hard and fast rule. We need only imagine a different scene in which Lord Darlington told Stevens to murder the Jewish maids. That is an illegal act in itself. It cannot be the case that professional ethics requires a professional to commit a crime because his principal told him to do so. And the law long ago made clear that anyone committing a crime in the course of her professional work is not absolved from liability just because her principal told her to do it. We did not need the Nuremberg trials to establish that "I was just following orders" is not a viable defense.

But how far up the chain does moral responsibility – if not criminal liability – extend? Clearly the person pulling the trigger that shoots the gun that kills the Jewish maids is criminally as well as morally responsible. Does Stevens, who is many, many steps removed from that act, also have some responsibility? If you say yes, then be prepared to say what that responsibility is. What should he do when Lord Darlington tells him to dismiss the maids? But if your answer is no, can you state where moral responsibility begins and ends? How should one go about determining whether and to what extent Stevens – or any professional in a similar position – has a moral responsibility to do anything other than to carry out the instructions of his principal, Lord Darlington?

Speaking of Lord Darlington, what is the nature and extent of his moral responsibility in this matter? And does that responsibility, whatever it is, intersect with that of Mr. Stevens or of Miss Kenton? In other words, does the determination of Stevens' responsibility depend to some extent on whether Darlington is complying with his

responsibility? Stevens implies as much when he tells Miss Kenton that His Lordship is much better versed in these matters and understands what he is doing.

Lord Darlington does not know for a fact that the maids will be expelled from England and returned to Germany. And even if they return to Germany, there is no certainty that they will end up in a concentration camp. Is it permissible for him to balance their (uncertain) fates against the importance of the international efforts he is making to avert a major war – a war in which over 50 million people eventually died? In military terms, the hardship or even death of the two Jewish maids might be seen as collateral damage, a byproduct of a more an effort to achieve an objective whose importance transcends the lives of the maids, the butler, the housekeeper, and even the Lord of the manner.

What, if any, responsibility does Miss Kenton have in the matter? She does not actually dismiss the maids. She merely learns about the impending dismissal. She is a bystander. By quitting, she will not likely change their fate at all. To argue that she might be able to persuade Lord Darlington not to dismiss them is purely speculative. She has no relationship with him. Even to meet with him would mean going over Stevens' head, a breach of protocol that itself could and perhaps should lead to her own dismissal. Protesting or resigning, therefore, is not likely to prevent the result she abhors.

But if action is not likely to be effectual, does that mean Miss Kenton should not speak out? Is that not a recipe for making guilty bystanders of us all?

That she can't stop the dismissal of the Jewish maids by protesting does not necessarily mean that she should keep quiet. Such a protest would be a moral statement, which is not nothing. In fact, in some circumstances, mustering the courage to speak out is a moral act of consequence in itself. Legions of dissenters, protestors, conscientious objectors, and others who have "gone to jail for justice" have helped establish the conventional wisdom about what is and is not morally acceptable by putting their bodies on the line. Rosa Parks took a stand when she refused to surrender her seat on a Birmingham bus. "Here I stand," wrote Martin Luther. "God help me, I can do no other."

In his article, "How the Butler Was Made to Do It," Robert Atkinson argues that "Miss Kenton's reaction to the firing of the maids offers a striking contrast to Mr. Stevens' response, and it implies a vision of professionalism quite different from neutral partisanship. She recoils from the technocratic, antiseptic attitude of Stevens, his treatment of the dismissals 'as though [he] were discussing orders for the larder.'"²

Atkinson continues by pointing out the contrast between Mr. Stevens' references to "contracts" and "employees," and Miss Kenton's reference to the maids by their first

² Robert Atkinson, "How the Butler Was Made to Do It," 105 *Yale Law Journal* at footnote 68 (1995).

names, Ruth and Sarah. She “invokes her long, personal relationship with them. And she does not dismiss deeply held personal aversions as ‘foibles and sentiments.’”³(70)

She may, indeed, have a personal relationship with the maids that colors her view. But should it? Is her professional responsibility any different because she happens to know them sufficiently well to call them by their first names? Is Stevens professionally obtuse just because his is a more “technocratic” relationship, to use Atkinson’s term?

Atkinson is relying on intuitions of disgust and outrage that arise more readily when personal relationships are involved. Put simply, it is emotionally much easier to kill people by dropping bombs from 30,000 feet than by ramming a bayonet through their guts. But is there any moral distinction between the two?

Atkinson says that Miss Kenton, “most significantly . . . takes direct moral responsibility for the immediate consequences of her actions, rather than insulating herself within her role. She will not be a partisan for what she believes to be a moral wrong, because she cannot be neutral professionally toward what she opposes personally.”⁴

First, I disagree that Miss Kenton “takes direct moral responsibility” for her actions. She does nothing other than to express her dismay to Mr. Stevens.

Second, Atkinson does not offer any standards or guidelines for telling the Stevens and Kentons of the world when it is appropriate to object to or even to refuse the orders of a principal in a professional relationship. Should it be left to the moral sensibilities of the individual in each case? That view is hardly worthy of the name “professional ethics.”

If your head is not hurting by now, you’re just not thinking hard enough. Ethics—especially professional ethics—is a skill set that requires concentrated thinking and produces few certainties, at least when we are talking about problems like those posed in *The Remains of the Day*.

Let’s move to a slightly different but no less difficult type of problem.

Death & Taxes at Green & Guillaume

Georgia Murphy looks up from the spread sheet under review as she hears a knock on her door. It’s Chad Wolfensohn, her supervising partner at Amber Accounting.

“How’s our brightest star in the manager ranks?” Chad asks jovially.

“Polishing her nose on the grindstone, as usual. What’s up?”

³ *Id.* at footnotes 69-70.

⁴ *Id.* at footnote 72.

“Well, since Harry left to take that CFO job, we need to replace him as team leader of the on-site tax group at Green & Guillaume. Everyone thinks you’d be perfect. I think I can get some of your other work transferred. We really need you on this. How about it?”

“That’s a great honor and a lot of responsibility,” Georgia responds. “Thanks for thinking of me. I’ll check through my projects and see what can easily be handled by someone else.”

“We want to make the change as quickly as possible. Let me know by the end of the day, if there’s a problem. And congratulations.”

As Chad leaves, Georgia starts to think through her situation. She’s been at Amber Accounting only three years and has been hoping to be promoted to Senior Manager next year. This assignment all but assures that promotion – unless she blunders somehow. Green & Guillaume Tobacco is one of Amber’s biggest clients. This is no doubt a great opportunity, a way to prove that she is ready for senior manager status.

Unfortunately, Georgia is not elated. Shortly after Chad leaves her office, Georgia puts in a call to Maryann Heineman, with whom she has developed a close relationship since joining Amber Accounting, and asks to meet for lunch. After the waiter leaves with their drink orders, Georgia tells Maryann about her new assignment.

“That’s great! You’re on the partnership express for sure now.” Maryann exclaims.

“Yeah, it’s a terrific opportunity,” Georgia replies, looking down at her napkin.

“Hey, you don’t sound excited about it. What’s wrong?”

“Well, I’ve never told anyone here, but my mother died from lung cancer four years ago, about eight months before I joined AA.”

“Oh, I’m sorry to hear that.”

“I’ve moved on more or less except for one thing. Mom was a life-long chain smoker. She couldn’t stop. I have no doubt that cigarettes killed her. She developed emphysema about three years before the lung cancer was diagnosed. When I was younger, I used to blame her for the filthy habit. But now I see that the real culprits are the cigarette companies, of which Green & Guillaume is the biggest.”

“I can understand how you would feel that way,” Maryann says.

“It’s not just that they sell the stuff. That would be bad enough. But they target impressionable children in their advertising and product placements in movies and TV

shows. And they had the gall to lie about the addictive nature of cigarettes in Congressional hearings.”

“I never thought about it much, but I guess you’re right.”

“So now I have this great opportunity, except it means that I have to do my best to find tax breaks for these merchants of death. What does that make me?”

“Wow. I don’t know. I can see how you might be concerned. But they’re a legal company. We provide a service. They’ve gotta have their taxes done. That doesn’t make us accomplices or anything anymore than the cleaning company that cleans the offices or the fuel company that sells them the fuel. Gee. I bet at least 20% of Amber’s gross income is attributable to Green & Guillaume.”

“I never really gave it much thought before. I work on other projects and did not expect to be put in this position. I just see it somewhat differently. Sure, you could say that we are just providing a service. But it’s a service that is intimately tied up in the operation and success of the company. Because of our advice, they save millions in taxes—millions that they then use to entice children into smoking. I just don’t know what I’m going to do.”

The Overlapping Circles of Moral Responsibility

In a society made only of individuals with responsibility toward other individuals and the entire group, morality is largely an individual matter. The group (tribe, clan, nation) has responsibilities to individuals within the group and responsibilities to other groups. But there is only one group. Things are fairly simple.

Once organizations are introduced, there are groups within groups. This complicates things. Now individuals have multiple roles and multiple responsibilities. They have responsibilities to the larger society, to the organization in which they work, to other individuals within the organization, to other organizations and institutions, and to individuals within their personal circles (family, friends, neighbors, etc.).

Organizations have multiple responsibilities as well. They have responsibilities to stakeholders such as employees, suppliers, customers, the community in which they operate, to the physical environment, to shareholders, to the profession or industry in which they operate, to the larger society, to other organizations, and to institutions within the society such as the law and professional or trade associations.

As we saw in *The Remains of the Day* and *Death and Taxes at Green & Guillaume*, individuals occasionally encounter conflicting responsibilities among the different parties affected by a particular course of action. Georgia has a responsibility to herself, her own moral integrity. As long as she is working at Amber Accounting, she has a responsibility to do her work professionally and not to put the firm and other

employees in it at risk. She has less clear-cut responsibilities to society at large, perhaps to take a moral stand. She has a responsibility to her daughter and husband not to drop a well-paying job impulsively. And, if she accepts the assignment, she will have responsibilities to Green & Guillaume. Each of these parties has legitimate interests that Georgia must somehow reconcile, if she can.

Lord Darlington, Mr. Stevens, and Miss Kenton are similarly constricted in a web or network of overlapping and interlocking responsibilities. Some of those responsibilities are well-defined and settled by etiquette, rules, and laws; and to the extent they are, the claims of interests that are incompatible with the laws must give way. We may have a responsibility to flee from someone who is threatening to attack rather than to use deadly force; but our responsibility to protect our children supersedes the responsibility to the attacker and may give rise to the right or even the duty to shoot to kill the attacker.

In the corporate setting, the corporation is the principal. It is not the board or the shareholders or the CEO or any other officer. It is the corporation, a legal fiction, that is the principal to whom the employee has a fiduciary duty. The manager is an agent of the corporation.

The employee's professional responsibility as agent of the corporation is to act in accordance with the principal's, i.e., the corporation's legitimate interests. The employee must act consistently with the moral responsibilities of the principal.

So, in the case of a problem such as that posed by Lord Darlington's order to fire the Jewish maids, someone in Stevens position should be asking whether the order is consistent with Lord Darlington's moral responsibilities. If it is not, then Stevens should not carry it out. As agent, Stevens' personal interests are subordinate to his responsibilities to Lord Darlington. But his responsibilities do not extend to doing something illegal or morally offensive. And the determination of what is morally offensive is not just a matter of Stevens' personal intuition, although that intuition might play a role in helping him discover the morally right thing to do. Rather, what is morally offensive (or acceptable) is judged from the perspective of whether what Lord Darlington wants him to do is something that is morally offensive (or acceptable) in some objective or publicly defensible sense. It is not, therefore, his place to impose his private moral scruples on Lord Darlington. His professional responsibility does not allow him to supersede Lord Darlington's wishes, so long as those wishes are not illegal or immoral. He may find it personally distasteful and something he would never himself do. But he is not acting for himself. He is an agent for a principal. And the principles of agency are such that the agent is not in charge. The principal is.

Stevens' problem should be carefully distinguished from Georgia Murphy's problem. In her case, the question is whether to accept the professional relationship at all. She may have personal misgivings or even her own moral scruples about having anything to do

with a tobacco company. Professional ethics do not require her to work for Green & Guillaume anyway. To the contrary, her own qualms may disqualify her from entering inter the relationship because they might cloud her judgment in providing professional services to Green & Guillaume. But so long as Green & Guillaume is not engaged in an illegal business and operates it in a legal and ethical manner, the company is entitled to legal representation and other professional services. And it is not a violation of professional ethics to provide them.

We should not leave this subject without noting that the principal has responsibilities to the agent as well. One of the most important is not to request the agent to do anything immoral or illegal. This responsibility draws a clear line in the sand to which the agent can and should point if asked to do something immoral.

I see four basic categories of moral problems that arise in the relationship between the professional manager and the corporation:

1. The manager is tempted to misbehave on her own (Joyce takes beer from the Carpenters' fridge).
2. The principal asks the agent to do something improper (arguably the Stevens case).
3. The agent is aware that someone else is misbehaving (another agent or the principal) and must decide whether to blow the whistle (Miss Kenton's situation).
4. The agent perceives a conflict between the principal's morality and her own personal morality (e.g., Georgia Murphy working for a cigarette factory).

THE TRUST ECONOMY⁵

On July 17, 1981, two skywalks at the Hyatt Hotel in Kansas City collapsed, killing 114 people and injuring more than 200 others. I remember this accident well because my law firm, Jenner & Block, represented the surviving spouse of a psychiatrist who was killed by the falling concrete and steel.



The hundreds of people gathered for a dance contest on the main floor of the recently built \$50 million Hyatt, implicitly trusted the skywalks above them to stay in place. Why they fell became the subject of a \$35,500 study conducted over three months. The authors of the study found several problems but ultimately laid the blame at the feet of the Codes Administration Division, which was understaffed and did not review all design changes.⁶



The web of trust that allowed the dancers to enjoy the festivities without being anxious about their safety included the expectation that (1) the design of the building was appropriate, (2) the builders had used the correct materials and had built the structure in accordance with the design, (3) the suppliers of the parts and other materials had built them correctly, and (4) the government building inspectors had assured themselves that the specifications for the building conformed to the best engineering knowledge and practices and that everything was built according to specifications.

In a highly complex society, we are continually called upon to trust others whom we do not know personally to do their jobs properly and professionally. Without this trust, we would not be able to function – at least not as well and not as cost effectively.

As you approach Boston on I-90, one possible route takes you into the Ted Williams Tunnel. Part of the multi-billion dollar public works project known as the Big Dig, the tunnel helps speed traffic into and through Boston to Logan Airport with minimal traffic delays. Until July 10, 2006, few people likely gave much thought to whether those who designed, built, and supervised the Big Dig had done their jobs

right. On that date massive concrete slabs fell from the ceiling, crushing Milena Del Valle, a 38-year old mother of three, in her car.



In the finger pointing that took place during the investigation, allegations of bribes, overcharging, improper materials, shoddy workmanship, and general skullduggery

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⁶ See [Study Faults Kansas City Building Inspection](#) (NY Times March 21, 1982).

abounded.⁷ It appears that Boston, the State of Massachusetts, and the Federal Government paid more and got less than it should have.

I don't know about you, but ever since the corruption around the Big Dig came to light following Ms. Del Valle's death, I have wanted to avoid driving through Boston tunnels. I don't trust them.

When I say "I don't trust them," I mean I don't trust the tunnels not to collapse, I don't trust the inspectors to have done their job properly, I don't trust the politicians in charge not to have been on the take, and I don't trust the contractors to have used the materials all of us paid for. In short, I don't trust the professionals whose job it was to build safe tunnels to have put the interests of the people using the tunnels ahead of their own greed. My mind is inhabited by doubt. What else could go wrong?

Trust is action taken in reliance that the trusted thing, animal, person, or institution will perform as expected. Trust typically involves some degree of vulnerability. In other words, if the trust is misplaced – if that which we trust does not perform as expected – the trusting person stands to be affected negatively in some way. If I step on the rungs of a ladder, trusting that they will hold my weight, I am running the risk of falling if one of the rungs breaks. If you give me \$20 to buy you some food while I'm in town, you expose yourself to the risk that I will abscond with the money or will forget what you asked me to get or, in some other way, will not perform as expected.

When we make a decision to trust – of objects, animals, people, and institutions – we are explicitly or implicitly assessing **six dimensions of trust**:

1. Competency/Capacity
2. Character (internal constraints)
3. Alignment of interests (motive)
4. Potential loss/gain
5. Available alternatives
6. Effectiveness of external constraints

In the Hyatt Skywalk case, the people gathered at the dance on July 17, 1981, implicitly trusted that whoever had constructed the building had done so competently. They probably gave it no thought at all. But by exposing themselves to the risk that part of the building would fall on them, they were trusting that the builders had used the

⁷ The Boston Globe has collected links to many of its articles on this accident at [Complete Coverage of Big Dig Ceiling Collapse](#).

correct materials and had constructed the building in accordance with proper engineering standards. They were also trusting that building inspectors, licensors, and permitting agencies and others approve construction had done their work properly.

All of this has to do with the competency or capacity dimension of trust. I may like you as a friend, but if I need a power hitter in the bottom of the ninth to try to pull out a win, I won't put you in the game unless I think you can do the job.

Competency/Capacity is the first pillar of trust. This first pillar poses the question: *Can you do what you say you will do?*

The Big Dig ceiling collapse underscores the importance of the character dimension. *Will you do what you say you will do?* Some, including public prosecutors, have alleged in the Big Dig case that shoddy materials and workmanship were used because corrupt contractors and inspectors chose not to do their jobs properly. They siphoned off part of the money that was to go into constructing a top-quality tunnel and put it into their pockets. The internal constraints that might otherwise have caused them to resist the temptation to steal from the public either were not there or did not function.

"Character" is a Greek word meaning imprint or mould. The Greeks used "character" when referring to the device used to stamp out coins. Character retains its form despite changing conditions. Character is resilient. It does not bend and conform to external pressures. A character in the Greek sense shapes more malleable material. When we pour lead or plastic into a mould to make objects, the mould has the qualities of character.

Just as a mould can have a flaw or some weakness that causes it to break under pressure, so too the character of a person can break down under the right conditions. And often not even the person herself will be aware of internal weaknesses in her character.

Competency and character are the two big pillars of trust. But the four other dimensions should not be ignored. Trust decisions often involve an implicit assessment of how well the interests of the trustee align with those of the trustor. It is probably not wise to trust your sworn enemy to deliver an important document for you. The extent, gravity, and risk of potential loss (or potential benefit) will be a factor in whether to trust someone else. Whether we have alternative courses of action will affect our decision to trust. And finally, our assessment of the effectiveness of external constraint systems such as laws and law enforcement can be a factor in trust decisions, especially those involving strangers.

Cooperation

Without cooperation human society is not possible. Indeed, developing cooperative relationships is part of what it means to be human.

Trust is essential to cooperation. You can't work together with others without at some level and to some degree relying on their capacity and character to do what they say they will do.

In business and professional life, the trust game comes down to a plea and a question:

1. Please trust me.
2. Can I trust you?

When you apply for a job, you are asking the potential employer to trust you to show up for work and perform the job well. Try me out. Give me a chance. A salesperson is asking the potential buyer to trust her not to mislead the buyer and also to trust the product or service to perform as described. We are constantly asking others to trust us.

The other half of the coin is equally important. The employer is asking, can I trust Jim to be able to do the job and to be the kind of person – i.e., to have the strength of character – to do it under a variety of challenging conditions? The employee likewise wants to know whether she can trust the employer to treat her fairly, to respect her interests, to recognize and reward her contributions to the company, and so on.

Trust and the Professional Relationship

Trust is at the heart of the professional relationship. Why? Because the principal cannot direct the work of the agent on a step-by-step basis as with Schmidt. The principal relies on (trusts) the agent to protect and pursue the interests of the principal. Discretion is, therefore, at the core of the professional relationship. How the agent exercises that discretion is the key question?

The principal must also trust that the agent is sufficiently competent to carry out the work with which the agent has been entrusted (the competency/capacity pole).

The principal must trust that the agent will act in the interests of the principal and not in someone else's interests (the character pole).

As noted, whenever we trust someone else, we are always assessing the capacity and character dimensions of trust. What makes the professional trust relationship different from other trust encounters? In a word, fiduciary duty. It is in the nature of the professional relationship that the professional makes a commitment to put the interests of her principal first. Ideally, the question of alignment of interests does not even arise. By definition, within the scope of the professional undertaking, the professional must subordinate her own interests and those of everyone else to those of the principal.

That is a different standard from the normal business relationship. If I walk into your store to buy a stereo set, I expect you to look out for your interests and you expect me to

look out for mine. I do not expect you to subordinate your interests to mine; and there is no reason that you should expect me to do any differently.

But with the professional relationship – whether between a lawyer and client or between an employee and the corporation for which she works – the structure of interests is different. The professional (agent) may never use her position to advance her own interests to the detriment of the client (principal).

The Trust Economy

In a modern, complex economy, trust does not appear in isolation in one-to-one relationships only. There is a web of trust.

We can see this in the Kansas City Skywalk case. Whether or not they were aware of it, the dancers on July 17 put their trust in the integrity of the building but also in building codes, the professional responsibility (character) of engineers and builders, professional capacity/competency of the builders and engineers, engineering science, the engineering profession, and the efficacy of negligence laws.

Whenever we drive down the street, we trust that the traffic lights will function properly, which means that we also trust those who have programmed them to have done their job well. When we buy meat in a grocery store, we trust interlocking trust relationships among farmers, slaughter houses, meat inspectors, those delivering the meat, and the grocery store personnel all to have done their jobs properly. We trust each participant in this chain to act in our best interests at each step of the way. But we also trust them to look out for our well being when they evaluate the work of the others in the chain.

Thus, when toys with lead paint show up on the shelves of Wall-Mart, we want to know what went wrong. Who dropped the ball? Where in the chain of responsibility did someone not do what we expected them to do?

As the toys from China example shows, once the web of trust is broken, it is hard to reweave it.

Economists have developed the notion of social capital to refer to the institutions and culture of trust that a society enjoys. The degree to which we can trust people and institutions whom we have never known and will never meet is a measure of social capital. In any given society, the more social capital, the higher the level of economic efficiency and, all things being equal, the more prosperity the society will enjoy.⁸

⁸ Numerous studies have established this connection. See, e.g., Edward L Glaeser et al., "Measuring Trust," *The Quarterly Journal of Economics* 811-846 (2000); Jonathan Leland et al., "[Measuring Trust and Trustworthiness](#);" Hans-Hermann Hohmann and Friederike Welter (eds.), *Trust and Entrepreneurship: An East-West Perspective* (Northampton MA: Edward Elgar, 2006).

The following table shows the results of a 1994 survey of the levels of general trust in various countries:

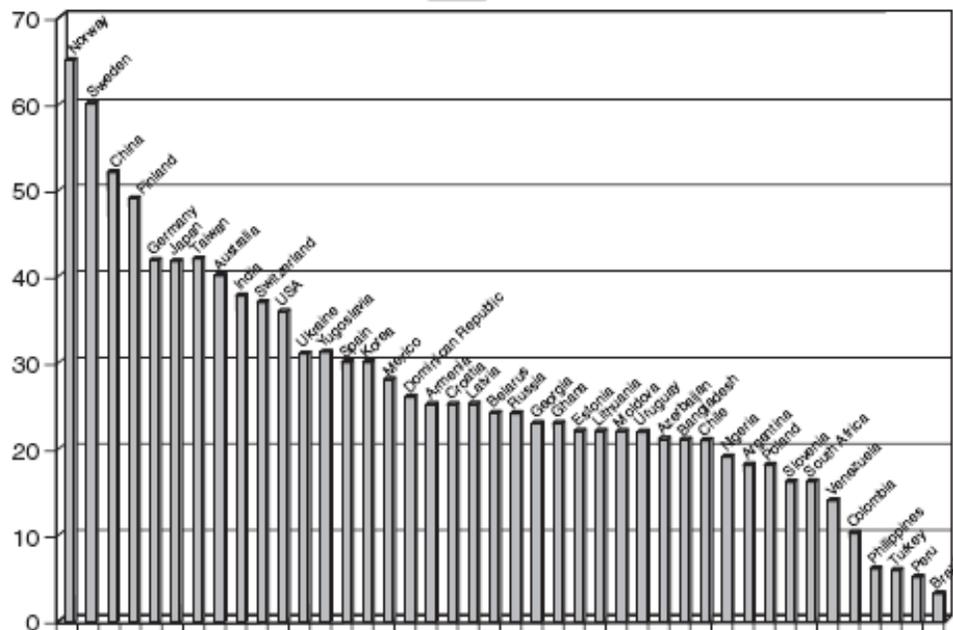


Figure 2.1 Survey data on trust in 1994 from 42 countries with varying institutional environments.

Zak and Knack have shown that every increase of 15% in the proportion of people in a country who think others are trustworthy correlates with a 1% rise in income for the people of that country for every year following that increase.⁹

Perhaps the relationship between trust as social capital and economic well being can be understood better by looking at places where generalized trust is lacking. In *The Sicilian Mafia: The Business Of Private Protection*, Diego Gambetta tells the following story:

A *vaccaro* (cattle breeder) I interviewed in Palermo succinctly expressed the core elements of the hypothesis I wish to present: "When the butcher comes to me to buy an animal, he knows that I want to cheat him. But I know that he wants to cheat me. Thus we need, say, Peppe [that is, a third party] to make us agree. And we both pay Peppe a percentage of the deal." This statement has far-reaching theoretical consequences. There are mutual low-trust expectations generating a demand for guarantees on

⁹ Paul J. Zak and S. Knack, "Trust and Growth," 111 *Economic Journal* 295-321 (2001). See also Paul J. Zak, "[The Neuroeconomics of Trust](#)" (2005).

both sides, and there is "Peppe," a man capable of meeting this demand and trusted by both butcher and *vaccaro* to be capable of doing so.¹⁰

In this vignette, Gambetta makes explicit the need for reliable institutions in a complex society. In this case, the parties feel they cannot rely on the courts or the legal system to handle disputes satisfactorily. Thus, they must hire someone to provide the services that in other societies are provided by the legal system. They pay a "commission" of 2% of every transaction. The cumulative cost of this kind of makeshift system both for individuals and the overall society is quite high. Not only does it operate as a kind of tax on each transaction; but the absence of effective trust-building institutions discourages people from launching new ventures or otherwise becoming investing in the economy.

While European and North American countries with rationalized economies have interlocking institutions that engender trust, others might rely on networks of personal relationships. In a travel book on his time in Italy, Joachim Fest tells the following anecdote that illustrates the point:

The son of [Pasquale's] neighbor took ill 14 days ago with inexplicable pains in his body. When none of the usual medicines helped, we recommended that the neighbor bring the child to the hospital. But no one thought of just going to the hospital to register him. After long and intensive consultations involving many friends and relatives, the following procedure was followed:

The neighbor knew a baker who was a member of a football club whose treasurer was married to a woman who came from a house behind the Plaza Miraglia. In this house there lived a street car conductor whose cousin was married to a nurse whose closest friend worked occasionally as a messenger for a lawyer. The lawyer was a man of great influence with far-reaching connections and, of course, he knew the CEO of the hospital in which the physician practiced whom they wanted to engage. Within six days the child was accepted into the hospital under the doctor's care.

Pasquale thought that the whole thing could have been taken care of in a less complicated manner. But then everyone involved would have had the feeling of a missed opportunity. For only in this way was it possible to show what far-reaching connections one had. Whoever does not comprehend this system, he remarked, will never understand Neapal or, indeed, Italy itself.

¹⁰ Diego Gambetta, *The Sicilian Mafia: The Business Of Private Protection* 15 (Cambridge: Harvard Univ. Press, 1993).

To an important degree, professional ethics is about creating the institutions that establish the kind of *impersonal* or rationalized trust that is essential to a complex, modern economy. We trust lawyers, accountants, physicians, engineers, policemen, teachers, and many others whom we have never met and whom we can never meet. But it is not really the individuals whom we trust. We trust the professional associations to which they belong. We trust the licensing agencies that can approve or deny their right to practice. We trust the news media to let us know when someone has grossly violated a professional trust. Perhaps most importantly, we trust a legal, police, and judicial system that establishes and enforces the rules of the game. We trust, in short, a large web of interlocking institutions whose primary purpose is to assure us that we can trust professionals whom we will never meet to do their jobs properly.

The social capital of trust to which I have been referring exists on the macro-societal level. But it also exists at the organizational level. In other words, inside a corporation, people need to trust others in order to get work done. Political infighting, deception, exploitation, and disrespect can significantly trust within the organization. When that occurs, the quality and quantity of work decline as do overall productivity and profitability.

We all contribute to (or deduct from) a bank account of trust at all levels of society. But it is not just our personal behavior that supports or diminishes social capital. The institutions of professionalism play an even more important role.

All of us depend on generalized trust. It is a social good. We all benefit when we are able to trust each other. If you betray expectations of trust, you diminish social capital. If you uphold trust (remain faithful), you help build social capital.

I have mentioned institutions of trust several times. We might call these the structural components of social capital:

Etiquette

Rules (including codes of conduct)

Procedures

Transparent practices

Etiquette is not just social manners. It also includes the specific behavior patterns that are accepted and expected in a particular social setting such as work in a corporation. Some businesses have formal cultures in which employees are expected to adhere to a business-like dress code, to observe hierarchical distinctions meticulously, and to be highly punctilious in the performance of their duties. Other corporate cultures are more relaxed and have a greater degree of flexibility in social conventions. But the important

thing is not so much the form of interaction as its substance. If respect pervades the atmosphere in the workplace, trust is likely to be higher.

Rules, policies, procedures, and transparent practices can all serve to build trust within an organization. They establish objective standards by which the behavior of individuals can be measured. More importantly, such structural components of social capital lay the foundation for trusting others with whom we have little or no personal contact.

Legal and ethical codes capture the technical and moral judgments we make about what should happen under certain circumstances (as in building codes). Such institutions provide a way of freezing wisdom and making it available to large groups of people.

In the end, therefore, the trust economy requires both personal integrity and social institutions such as laws, licensing procedures, training, monitoring, and enforcement. Perhaps moral failings of individuals contributed to the lapses that led to the collapse of the Hyatt Skywalks. But it may also have been a case of not having committed enough resources to operate the building inspection regime properly. There has been much finger pointing in the Big Dig ceiling collapse case. But maybe we should redouble our efforts to limit the extent to which we must rely on the honesty of the individuals.

In the end, therefore, professional ethics is not just about the responsibility of individuals. It is also about the development of systems that engender trust irrespective of the particular people who might have assumed a specific professional responsibility.

DISCRETION AND FIDUCIARY DUTY¹¹

The Prosecutor Blundered

If you've been living in the United States for the past few years, you surely will recall the Duke Lacrosse Team Case. Mike Nifong, the district attorney of Durham County in North Carolina, announced one day that he had charged three players on the Duke University Lacrosse Team with having raped Crystal Gail Mangum. This was a major news story in Durham County, where Nifong was running for re-election. But it was a sensational story throughout the United States – especially on the sports pages. In short order, many journalists and much of the public had tried and convicted the three men for their heinous crime. The president of Duke University suspended two games and then cancelled the remainder of the Lacrosse Team schedule. Three-time ACC Coach of the Year, Mike Pressler, was forced to resign.

The only problem was . . . no one from the Duke Lacrosse Team had sex with Crystal Gail Mangum that night. No crime took place. They didn't do it. It was all a complete fabrication by Ms. Mangum. As reporters from 60 Minutes showed, the evidence of the men's innocence was overwhelming. By the time the dust settled, the three lacrosse players had been completely exonerated and Nifong had been disbarred.

People who get caught in a nightmare like this might well wonder: How can this be happening? How can a prosecutor charge someone on such flimsy evidence?

As the district attorney of Durham County, Mike Nifong wielded the same discretion as prosecutors throughout the United States. Prosecutors are expected to exercise their professional judgment in deciding which matters to investigate, how to investigate them, and whom, if anyone, to charge with a crime. In the case of the Duke Non-Rape Case, many lawyers and judges have concluded that Mike Nifong abused that discretion.

Police officers and prosecutors are continually exercising discretion in the fulfillment of their duties. You get pulled over on your way to Montpelier. The officer determines that you were only a bit absent minded and lets you off with a warning. Your neighbor calls the police with a complaint about your barking dog. The officer in charge asks you to keep the dog inside and says that if called again, he'll have to write you up. Otherwise, he takes no action.

The Duke Lacrosse Team Case shows how prosecutors can go off the rails in pursuing a criminal case against wrongfully accused defendants. The hundreds of convictions that have been overturned as a result of the work of The Innocence Project are sufficient testimony to this problem.

¹¹ © 2010 Michael Palmer, *Ethics By Design*

But equally troubling are decisions by prosecutors not to seek an indictment of someone who may well have committed a crime. In 1988, independent prosecutor James McKay declined to prosecute Edwin Meese for tax crimes and other illegalities despite substantial evidence that the former U.S. Attorney General may have committed serious felonies.¹² Until recently, many prosecutors would not pursue date-rape cases. The latitude given police and prosecutors in the American system borders on arbitrary power because judges almost always refuse to intervene. The outcome in the Duke Lacrosse Team Case is the exception that proves the rule.

Prosecutorial discretion is only the most dramatic instance of professional discretion, however. It is in the very nature of the professional relationship that professionals are given discretion to make judgment calls in the exercise of their authority. Teachers, for example, have discretion to set grading policies, to decide in individual cases when to depart from the policies by granting extensions, and to determine whether a student receives an A or a C on a paper. Accountants exercise discretion on a regular basis when deciding whether to classify some kinds of payments as capital expenditures or ordinary expenses. A building contractor may have discretion about which materials to use or which subcontractor to employ. A procurement officer may have discretion about which vendor to use for computer training programs.

David Makes a Great Investment

Jeff Cornblum goes to his friend David Heath with a request that David manage a \$1 million fund for Jeff's 2-year old son's benefit while Jeff is away on a mountain-climbing trip. David is a venture capitalist and a certified financial planner with considerable experience in financial management.

Jeff tells David that he wants him to invest the money prudently, and adds, "Do what you can to make the fund grow by at least 10% on an annual basis." David tells Jeff that he will do what he can but stresses that he can't guarantee any particular amount of growth in today's market. Two days later, David sees his friend Jeff off at the airport, when he leaves for his adventure of a lifetime.

Jeff did not give David specific directions on how or where to invest the money. He just said David should be prudent and asked him to try to grow the fund by 10%. David has considerable discretion about where to put Jeff's money. He could put it all in certificates of deposit that earn 4% interest. It would be safe. But the fund would not grow nearly as much as Jeff would like. As a professional money manager, David knows that it is best to diversify. Invest part of the money in low-risk investments and the rest in riskier but potentially more rewarding ones. He puts half of the money into tax-free government bonds that earn 3.65% interest. That is a virtually risk-investment.

¹² See Stuart Diamond, "[Prosecutorial Discretion: Worthy of Defense?](#)" NY Times, July 22, 1988.

David is pondering how to allocate the remaining \$500,000 when he learns of an opportunity for his venture capital firm to invest in Sure-Fire Products, Inc., a company with a can't-miss diet program. To land the deal, David needs a total of \$7 million. The firm's investors have put up \$6.5 million, but David needs an additional \$500,000 to make the deal work. If David helps get this deal, his firm will do well and he will probably earn a bonus too – at least if the investment pays off.

David decides to add Jeff's remaining \$500,000 to the venture fund and is able to land the deal for his firm. About two months after making the investment, David learns that Jeff tragically died in a climbing accident. Under the agreement David made with Jeff, David is to continue managing the \$1 million fund until Jeff's son turns 21.

A year after David added Jeff's \$500,000 to the venture fund for Sure-Fire Products, Inc., he receives the good news. Sure-Fire has done even better than expected and is repaying the venture investments with 25% interest. Jeff's \$500,000 has now increased to \$625,000. David has exceeded Jeff's investment goals for the fund overall and, in the process, has solidified his position as vice-president of Best Ventures, the venture capital firm at which he is employed. He also earned a nice bonus of \$35,000.

To Promote or Not To Promote

You are a senior manager in the marketing department of Amalgamated Plastics, a mid-size corporation with 10,300 employees. There is an opening for a manager's slot that you need to fill within the next 3 weeks. You have several people under consideration, some of whom, like Caroline, already work for Amalgamated.

As the senior manager, you have considerable discretion in determining who should be the new manager. Technically, you won't make the final decision all by yourself, but Jim, the vice president of marketing, has already told you it's basically your call.

As you look over the candidates, it becomes obvious that Caroline is far and away the best available person. She is talented, is overflowing with energy and creativity, is easy to work with, and will probably develop the kind of managerial skills that could take her far in Amalgamated. Moreover, if you don't promote her, she will likely jump ship and go to work for a competitor soon.

There's just one problem. Jim is set to retire in about a year, and you are in line for a promotion to the vice president's slot. You're good at your job, but frankly you feel somewhat threatened by Caroline's potential. If she becomes a manager and does as well as you expect, she might be a legitimate contender for vice president when Jim retires. You could be promoting the person who prevents you from making it to the top tier. After thinking about it some more, you decide to recommend Kathryn, one of the outside applicants who will make a great addition to the team.

The Necessity of Discretion

Why would we entrust professionals with discretion? Why not just tell them precisely what they must, may, and may not do, as F.W. Taylor did with Schmidt, the high-priced steel worker?

It won't work, that's why. There are way too many things that can come up that we could never foresee to be able to dictate precisely what professional managers must do when exercising their professional responsibility. And even if we could foresee it all, the list of commands would be impossibly long. Context is important. Imagine trying to specify in detail every instance of an acceptable excuse for failing to turn in a paper on time. However many examples you can think of, there would be new instances that would not be on the list. It seems better to leave it to the judgment of the teacher to determine whether the excuse is legitimate, whether it is honestly presented, and whether it would be fair both to the student and other students in the course to grant the exception. It is the limitation of rules that gives rise to the need for discretion in the first place.¹³

Thus, we must rely on professional managers to exercise the authority with which they are entrusted responsibly. Well, what does that mean? How can you, the manager, know when you are exercising your discretion improperly? How can the rest of us assure that you will not abuse your discretion but use it fully? Are there any boundaries? Are there any guidelines, i.e., lines that guide the manager's use of discretion?

Guiding Discretion with Rules and Standards

As prescriptions for behavior, including the exercise of discretion, professional ethics fall into two main groups: Rules and Standards. Rules set precise limits. You may not drive over 25 miles per hour within the town. You must have your car inspected at least once a year and display an inspection sticker showing that you have complied. You may not represent a client whose interests conflict with those of another client whom you are representing at the same time. You must keep client funds in an account separate from those containing your own funds. You may not sexually harass a co-worker.

Standards on the other hand imply judgment and flexibility. When driving a car, you are liable for all damage caused by the failure to operate the vehicle the way a reasonably prudent person would. This is the negligence standard. How would a reasonably prudent person drive the car? We can't always know in advance. Wait until something happens, when we know the precise context – the road conditions, the time

¹³ See Excerpts from Robert Baldwin, *Rules and Government* (New York: Oxford, 1995), which are included in the reading assignments for this week.

of day, the amount of traffic, the weather, the ability to see, your knowledge of any mechanical problems with the car, and the speed limit and other applicable traffic rules – and we will tell you.

Good faith can also be a standard by which we judge behavior. This too has an after-the-fact quality to it. We cannot describe for every possible case what it would mean to be acting in good faith. But, as Justice Stewart said with respect to pornography,¹⁴ we generally know it when we see it.

With respect to professional responsibility, however, there is a standard by which we judge all professional conduct, including the exercise of discretion, that is seldom, if ever, applied outside the principal-agent context, i.e., what I am here calling the professional relationship. That standard is **fiduciary duty**.

A fiduciary is one who is expected to use her expertise and authority in the best interests of the principal (client, patient, corporation, etc.). To fulfill a fiduciary duty, a professional necessarily must not only know what the principal's interests are; but she must also exercise her best judgment in determining how best to protect and advance those interests. A short-hand way of thinking about this is to ask, "What would my principal do, if she/it had my expertise and my knowledge of the particular facts of the situation?"

In court, judges sometimes determine what a fiduciary duty required by inquiring about the interests of a reasonable person in the client's situation. This works if nothing more is known about what the client actually wants. Thus, a court might determine that a physician has a fiduciary duty to use all her expertise and resources to keep the comatose patient alive because the judge believes that is what most reasonable people would want if they could speak. However, if the patient has signed an advanced directive stating that she does not want her life to be sustained artificially, then that is the overriding interest that controls.

Perhaps it will help to relate a story from my international consulting work. Along with others on an international team of legal experts, I was working with a commission in Macedonia to draft a revision of Macedonia's bankruptcy law. In one session, I argued in favor of including a provision that laid out the bankruptcy trustee's fiduciary duty to the creditors of the bankrupt's estate. To my consternation, the local experts kept articulating a standard of negligence – exercise of due diligence and reasonable care – which is a lower standard. After much discussion, one of my colleagues from Canada explained that the Macedonian legal system, like many others, had never developed the

¹⁴ In *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964), Justice Potter Stewart wrote perhaps his most famous lines in a concurring opinion: "I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description [i.e., "hard-core pornography"]; and perhaps I could never succeed in intelligibly doing so. **But I know it when I see it**, and the motion picture involved in this case is not that." (emphasis added)

concept of fiduciary duty. Undaunted, I plodded on, making repeated efforts to explain what the standard meant and why it was important that bankruptcy trustees be held to it.

Finally, the chairman of the commission had a Eureka moment. “Oh,” he said, “you’re talking about the kind of responsibility I have to my wife.” At which point, both my Canadian colleague and I shouted, “Yes. That’s it precisely.”

I relate this story to underscore the difficulty some people have in understanding the concept of fiduciary duty. But if you think about Joyce Howard, the babysitter, you may find it easier to grasp. The Carpenters want Joyce to keep faith with them. That is, they want her to watch over and take care of their daughter Cynthia much as they would if they were home.

That standard automatically and necessarily places limits on the exercise of discretion. The Carpenters would not knowingly do anything to harm their daughter. Joyce Howard’s discretion should be limited in that way as well. The Carpenters would also do everything to make sure their daughter is treated well.

When a problem arises – Cynthia wakes up – Joyce must exercise her discretion. The Carpenters left no instructions about what to do if Cynthia wakes up. Joyce must figure out the best course of action. She needs to find a way to help Cynthia get back to sleep without doing something that the Carpenters would not approve of if they knew about it. Giving Cynthia a glass of orange juice spiked with vodka probably is a bad choice. Joyce may not yet know this, but giving alcohol to children is not a good idea.

Did Joyce abuse her discretion? From an objective perspective, yes she did. She exercised it in a way that we cannot approve of generally. This does not necessarily mean that Joyce is a bad person or that she was immoral. It means merely that, knowing what we know about children, alcohol, and the interests of parents such as the Carpenters, her action is not consistent with the standards of reasonable care (negligence) and of fiduciary duty.

Inviting Brad over for fun on the couch and raiding the fridge for beer and snacks are clearly violations of Joyce’s fiduciary duty to the Carpenters. These activities are outside the scope of her professional mandate and in violation of her responsibilities to the Carpenters. Drinking the beer (a violation of law in all 50 states) is not even something about which she has any discretion.

Let’s return to Mike Nifong and his decision to indict the three Duke Lacrosse players. While most legal authorities would say that prosecutors have broad discretion, some might argue that they do not have discretion to indict people on evidence as flimsy as what Nifong had. They might say that his action was more like Joyce’s taking beer from the fridge – i.e., simply wrong. Nifong’s apparent reason for bringing the prosecution –

to improve his standing in the African-American community so as to increase his chances for re-election – was also wrong. He let his personal interests interfere with his professional responsibility. The objectivity of his discretionary judgment is questionable.

Did Nifong have a fiduciary duty? If so, to whom did he owe this duty of faithfulness?

This question is important in understanding managerial ethics in the context of organizational and official actions. As district attorney, Nifong does not have an individual or even an organizational client. His client, if that is the right word, is the public at large. As a government official, he had explicit duties under the laws and constitution of the state of North Carolina as well as under the Constitution of the United States. But did he have a duty to put the interests of the state and of the people of the state above his own in exercising the powers of his office?

Let's return to the investment of Jeff's million dollars on behalf of his son. Remember that David had an opportunity to put half of it in a venture fund that you managed and might bring a substantial return. As it turned out, the investment was a huge success. But it could have turned out differently. The entire \$500,000 could have been lost.

Seen from the perspective of David's fiduciary duty, David should not have made this investment. The problem is not the riskiness of the investment. Whether it was prudent depends on a variety of factors that we don't have available. Rather, the problem is that David's own interests were mixed up in the decision. David was engaging in a kind of self-dealing when his interests should not have been involved at all. Once he allowed himself to consider using Jeff's money in a venture that would benefit him, his independent professional judgment was clouded. The very purpose of engaging a professional investment advisor was compromised.

Finally, let's take a quick look at your decision not to promote Caroline at Amalgamated Plastics. In telling the story, I made the potential threat that Caroline's success poses to your advancement at Amalgamated explicit. Your fiduciary duty to the company requires that you make the decision that is best for it. Your own interests should have nothing to do with it.

But can you really avoid being affected by the conflict between your own interests and those of Amalgamated Plastics. After all, there is much to be said for Kathryn. Maybe she will turn out to be even better for the firm in the long run than Caroline. And, while it would be good to hang on to Caroline, it's not obvious that she would make a better vice president of marketing than you would. Perhaps it would be good for Caroline to get a bit more experience in the field.

We call this kind of thinking "rationalization." It is the process of inventing reasons to justify a decision we have already made. In this case, you are groping for reasons to

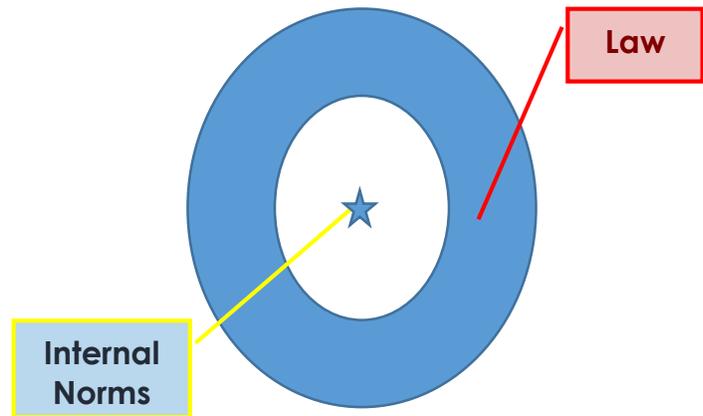
prevent Caroline from competing with you for the vice president's job down the line. And you may not even be aware that that is what you are doing.

The problem presented by the Amalgamated Plastics case is perhaps the most difficult kind of managerial ethics problem we have, one that is often difficult to recognize as a problem at all.

The Nature of Ethics and the Purposes of a Code of Conduct

Overview

1. The nature of ethics
2. The four primary purposes of a code of conduct
3. The nature of principles and rules
4. Efforts to sum up ethics in a few rules
5. Rules have exceptions



Radio Station WIIFM and Other-Interest



We are all tuned in to Radio WIIFM. What's in it for me?

Infants and small children are devoted to their own interests. While they have some awareness of others, that awareness is almost exclusively framed in terms of the benefits others provide to them.

This is natural and healthy. It is an essential feature of survival not only of the individual but also of the species. As Hillel, the great sage from Jerusalem, put it thousands of years ago, "If I am not for myself, who will be?"

To do something for others, you must first be healthy, competent, and able to take care of yourself.

In business circles, we sometimes express our focus on self-interest by saying that we are all tuned into radio station WIIFM – What's in it for me?

But Hillel also said, "If I am not for others, what am I?" What, indeed? Surely not someone welcome in the society of other human beings.

The foundation of morality is respect, which is about awareness of others. More precisely, it is awareness and consideration of the interests of others as they are affected by my behavior.



As humans, we start our journey focused on self-interest. Ethics is about looking out for other-interest.

Ethics is about what is and is not socially acceptable behavior, what conforms to social norms, what will lead to acceptance or rejection by others.

The Purposes of a Code of Conduct

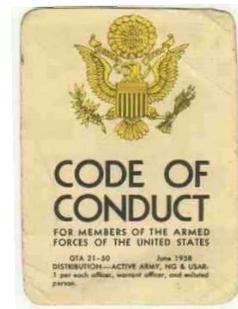
Although codes of conduct serve many functions, we can summarize the basic purposes of a code of conduct program in four parts:

First, assure compliance with the law.

Second, we want to promote goodness.

Third, prevent misconduct.

And set priorities among values and interests.



Comply with the Law

We might think that compliance with the law is a given. However, it never hurts and is often helpful to remind everyone in the company that both the organization and the people working in it are subject to numerous laws designed to assure a minimum level of goodness in the business. Laws pertaining to safety and health, discrimination, wages, harassment, antitrust behavior, financial reporting, and much more all limit and shape what people in the business may do.

No one expects everyone in a business to be an expert on all of the laws that affect the business and its relationships with others. Each department has its own set of laws and regulations that the managers and executives in that department should know about. In larger companies, the final responsibility for assuring compliance with the laws rests with the legal department. In smaller companies, the president is responsible for working with outside counsel to ensure that the company is in compliance with all regulations.



Including a reference to the requirement to comply with applicable laws in a code of conduct serves to remind everyone that the company is committed to complying with the law and will hold its employees, agents, suppliers, and contractors responsible for doing the same.

This last point may also seem to be obvious. But it sometimes happens that people within a business take the Leona Helmsley view — “only little people pay taxes” — or the Greg Reyes approach — “it’s not illegal if you don’t get caught.”

Making compliance with the law an explicit provision of a code of conduct sends a signal to everyone in the organization that the company does not play games with the law and will not tolerate anyone who does.

Promote Good Behavior

In talking about the impact of the 4-Way Test, the mini-code of conduct he developed for Club Aluminum in 1932, Herb Taylor gave several examples of the difference it made in actual day-to-day business practices. As he put it, "The test worked wonders." For example, part 4 of the test asks, "Will it be beneficial to all concerned." Salespeople might have focused solely on making the biggest sales possible, regardless of whether having excess inventory was good for the buyer. But when they applied the 4-Way Test, the salespeople realized that such sales practices were not beneficial to the buyer. "Instead of persuading dealer[s] to take more merchandise than [they] needed, The salesman helped the dealer determine what he could reasonably expect to sell. Then the salesman gave them tips and other material to help him sell it."



Taylor told a story about how one day the sales manager breathlessly announced a possible order for more than 50,000 utensils! Remember, this was during the Great Depression and at a time that Club Aluminum was still struggling to become solvent. The potential customer intended to sell the products at cut-rate prices. After thinking the matter over, the sales manager concluded that this arrangement would violate the second prong of the 4-Way Test. It would not be fair to all concerned, because the company's regular dealers advertised and promoted the products consistently at a set price, which the company agreed was fair. Making such a huge order to a buyer who intended to undercut the standard price would not be fair to the regular dealers.

Club aluminum turned the order down. Taylor said it was probably the most difficult thing they had to do in those early bankrupt days. But, he added, "there was no question that this particular business transaction would have made a mockery out of the Four-Way Test principles we lived by." [Taylor 43]

In a strong ethical culture, people work together to create a climate in which trust flourishes. Because all business activity requires cooperation, not only is trust essential; but there also needs to be a congenial, positive, pleasant working atmosphere.

This is not just choosing to do the right thing when there is a possibility of doing something less proper. It is also about the positive side of ethics. Respecting other people, observing the rules of etiquette, being polite, showing concern for the well-being of others, helping out a colleague who is having medical problems or other personal challenges – all this is goodness too.

To achieve a positive climate, people need to be doing good things for each other, not just avoiding bad behavior. A code of conduct can help to make niceness part of the default mode of any workplace.

Even more fundamentally, we can use a code of conduct to develop practices that engender trustworthiness. Helping a customer solve a problem with a company product may not be part of the job description or even be required by the warranty, but it is a good thing and, coincidentally, also helps build goodwill for the company.

Prevent Misconduct

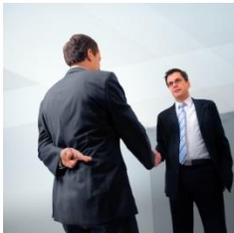
Imagine that a sales manager in your company is straining to meet her quarterly quota when one of her top sales people shows up with a problem. It seems last year he took the buyer for one of his top accounts to a game between the New England Patriots and the New York Giants. This year the buyer told him he plans to continue doing business with your firm, but he wants season tickets to the Patriots home games before he will approve the sale.



The sales person asks the sales manager what he should do, pointing out that there is no money in the budget to cover this kind of expense, which would be several hundred dollars. Does the company have a set of rules clearly stating that the sales person has no discretion to bribe the buyer in this manner? If not, can you rely on the sales manager to do the right thing?

At its most basic level, a code of conduct is a means for preventing misconduct. Specifically, it can help prevent fraud, theft, harassment, and other misconduct.

Fraud is one of the biggest threats to business success. By its nature, business is about commercial exchanges. You promise me that you will deliver a truckload of good lumber; and I promise you that upon receipt of the lumber I will pay you an agreed price. Participants in this kind of arrangement always face the risk that one or both parties will lie or deliver something other than what was promised. Businesspeople continually must protect against being cheated.



Here is the unpleasant truth you must confront: the more financially successful your business becomes, the more it will attract predatory sociopaths whose sole motivation is greed. I call them Corporate Willie Suttons. You remember Willie. When asked why he robbed banks, he replied, "That's where the money is." Corporate Willie Suttons are typically smooth, well-educated, and hard driving. But make no mistake. They have destroyed many successful companies – Enron, World Com, and Parmalat being among the most recent examples.

A well-crafted code of conduct cannot eliminate the possibility of being victimized by a Corporate Willie Sutton. But it can help reduce the possibility that they will do much

damage or even seek entry in the first place. When they find a house with a good security system, burglars typically move on to the one not so well secured.

Companies that develop a reputation for ironclad honesty in business dealings incur less transactional costs than those that are known for sharp practices. A code of conduct that places emphasis upon the highest level of integrity in all contexts helps to create a culture in which fraud becomes less likely.

Theft may be one of the biggest unseen costs of businesses with poor ethical cultures. People who are bitter about how they have been treated in the company are more likely to steal from it than those who feel accepted and acknowledged. As a means for creating a healthy ethical culture and positive work climate, a code of conduct helps prevent the conditions that lead to theft. But it also can set out procedures that make theft less likely. For example, requiring two signatures on every check above a certain minimal amount such as \$500, is a simple procedure that helps to prevent embezzlement.



According to a study reported by Fulbright and Jaworski, the largest share by far of lawsuits brought against corporations are the result of personnel problems, with sexual harassment and various forms of bullying leading the way. Not only is harassment personally offensive to the victim; but it also contributes to a climate of disrespect and ultimately undermines the ethical culture that is essential for a sustainable business.



Set Priorities and Balance Among Competing Values and Interests

Suppose you're getting ready to leave the house for an important meeting at the office on the launch of a new product your company is working on when you're five-year-old daughter falls off a ladder and breaks her arm. No one else can take her to the hospital. You have to choose between making the meeting and taking care of your daughter. What do you do?

It's almost insulting to ask the question. Of course, you rush to the hospital with your daughter, because her health and well-being is much more important than the meeting at the office. The priorities among your values are clearly set. You probably call in, letting everyone know that you will not be able to make the meeting. And everyone will tacitly agree that you made the right choice.



Now suppose you discover that there is a problem with a product your company makes and sells. Not only is it defective, but it also is life threatening in some circumstances to the ultimate user. What should you do?

Most people, when asked this question in the abstract, would likely say that the course of action is clear: recall the product. Don't ship any more until the defect has been eliminated. (And that's what jurors are likely to think too.)

But it is seldom that simple because a variety of interests come into play. How expensive will it be to recall the product? What are the chances that the defect will cause any severe damage? How strong is the company's cash position? What impact will recalling the product have on jobs in the company? What will the potential impact on the community be? Who within the company will be blamed for the defect? Will it be you?

These are the kinds of problems that must be dealt with when confronting a decision such as whether to recall a defective medical device, to continue with the production of a car known to have safety problems, to put out an FDA-approved drug even though well-organized interest groups plan to boycott the company if it does, or to lay off employees or even close the plant in order to increase profitability for the whole company.

Several famous cases involve decisions by high-level executives in similar situations. In the Ford Pinto case, managers had to decide whether to redesign the car after it was discovered that the gas tank would explode in rear end collisions, creating an inferno in which people within the car would likely be burned to death. The executives at Guidant, a maker of implantable cardio defibrillators, chose to keep shipping defective devices after discovering that they could short out and endanger the lives of the patients. The head of Johnson & Johnson had to choose among competing values and interests in 1982 when it came to light that several people had died from cyanide poisoning traced to Tylenol capsules.

Because every company faces both large and small decisions of this kind, it is important to establish in advance the priorities among interests and values that will govern those decisions when they come to be made. Unlike decisions such as the one with the five-year-old daughter's broken arm, the priorities among interests and values for business decisions are not always clear.

When a company does not have a clearly pre-established set of priorities among values and interests, it is more likely that the decision-makers will choose self-interest over other-interest when making decisions of this sort.

The most famous illustration of the need to prioritize values and interests is the case of the Tylenol poisonings that created a major crisis for Johnson & Johnson in 1982. As those who were involved tell the story, it was Johnson and Johnson's *Credo* and the ethical culture that had evolved around it that led them to recall all Tylenol capsules without hesitation. Johnson & Johnson was not at fault in any way for the poisonings that occurred. Nevertheless, its executives put the customers first even though it would

cost over \$100 million to make sure that all Tylenol capsules were removed from commerce. The cost to the company and even the survival of the division that made Tylenol were secondary considerations, which did not trump the primary responsibility to people who had purchased or might purchase Tylenol capsules.

The Johnson & Johnson Credo sets forth a clear hierarchy of interests and values that the company follows. The customers, patients, and medical personnel who use the products are the highest priority. The Credo then says that the people who make the products – the employees – have the next claim on the company’s decisions. The communities in which the plants are located are third in the list of priorities. Finally, the interests of the shareholders **are** recognized as well.



This *Credo* with its prioritization of values and interests has been the cornerstone of Johnson & Johnson’s ethical culture since the company went public in 1946.

Not every company will want to set the priorities among competing interests and values the same way that Johnson & Johnson did. But it is important to make clear in advance which interests and values take precedence whenever there is a conflict among them.

A code of conduct can address this issue and, in doing so, helps the company and the employees who make decisions within it avoid falling into the trap of expediency, giving preference to interests such as cost savings or higher profits when other interests such as customer safety or long-term relationships with suppliers may, in fact, be more important.

Remember, you don't need a compass when the sky is clear and the stars are bright. You need a compass when you're deep in the woods, can be found, the sky is cloudy, and no stars can be seen.

Principles and Rules

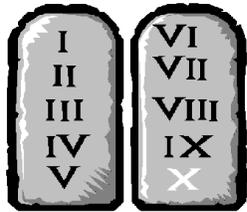
A code of conduct consists primarily of principles and rules about behavior in social and business relationships.

Principles have broad application in many different settings. For example, we call the notion of fair play that seems to be part of our genes “the reciprocity principle.” It illustrates what we mean by the word “principle.” It is not so much a particular rule as it is a foundation on which rules can be built.



Rules, on the other hand, are specific directions about what must be done, may be done, or may not be done.

Rules are encapsulated judgments. By that I mean that we devise rules based on



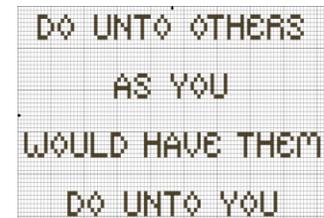
experience or what we think is appropriate for future behavior. For example, we know that we are likely to have collisions if cross traffic at an intersection is not regulated. We make judgments about how best to deal with traffic at an intersection. We translate those judgments into rules that state when the north-south traffic may proceed and when the east-west traffic must stop. With rules we do not need to continually make judgments about how to act in various situations. The judgment has been premade and reduced to a rule. That is what I mean by "encapsulated judgments."

Efforts to Sum it Up

For thousands of years people have tried to discover the ultimate rules that capture the essence of all the others. These efforts to sum it all up in a few rules provide a starting point for work on the nucleus of a code of conduct.

Perhaps the most famous short summary of an ethical code is the 10 Commandments associated with Moses.

The Golden rule, do unto others as you would have them do unto you, has been cross-stitched into samplers since colonial times and goes back to well before the time Jesus.



Golden Rule

Confucius articulated what has become known as the Silver Rule: Whatever you would not want to see done to you, don't do that to others.

The 18th-century philosopher, Immanuel Kant, tried to capture the essence of morality in what he called the categorical imperative: Act only according to that maxim whereby you can at the same time will that it should become a universal law. Kant continued to work on this categorical imperative, which took different forms in later publications, one of which was: Act in such a way that you treat humanity, whether in your own person or the person of any other, always at the same time as an end and never merely as a means to an end.

We've already encountered Herbert J. Taylor's Four-Way Test which has been made widely known through Rotary Clubs around the world: Is it the truth? Is it fair to all concerned? Will it build goodwill and better friendships? Will it be beneficial to all concerned?

We've also talked briefly about the Johnson & Johnson Credo, which is distinguished by being both a concise statement of the company values and a prioritization of them as well.

Finally, there is my own Checklist of Trustworthy Behavior in Business, which can serve as a set of reminders to keep us oriented and working in the right direction. Do good work. Keep your word. Tell the truth. Play fair. Respect everyone. Mind your manners. Do no harm.

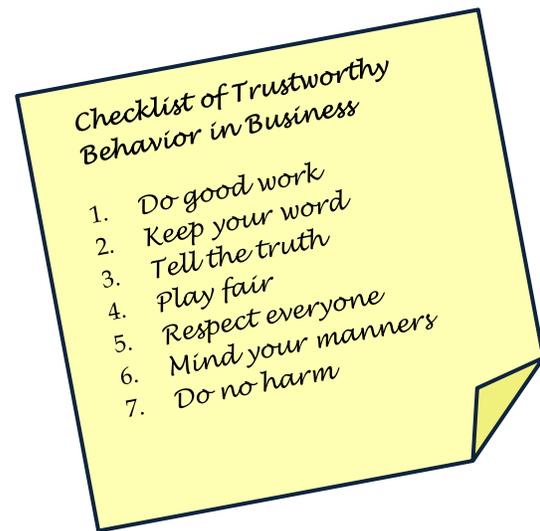
Corporate codes of conduct often contain short summaries such as these as well. They serve as compact reminders of the main features of the company's ethical principles.

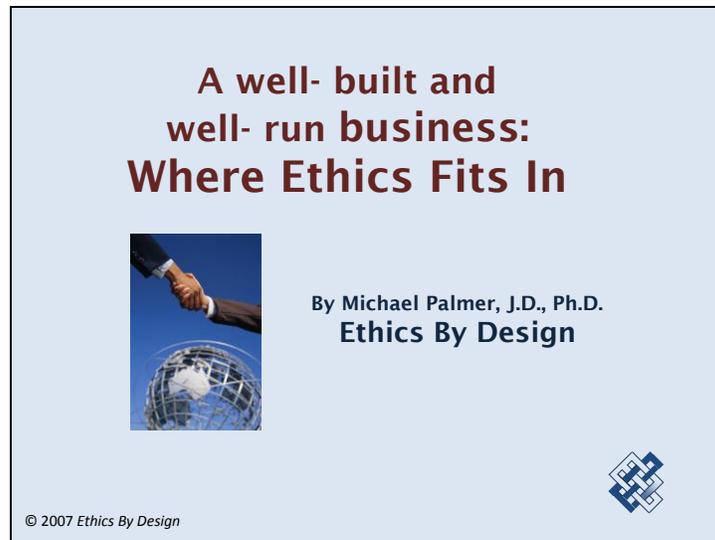
Every Rule Has Exceptions

Finally, when drafting a code of conduct, we need to remember that it is not possible to write absolute rules, that is, rules that are valid and binding in every situation. Every rule has exceptions in special circumstances. Red lights should not stop emergency vehicles. "Thou shalt not kill" does not apply in cases of self-defense or defense of family or country. It would be wrong to tell the truth to a pirate determined to kill your friend when he asks where she is.



We need to be aware of the limitations of rules, therefore, in order to have a code of conduct in which both the spirit and the letter of the rules are honored. We want to make sure that we do not gag on gnats and swallow camels.





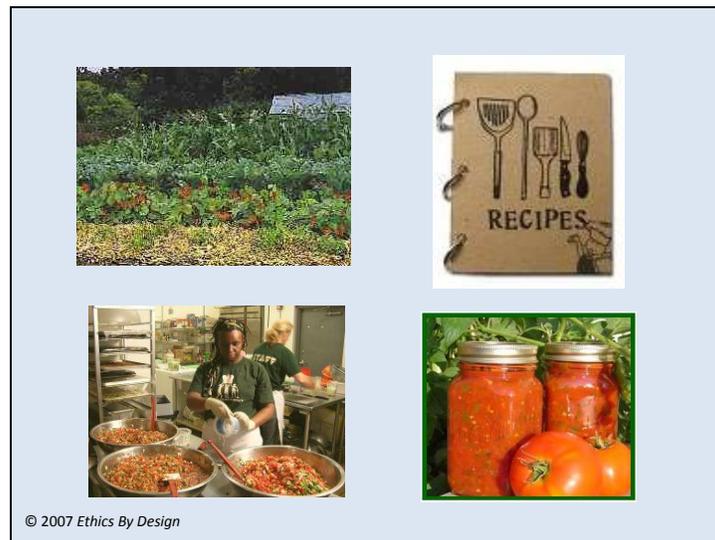
Every business has two sides: its structure and its operation. If a business is to function ethically, ethics must be built into its structure and must be a continual aspect of its operation. Ethics is a build in, not an add on.

This chapter provides a brief overview of the centrality of mission and the structural and operational sides of business, pointing out where ethics fits into both.



One year Holly and Jim found they had raised way too many tomatoes. Neither they nor their friends and relatives could eat them all before they spoiled. In the old days, Holly and Jim would have spent a couple of days canning tomatoes for the winter. But Jim suggested they use the tomatoes to make salsa instead.

Their friends raved about the salsa and suggested they should sell it to some of the local stores. Thus was born Jolly Salsa, a product now distributed in 5 states.



At first, the Jolly Salsa business was just Holly and Jim. They planted, raised, and harvested the tomatoes and vegetables. They perfected the recipes. They prepared the salsa and put it into jars. They ordered the labels. They put the labels on the jars. They took the jars of salsa to farmers' markets and other local outlets. They made the deals with the stores. They applied for the trade name certificate from the secretary of state and obtained an employer identification number from the IRS. They collected the money and kept the records of what they spent and took in. They opened the bank account. They did everything, just the two of them.

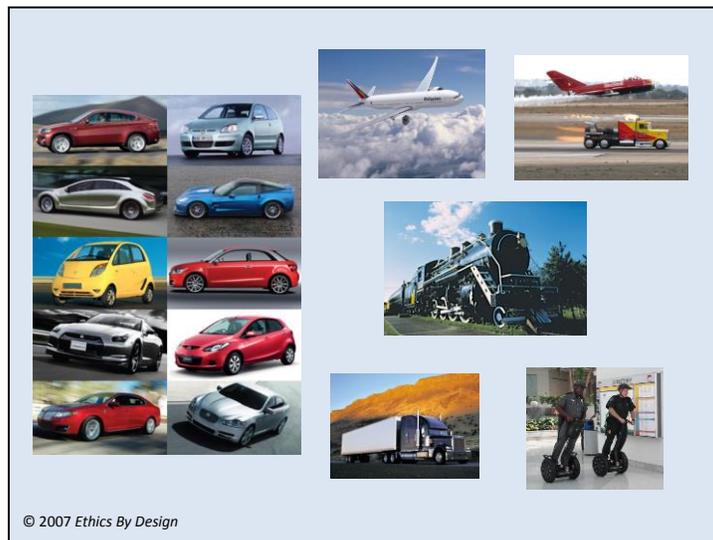
Within six months, however, despite working more than 12 hours a day seven days a week, Holly and Jim were unable to keep up. The Jolly Salsa was a success, but they were going to need help if it was to continue.



Let's pause here to take a look at the Jolly Salsa business. It consists of three parts: a mission, a structure, and operations. At the very beginning, Holly and Jim probably don't give much thought to any of this. Their mission was to make up batches of salsa and sell and deliver it to their customers. The operational side seems to take care of itself because they are doing all the work. They make the salsa. They sell and deliver the salsa. And they deal directly with the grocery stores that stock the salsa. The structure of the business is embryonic at best. It consists largely of a name, a bank account, and a tax ID number. The functions of the business have not been separated out. Holly and Jim make all the significant decisions together, sitting at their kitchen table. Legally, they are a partnership, not because they deliberately chose that form but because the law says that two or more people doing business together are a partnership unless they actively choose another form such as a corporation or limited partnership. Holly's business agreements with third parties bind Jim and vice versa.



Now that Holly and Jim are unable to keep up with the growing demand for Jolly Salsa, however, they will be hiring employees and entering into stable, contractual relationships with suppliers and buyers. At this point, The Jolly Salsa business is starting to become a separate entity, more than just Jim and Holly. Even though they personally are still very much at the center of the business and may remain so for decades, the business is distinct from them. In a sense, it is like a vehicle that they use rather than a mere extension of themselves.

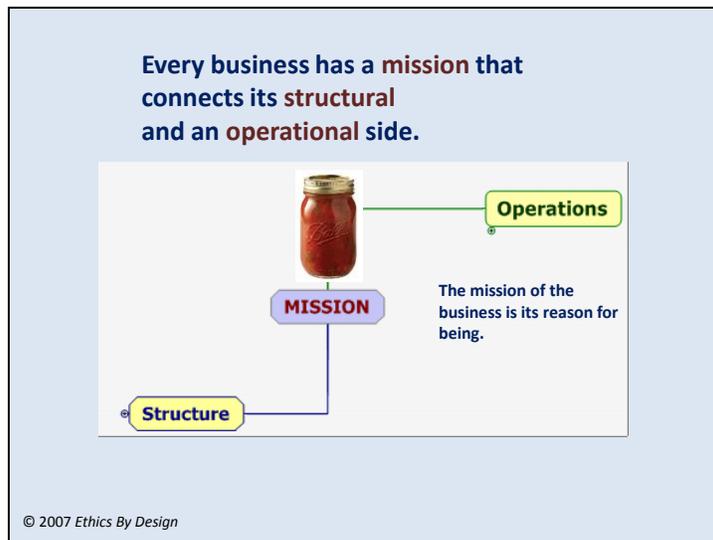


The vehicle analogy helps explain the three parts of every business. Transportation vehicles come in a variety of types, shapes, and sizes: cars, trucks, trains, planes, and

even two-wheel segues. But all transportation vehicles, no matter their size or shape, have one or more purposes, a structure, and an operational side.



A vehicle can be a simple cart or a complex machine with many intricate parts all working together. It can be pulled by animals or humans or moved by high-powered jet engines.



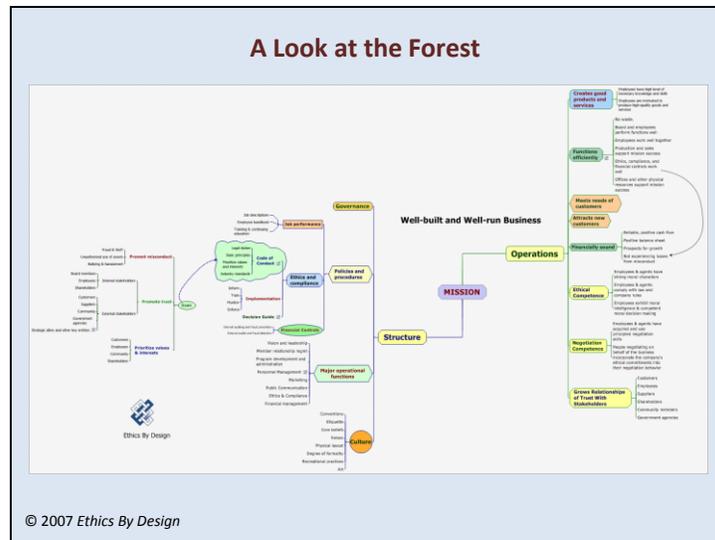
Like vehicles, businesses have a purpose, a structure, and an operational mode.

Once the Jolly Salsa business grows beyond the mom and pop stage, Holly and Jim must start paying attention to both its structure and its operational mode. How is it put

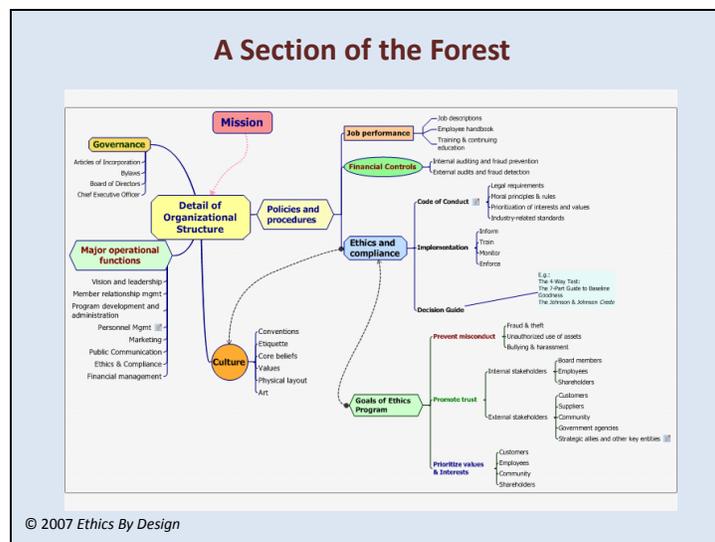
together? How do they *want* it to be structured? And how do they want it to actually work in practice? What guidelines and standards do they want to govern its operations?



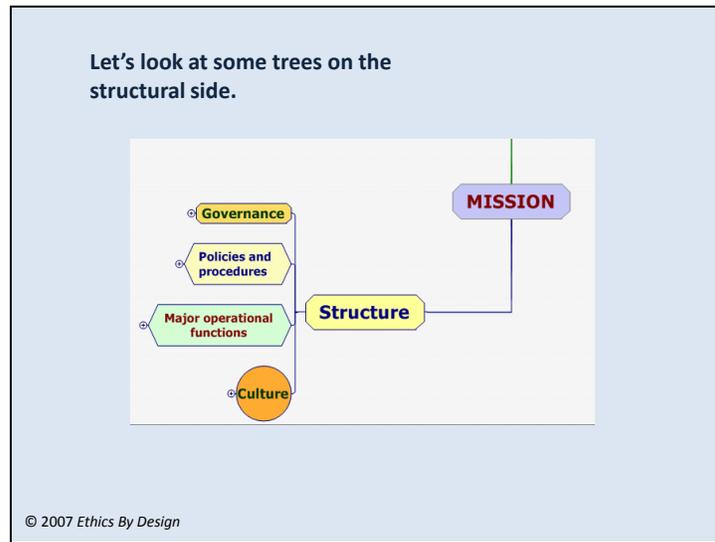
In the beginning, Holly and Jim's purpose may have been simply to get rid of a surplus of tomatoes in a way that provided some pleasure to their friends and gave them a feeling of accomplishment. However, as the business grows, the mission evolves with it. At the outset of the fledgling business, the mission could be stated as simply as "make and sell good salsa." Later, after giving it some thought, Holly and Jim and other leaders in the business may refine the mission statement, for example, by specifying the particular markets to which they sell, thereby reflecting any specialization that has developed. But even a mission statement as simple as "we make and sell good salsa" is a valuable organizing tool for their business. It tells everyone clearly and succinctly what they are about, helping employees and suppliers to focus on the ultimate purpose and announcing to potential customers what the company intends to provide. Understanding the mission of the business is vital to both the structural and the operational development of the business.



This chart depicts the structure and operational aspects of a mature business. It could be The Jolly Salsa 2-3 years after Holly and Jim made their first batch of salsa. There may be 15-20 employees. Holly and Jim have probably incorporated or selected some other business form. The Jolly Salsa has a full-time bookkeeper, a sales manager, a chef and a team of cooks, packers, and a truck driver or two.



This section of the chart, depicting the organizational structure, shows several major components of a mature business: governance, culture, policies and procedures, and major operational functions.

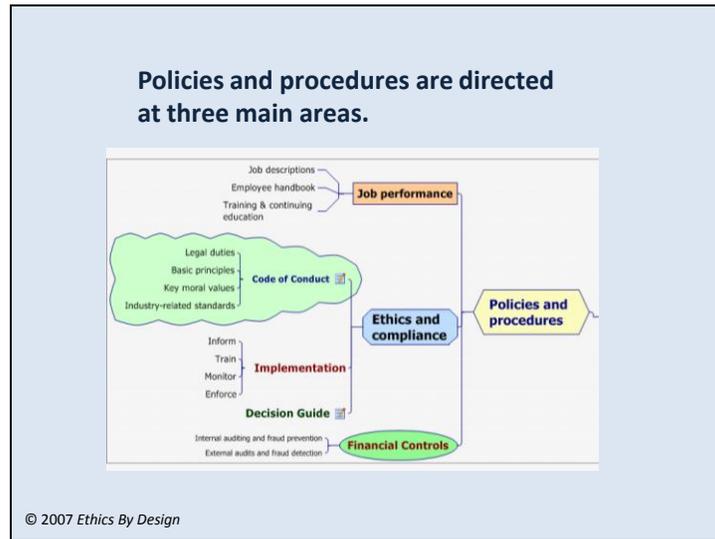


On the structural side, the key components are governance, policies and procedures, major operational functions, and culture.

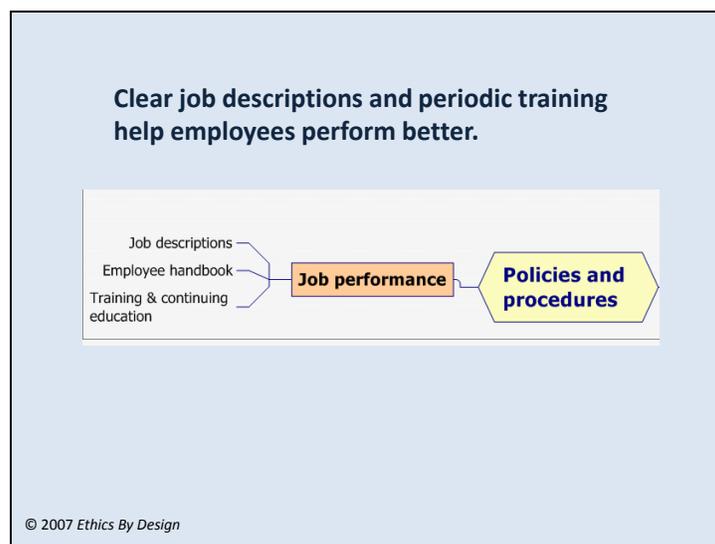


At the most general level is the governance aspect. Traditionally, corporations have articles of incorporation which for small businesses usually do not amount to much more than a statement of purpose and the designation of the number of initial shares that will be issued. The bylaws should be the place where the constitutional regulation of the business is laid out. In most small businesses, however, the people running the business seldom pay much attention to the bylaws. Corporations typically have a Board of Directors that acts on behalf of the shareholders in deciding what bank to use,

whether to sell or purchase expensive assets, whether to enter into major joint ventures, and such matters. And finally the governance structure often will set up several offices or functions to be performed by one or more people hired for the purpose. At a minimum there will be a chief executive officer such as a president and a secretary who is responsible for keeping accurate records of board meetings and official resolutions.



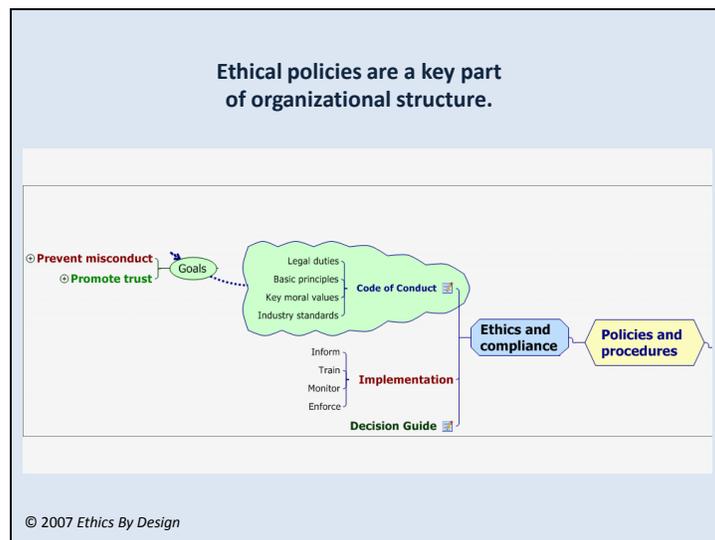
A major part of the organizational structure of a mature business is comprised of the policies and procedures the business leaders put in place to guide the operational side of the business. We can divide policies and procedures into three major categories: job performance (production of goods and services), ethics and compliance, and financial controls.



For each job there may be a written description setting forth what anyone occupying that job is expected to do. The business may have an employee handbook that states what the business expects from the employees, what the employees can expect from the business, and the procedure for addressing conflicts and problems. Written procedures for conducting training to ensure that employees understand their responsibilities and improve their knowledge and skills for performing them are sometimes part of the organizational structure.



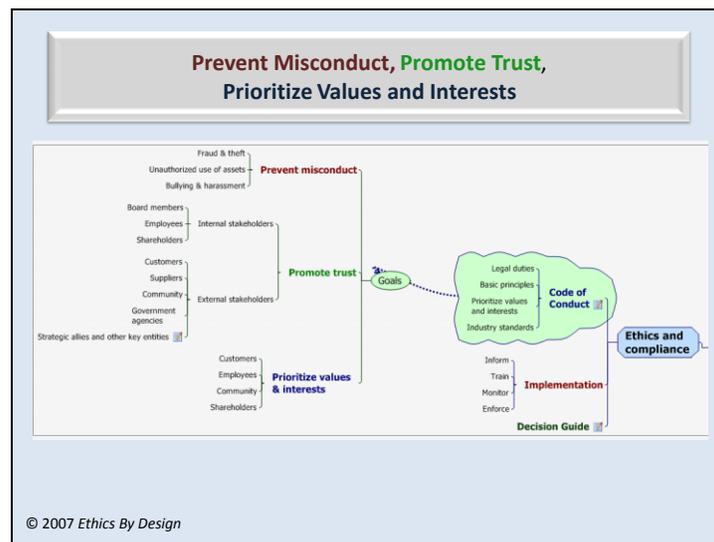
Because every business handles money as a medium of exchange, part of the organizational structure typically needs to address the financial controls, policies and procedures that state who will be handling funds, what level of payments require two signatures, what internal auditing procedures will be used, and in larger businesses what system will be put in place to conduct external audits and fraud detection.



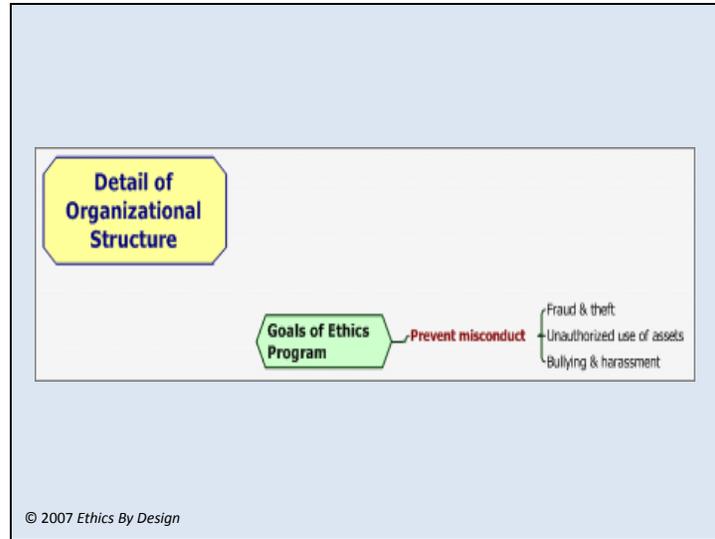
A final set of policies and procedures concerns ethics and compliance. It is here that we encounter the code of conduct, which addresses legal requirements, moral principles and rules, prioritization of interest and values, and industry-related standards.

This group of policies and procedures also lays out the process for implementing the code of conduct, including procedures for informing new hires about the code, training all employees to assure that they understand the contents of the code of conduct, monitoring compliance, and enforcing the rules.

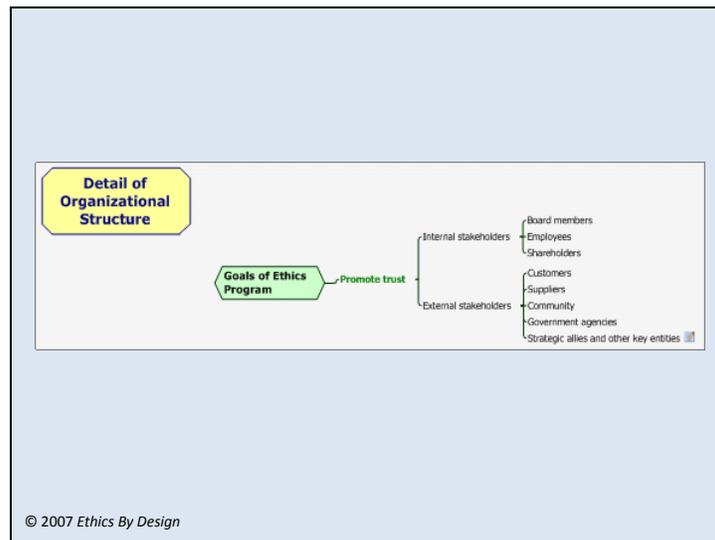
A third part of the ethics and compliance package might include a brief decision guide to help managers and agents resolve ethical dilemmas and conflicts between different values and interests in a way that furthers the realization of the companies stated values.



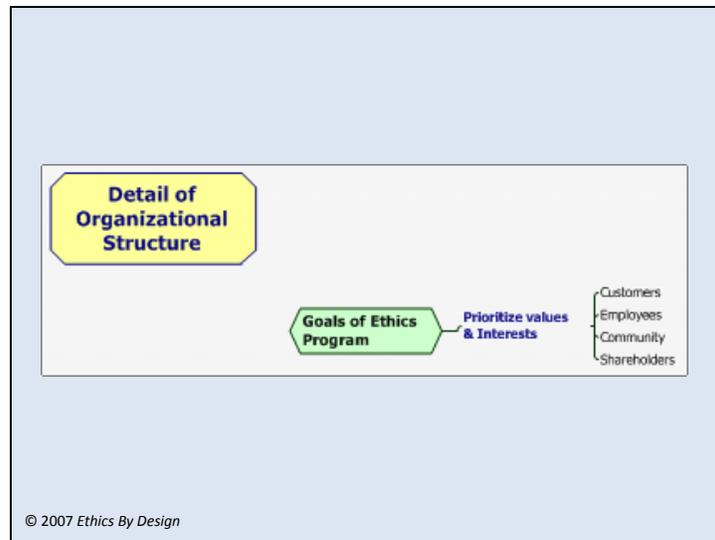
The goals of a good ethics program are to prevent misconduct, to promote trust, and to prioritize values and interests.



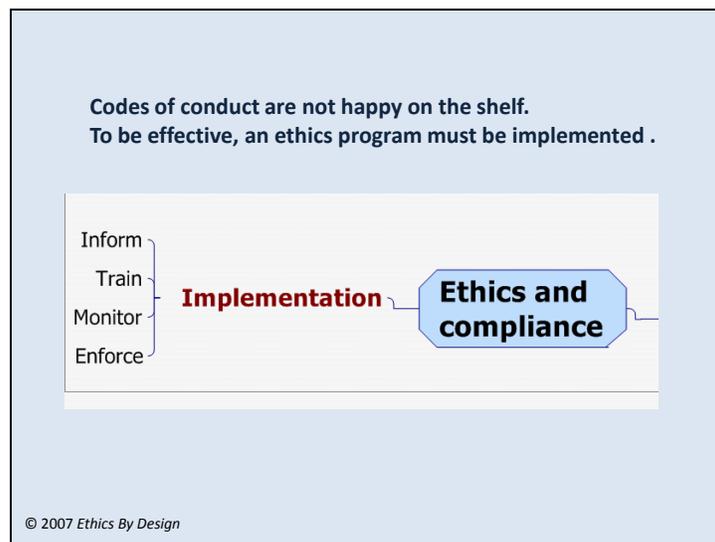
Misconduct comes in many forms including fraud and theft, the unauthorized use of company assets, bullying and harassment, bribery, extortion, and, in general, the full range of bad stuff that people do from time to time.



A mature company seeks to promote trust among both internal and external stakeholders. Internal stakeholders include board members, employees, and shareholders. The major external stakeholders consist of customers, suppliers, independent contractors, and professionals, members of the community in which the business is located, government agencies, and strategic allies and other key entities.



Finally, although often neglected, one of the most significant goals of an ethics program is the establishment of policies that prioritize the values and interests of different stakeholder groups in addition to the values and interests of the company itself. Simply making a list of values without designating which shall control they are in conflict will not be of much use for decision-makers when trying to resolve ethical dilemmas. One way to prioritize values and interests is to select which stakeholder groups take precedence over which others.

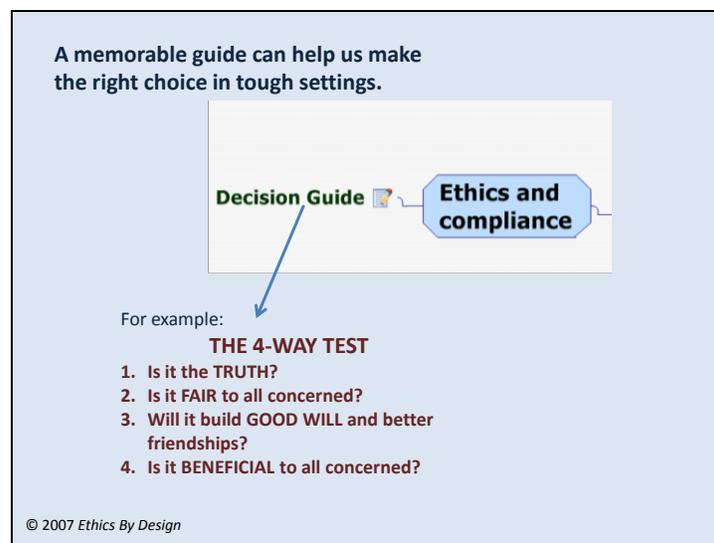


A code of conduct and related policies that are nicely printed but remain in a book on the shelf are of little use. In fact, because policies adopted but not practiced lead to cynicism, the failure to implement a code of conduct may be worse than not having one

at all. It is somewhat like checking off items on a checklist without really making sure that they have been done, giving those who rely on it a false sense of security.

People in the governance risk and compliance industry refer to the adoption of a code of conduct without simultaneously attending to the implementation process as “print, post, and pray.” This is not a strategy likely to yield good results.

As part of the implementation process, the company needs to inform all new hires of the code of conduct and related documents. It needs to conduct training on a regular basis. It must have some system in place to monitor compliance. And, fourth, there should be procedures for dealing with alleged violations and enforcing the provisions of the code.



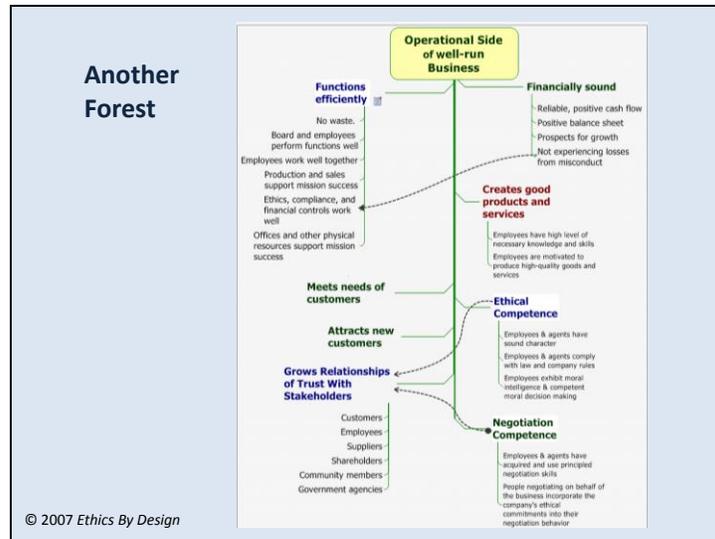
Finally, a good ethics and compliance program often will include a decision guide for use in Resolving ethical dilemmas or conflicts among values and interests. Holly, Jim, and others in The Jolly Salsa will inevitably encounter situations in which they must choose between making a quick buck and adhering to basic principles of honesty, fairness, and respect. A decision guide will not make those choices for them. However, it will make clear what the company policy is with respect to such conflicts. As we saw in the story of Herb Taylor and the four-way test, if the company has already committed to pursuing fairness to all concerned, a contract with a large buyer that simultaneously undermines relationships with existing buyers may not only be imprudent; it may also be a violation of basic company policy. When there is no policy and no decision guide making these judgments clear, it is more likely that individual decision-makers will succumb to the pressures of the moment and make expedient decisions that undermine the long-term interest of the company.



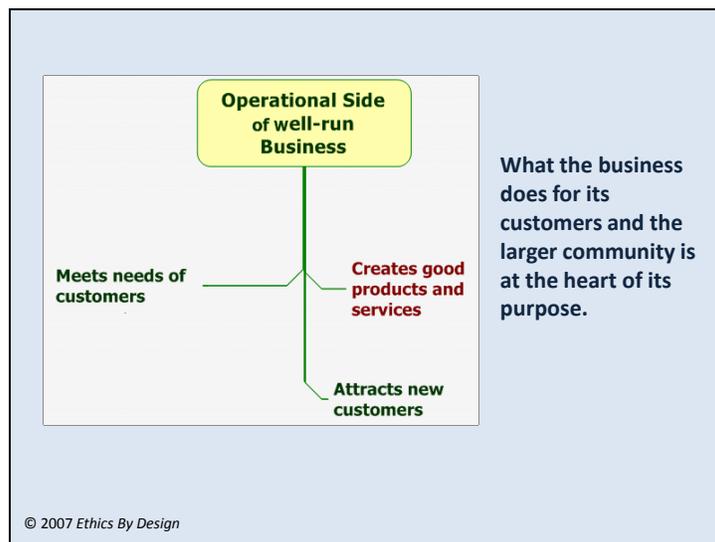
Part of the unwritten organizational structure of a business is its culture. The culture of a business is the totality of conventions, standard operating procedures, core beliefs, actual values (as distinct from nice-sounding values suitable for framing), the physical layout and working conditions, the traditions, the aesthetic tone of the workplace, and other idiosyncratic characteristics that distinguish one business from another. The level of familiarity that employees show with each other, the style of language, the aesthetic presentation of the business to the outside world, and much more are all part of the business culture.



The company mission is at the heart of the company’s operations too. Holly and Jim’s business will not make and sell good salsa unless that mission pervades all its operations.



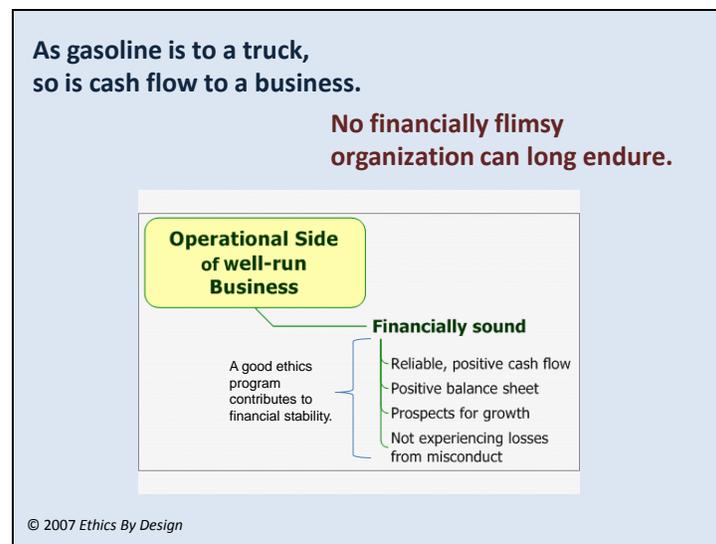
This is the overview of the operational side of a well-run business. The various parts function efficiently in coordination with each other. The business is financially sound with sufficient capital and reliable cash flow. It creates good products and services. It addresses the needs and desires of its customers within the scope of its mission. It attracts new customers. Its employees and agents are ethically competent and have acquired good negotiation skills, which together help these representatives build trust among themselves and other stakeholders.



Do good work. That is the first responsibility of anyone who engages in business. That does not mean that every product or service must be a Rolls Royce. But it does mean that the company provides equivalent or better value in exchange for the payment it receives. And, in any event, no shoddy or slipshod work is permissible.

In a well-run business, the needs of the customers are uppermost in the minds of those who design, make, and sell its goods and services. A business that does not respond to the needs of its customers is likely to wither. For example, a well-run company will not run its customers through the gauntlet of voice mail hell just to scrimp on expenses, because such devices are fundamentally disrespectful.

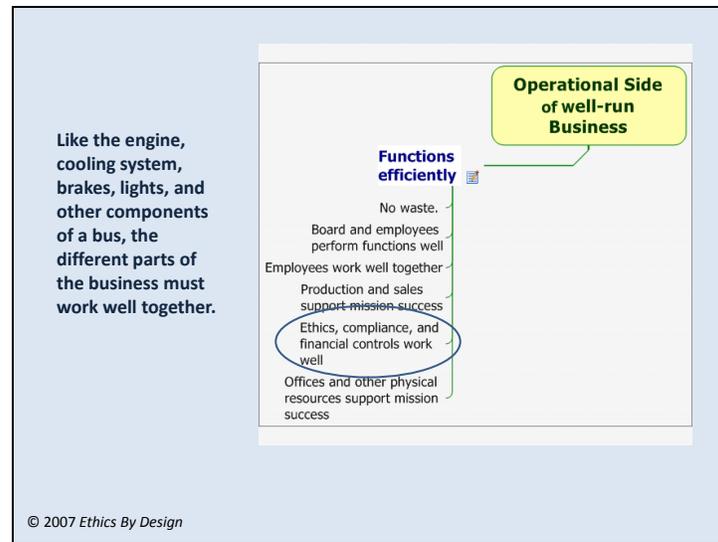
A well-run business will also seek to attract and keep new customers. All customers not only buy what the company produces; but they also serve as mini-marketers, telling others about the good (or bad) experiences they have had. If the proper attention is paid to the needs and desires of customers, growth can be exponential.



David Packard, the co-founder of Hewlett-Packard, put it well: “Profit is not the proper end of management. It is what makes all the proper aims and ends possible.”

Whether a business generates profits for its owners or is a charitable organization, it must be financially sound. Income must exceed expenses. Sufficient resources must be available to purchase or replace equipment, make repairs, expand as needed, and grow.

A good ethics program and an ethical culture will contribute to the financial stability of the organization by helping to reduce losses from pilfering, embezzlement, fraud, absenteeism, high turnover, low productivity, and bad morale.

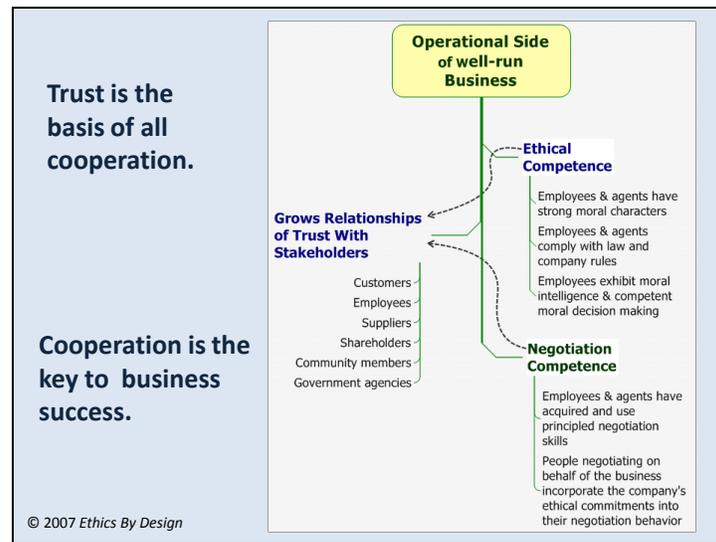


Any business larger than one person requires the coordinated cooperation of people and entities. People and departments within the business must work together to achieve the mission efficiently and cost effectively. They must work with suppliers, professionals, bankers, and independent contractors to obtain the resources, guidance, and other means of carrying on the work of the business.

The efficient, cost-effective, coordinated cooperation of people and entities is perhaps the most important job of managers at all levels. The continual need to improve this aspect of operations is one reason why methods and processes such as Six Sigma, strategic management, and Total Quality Management have become popular among business leaders. It is also the reason why the best managers are increasingly paying attention to emotional intelligence, social intelligence, and negotiation competence – the set of native abilities and learned skills we use to understand, persuade, and work with each other.

The ethical culture of a business plays an important role in this context of efficiency and cost-effectiveness as well. When some employees are inconsiderate and fail to mind their manners – for example, by failing to wash their own dishes or by borrowing someone else’s sandwich from the refrigerator – their colleagues can become irritated, resentful, and unhappy, leading to dissension and lower productivity. When employees steal from the supply room for their personal use or take home products from the shipping dock, the cost of production increases. When managers disrespect, abuse, or harass subordinates, the best people find jobs elsewhere, contributing to higher recruiting, replacement, and training costs and depressing the overall mood of the workplace.

On the other hand, when respect is at the core of all human relationships in a business, productivity rises and wasteful costs decline. And the chances of longevity improve. A good ethical culture, like high-quality production, is the result of deliberate efforts, the use of tools and techniques designed to bring about the desired result.

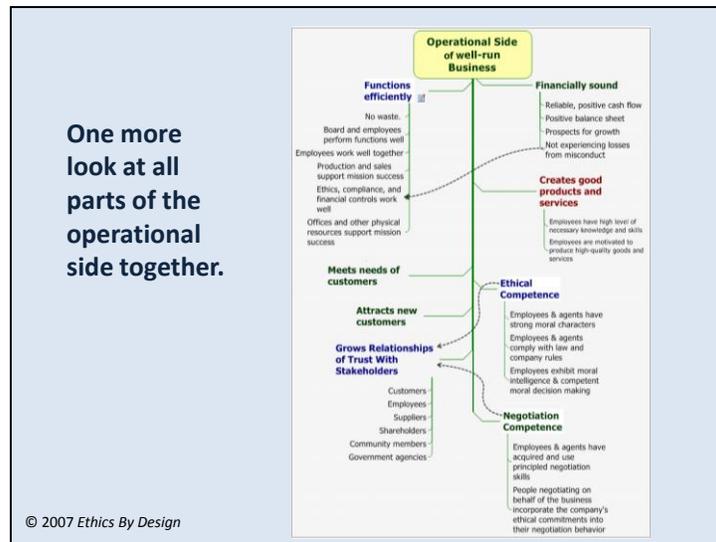


Looking deeper into the operational side of a business, we see that ethical and negotiation competence are partners in the process of building trust with and among the company's main stakeholders. As the name implies, stakeholders are those who have a stake in what the business does. Customers want good salsa. Some particularly like Jolly Salsa and would be less happy if it no longer were available. They have a stake in the success of the business because it is the source of something they enjoy. Employees not only need the income that working at The Jolly Salsa Company provides, but they also need the sense of purpose and accomplishment that they receive by contributing to the production and sale of Jolly Salsa. And many of them need the social camaraderie they enjoy at a good workplace. As people who are integrated into the work of the company, they have perhaps the largest stake in its success and well-being. Suppliers can develop a symbiotic relationship with their customers that gives them a stake similar to that of employees. The shareholders, who have invested part of their assets into the business, certainly want to see it grow so that it eventually provides a return on their investment. The community and government agencies are part of the stakeholder group as well.

As noted previously, cooperation is the key to business success. Trust is the basis of all cooperation. People and companies that behave unethically destroy trust. Those that fulfill their moral responsibilities build trust. It's that simple. Ethical behavior – both by the company as a business entity and by the people who work within and on its behalf – are essential to business success. In this context, ethical competence is not a

vague sense that everyone will do the right thing. It has three main pillars: (1) strong moral character, (2) consistent compliance with the law and company rules, and (3) demonstrated ability to resolve moral dilemmas in ways that promote the best interests of the company’s stakeholders in accordance with a previously determined order of priority.

Negotiation competence is the companion of ethical competence in the trust-building endeavor. This is the subject of an entire course. Suffice to say here that the more skilled the employees and agents of The Jolly Salsa are at using the tools and techniques of interest-based negotiation, the more likely it is that they will craft durable agreements that enhance the success of the business.



The different components of the operational side all work together. Some can be neglected for a while. But neither The Jolly Salsa nor any other company will long endure if it does not find a way to assure that these components are being managed effectively.

What is a Code of Conduct?

General Electric's *The Spirit & the Letter*

Overview

In this section of the course, we take a look at three different approaches to setting up a written framework for building goodness into the structure of the business or, in other words, laying the foundation for an ethical culture.

In this part, we look at one of the best examples of a traditional code of conduct, General Electric's *The Spirit & The Letter*.

In the next part, we examine Johnson & Johnson's famous *Credo*, which although it is almost 65 years old is still at the cutting-edge of resources for building an ethical culture.

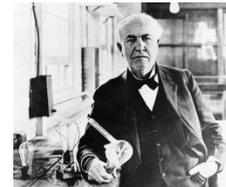
Finally, we take a look at American Flatbread's philosophy, which illustrates how an entrepreneur's values can be worked into the fabric of the company from the beginning in a natural and seamless way.



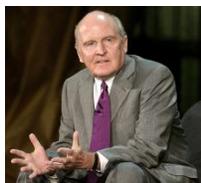
Background to GE's *The Spirit & The Letter*

The now legendary Jack Welch became CEO of General Electric in 1981.

One of the original 12 companies forming the Dow Jones Industrial Average, GE had by then grown to over 400,000 employees worldwide since Thomas A. Edison founded it in Schenectady, New York, 91 years earlier.



On March 26, 1985, Nearly 4 years after Welch took the helm as



chairman and CEO of GE, he received the news that a federal grand jury had indicted his company for filing \$800,000 in incorrect time cards and, on a separate matter, for lying to the government about work it had carried out on a nuclear warhead system. Nothing concentrates the mind quite like the news that a federal prosecutor is alleging criminal conduct.

At the time, GE, like most publicly traded corporations, did not have a written code of conduct or, indeed, any kind of written ethical guidelines.

That was about to change. Within 2 years, GE had formally adopted an 8-page written code of conduct with the title *Integrity: The Spirit & The Letter*.

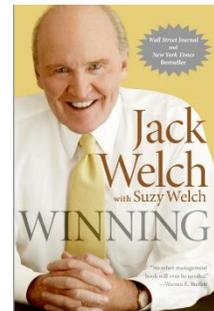
Over the 23 years since, this document has been revised and expanded many times, today, extending to 64 pages, 8 times its original length.

As at the beginning, “integrity” is still the watchword throughout the document.

Before we take a look at the insides of GE’s code of conduct, let’s pause for a moment to hear what Welch himself has to say about efforts to capture ethical guidelines in writing:

“Bear with me, if you will,” Welch writes in his best-selling book, *Winning*, “while I talk about mission and values.”

“I say that because these two terms have got to be among the most abstract, overused, misunderstood words in business. When I speak with audiences, I’m asked about them frequently, usually with some level of panic over their actual meaning and relevance. . . . Business schools add to the confusion by having their students regularly write mission statements and debate values, a practice made even more futile for being carried out in a vacuum. Lots of companies do the same to their senior executives, usually in an attempt to create a noble-sounding plaque to hang in the company lobby.



“Too often, these exercises end with a set of generic platitudes that do nothing but leave employees directionless or cynical. Who doesn't know of a mission statement that reads something like, “XYZ company values quality and service,” or, “Such-and-such Company is customer-driven.” Tell me what company doesn't value quality and service or focus on its customers! And who doesn't know of a company that has spent countless hours in emotional debates only to come up with values that, despite the good intentions that went into them, sound as if they were plucked from an all-purpose list of virtues including “integrity, quality, excellence, service, and respect.” Give me a break – every decent company espouses these things! And frankly, integrity is just the ticket to the game. If you don't have it in your bones, you shouldn't be allowed on the field.

“By contrast, a good mission statement and a good set of values are so real they smack you in the face with their concreteness. The mission announces exactly where you are going and the values describe the behaviors that will get you there. Speaking of that, I prefer abandoning the term *values* altogether in favor of just *behaviors*.”⁴⁰

So let’s take a look at the current version of The Spirit & The Letter to see how well the folks at GE have avoided generic platitudes and created a practical guide to good behavior at General Electric.

Guiding the Way We Do Business

At the very beginning of *The Spirit and the Letter*, employees and other interested parties are told that this document is designed to help them conduct the affairs of General Electric with unyielding integrity.

This introductory material also reminds readers that they stand in a tradition that reaches back over 100 years.

The goal is to do more than simply comply with the letter of the law; it is to “embrace the spirit of integrity.”

There is no effort here or elsewhere to define what the word “integrity” means. The meaning will become evident from the content of the document, the illustrations used and the topics covered.

The Spirit & The Letter: Guiding the way we do business

Every day, everyone at GE has the power to influence our company's reputation—everywhere we do business. The Spirit & The Letter helps to ensure that, after more than 125 years, we still conduct our affairs with unyielding integrity.

For well over a century, GE employees have worked hard to uphold the highest standards of ethical business conduct. We seek to go beyond simply obeying the law—we embrace the spirit of integrity.

GE's Code of Conduct articulates that spirit by setting out general principles of conduct everywhere, every day and by every GE employee.

Obey the Law

Many large corporations began their codes of conduct with a statement similar to the one found here:

“Obey the applicable laws and regulations governing our business conduct worldwide.”

As we shall see, it is not always necessary to make this injunction explicit, especially in smaller companies and those in which workplace safety, wages and hours, discrimination, tax reporting, and other aspects of general laws come into play.



But General Electric’s business activity is subject to numerous laws that relate to the kinds of business relationships it has. Thus, its military contracting work is governed by a complex set of regulations that the responsible executives need to know and follow. Because its businesses have a global reach, it must be aware of and in compliance with the Foreign Corrupt Practices Act as well as with the laws of the countries in which they work.

The summary code of conduct shown here provides a compact list of the high points that the GE leadership wants everyone to be sure to remember.

Be honest, fair, and trustworthy.

Avoid all conflicts of interest.

Foster an atmosphere in which fair employment practices extend to every member of the diverse GE community. (This particular statement seems slightly cryptic and needs further clarification in training work.)

Strive to create a safe workplace and to protect the environment.

And finally, “Through leadership at all levels, sustain a culture where ethical conduct is recognized, valued and exemplified by all employees.”

Your Personal Commitment

As part of the introductory material, this particular section attempts to impress on General Electric employees and agents that they are bound by the provisions of the code of conduct and are also responsible for helping to monitor compliance by raising concerns about violations.

Here as elsewhere in the document the reader is referred to a website for more detailed statements of the policies, which are not available to people outside the company.

This part of GE's code of conduct makes use of research in the social sciences showing the importance of obtaining a commitment of compliance if one wants a code of conduct to be effective. By stating up front that every GE employee is personally committed to the code, GE helps to instill its policies as legitimate norms within the organization.

Who Must Follow GE Compliance Policies

This document wisely does not assume that everyone knows who is bound by its provisions. It is important to make explicit that the document applies subsidiaries and affiliates as well as directors, officers, and employees. But it would not automatically be apparent to everyone that third parties representing General Electric are also covered by this code of conduct. This section also makes explicit how GE representatives must assure that consultants, agents, independent contractors, and others know that they must comply with the provisions of this document.

Your Personal Commitment

You will be asked to acknowledge your awareness that every GE employee must follow The Spirit & The Letter Policies and raise concerns about possible violations of law or policy with a GE manager, company legal counsel, GE auditor, GE ombudsperson or other GE compliance specialist.

For the complete text of policies, visit the GE integrity Web site: integrity.ge.com.

Who must follow GE compliance policies

<p>GE DIRECTORS, OFFICERS AND EMPLOYEES.</p> <p>SUBSIDIARIES AND CONTROLLED AFFILIATES Entities in which GE owns more than 50 percent of the voting rights, or has the right to control the entity, are required to adopt and follow GE compliance policies.</p> <p>NON-CONTROLLED AFFILIATES Non-controlled affiliates should be encouraged to adopt and follow GE compliance policies.</p>	<p>THIRD PARTIES REPRESENTING GE GE employees working with third parties, such as consultants, agents, sales representatives, distributors and independent contractors, must:</p> <ul style="list-style-type: none"> • require these parties to agree to comply with relevant aspects of GE's compliance policies • provide these parties with education and information about policy requirements • take action, up to and including terminating a contract, after learning that a third party failed to abide by GE's compliance policies.
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What Employees Must Do

Employees have a responsibility not only to understand and comply with the policies but also to raise concerns when they see something that may be a violation either of the letter or the spirit of the code.

What Leaders Must Do

A recurring theme of the literature on ethics in business is the indispensable role of top management in providing ethical leadership. Often this is referred to as “the tone at the top.” Without it, ethical programs are worse than worthless; for employees who see executives disregarding ethical guidelines become cynical and jaded and are not likely to comply themselves.

Thus, this provision discusses what leaders must do to create a culture of compliance and to help employees feel comfortable about raising concerns without fear of retaliation has special value. It encourages leaders within the organization to consider compliance efforts when evaluating and rewarding employees.

Perhaps most importantly, this section tells managers that it is part of their job to “ensure that employees understand that business results are never more important than ethical conduct and compliance with GE policies.”

Message: Moral and legal shortcuts are not an option.

By itself, this sentence is unlikely to prevent fraud when there is substantial pressure to make a quota or achieve some other business goal. But it is better than nothing at all and provides legitimacy and support for those who refuse to participate in morally questionable activities for short-term gain.

Raise Your Voice

Once again, the document tells GE employees that they have an obligation to speak up when they have a concern about a matter of integrity. Not only that, but the document reminds the reader that she may remain anonymous, that confidentiality will be maintained, and that retaliation is not permitted.

By themselves, these assurances may not make the potential whistleblower sufficiently comfortable to come forward. However, coupled with procedures and technology designed to assure confidentiality, they might have the desired effect. At any rate, they show that the top executives in the company take the protection of those who raise integrity concerns seriously.

What leaders must do

A leader must create a culture of compliance in which employees understand their responsibilities and feel comfortable raising concerns without fear of retaliation; encourage ethical conduct and compliance with the law by personally leading compliance efforts; consider compliance efforts when evaluating and rewarding employees; and ensure that employees understand that business results are never more important than ethical conduct and compliance with GE policies. Leaders must also take the following steps to build an infrastructure to prevent, detect and respond to compliance issues:

- | | | |
|--|---|---|
| <p>PREVENT COMPLIANCE ISSUES</p> <ul style="list-style-type: none"> Identify business compliance risks. Ensure that processes, tailored to address your particular risk areas, are communicated and implemented. Provide education on GE policies and applicable law to employees and where appropriate board members and third parties. Commit adequate resources to your business's compliance program. | <p>DETECT COMPLIANCE ISSUES</p> <ul style="list-style-type: none"> Implement control measures, such as "redlines" and "scorecards," to detect high-risk compliance risks and/or violations. Promote an effective ombudsman system. Ensure that periodic compliance reviews are conducted with the assistance of business compliance leaders and/or the Corporate Audit Staff. | <p>RESPOND TO COMPLIANCE ISSUES</p> <ul style="list-style-type: none"> Take prompt corrective action to fix identified compliance weaknesses. Take appropriate disciplinary action. Consult with GE legal counsel and make appropriate disclosures to regulators and law enforcement authorities. |
|--|---|---|

Raise Your Voice: Your obligation to raise integrity concerns

Raising an integrity concern protects the GE community, our company, our colleagues and our stakeholders. If you have a concern about compliance with GE policy, you have a responsibility to raise that concern.

- | | |
|--|---|
| <p>RAISE CONCERNS EARLY
The longer we wait to address a concern, the worse it may become.</p> | <p>CONFIDENTIALITY ASSURED
Your identity and the information you provide will be shared only on a "need-to-know" basis with those responsible for resolving the concern.</p> |
| <p>HOW MAY WE HELP YOU?
Whenever you need help, we'll do our best to follow up with you on your feedback.</p> | <p>RETALIATION PROHIBITED BY POLICY
Our discipline policies prohibit any actions taken for raising or helping to address or investigate compliance concerns. Retaliation is prohibited for discipline up to two disciplinary demerits.</p> |

What Happens When an Integrity Concern is Raised

This last point is underscored by the section shown here which briefly summarizes the process that the company falls whenever an integrity issue has been reported.

By providing an outline of the steps, the document again helps reassure those who might need to make a report that their action will not get lost in a mass of red tape.

What happens when an integrity concern is raised

Concerns about compliance with GE policy will be investigated. GE's investigation process includes:

1. **ASSIGNING AN INVESTIGATION TEAM**
Experts with the right knowledge and objectivity are assigned to investigate.
2. **CONDUCTING AN INVESTIGATION**
The team determines the facts through interviews and/or review of documents.
3. **CORRECTIVE ACTION**
If necessary, the team recommends corrective actions to the appropriate managers for implementation.
4. **FEEDBACK**
The person raising the concern receives feedback on the outcome.

Penalties for Violations

The main difference between a statement of ethics and a code of conduct is enforceability. Unless people know that there are consequences for violating the provisions of a code of conduct, some will take it as simply window dressing that only fools would pay attention to. It is essential that everyone know that there are consequences for noncompliance.

Penalties for violations

Employees and leaders who violate the spirit or letter of GE's policies are subject to disciplinary action up to and including termination of employment. Misconduct that may result in discipline includes:

- Violating GE policy
- Requesting others to violate GE policy
- Failure to promptly raise a known or suspected violation of GE policy
- Failure to cooperate in GE investigations of possible policy violations
- Retaliation against another employee for reporting an integrity concern
- Failure to demonstrate leadership and diligence to ensure compliance with GE policies and law

This part of the introductory material not only makes that point but also reminds everyone covered by the code of conduct that they are bound both by the letter of its provisions and by its spirit as well.

Here the reader learns what conduct will result in disciplinary action and tells everybody that a failure to comply with the provisions of the code of conduct may result in termination of employment.

Regulatory Excellence

The final segment of the introduction reminds the reader that GE is subject to numerous regulations. Indeed, although it has little resemblance to a set of legal statutes, GE's code of conduct is based largely on those regulations.

Regulatory excellence

Virtually all of our *Spirit & Letter* policies are based on government laws and regulations. These regulations impact every GE business and every GE employee. Regulators establish and define the rules that we must comply with to conduct business. Effectively engaging with regulators as they establish regulations and assuring compliance with these regulations are critical to maintaining GE's reputation for integrity.

By stressing the need to know and comply with the laws, the document contributes to a culture of compliance, one in which efforts to circumvent the laws constitute a serious violation of company policy.

Today's regulatory environment is becoming more and more challenging. GE is subject to a growing number of regulations and enforcement activities around the world. This environment demands that every employee and leader be aware, knowledgeable and committed to regulatory excellence.

How the Material is Organized

The substantive provisions of *The Spirit & The Letter* are collected in five main topic areas:

Working with Customers & Suppliers.

Government Business

Competing Globally

In the GE Community

Protecting GE Assets

WORKING WITH CUSTOMERS & SUPPLIERS	16
Improper Payments	18
Supplier Relationships	20
International Trade Controls	24
Money Laundering Prevention	26
Privacy	28
GOVERNMENT BUSINESS	30
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COMPETING GLOBALLY	34
Complying with Competition Laws	36
IN THE GE COMMUNITY	38
Fair Employment Practices	40
Environment, Health & Safety	44
Security & Crisis Management	46
PROTECTING GE ASSETS	48
Intellectual Property	50
Controversial Relationships	52
Conflicts of Interest	56
Insider Trading & Stock Tipping	58

We will not look at all five, but it is worthwhile to see how the authors of this document approached the task of capturing the main points while simultaneously making it engaging and readable.

Some Examples of Substantive Material

The first group has the heading: Working With Customers & Suppliers.

Notice the use of pictures of people, the clean text, and the color scheme. All these convey messages at a subconscious level and invite the reader to look more closely.

The authors use case-related questions to stimulate thinking and engagement on the subject matter.



An overseas customer wants to tack on a weekend pleasure trip to a training visit funded by GE. May GE pay for the entire trip, including the weekend at Universal Studios?

This is a real-world question that illustrates the kind of issues that managers frequently confront. No one expects them to know the correct answer to every one. The important thing is to show that it is a question to take seriously and to explain how to go about getting the answer.

Here there is a reference to page 18 for the answer. But the answer does not appear on page 18. Instead, the reader is told that it depends on many factors, directing the reader to consult with GE counsel and the manager in charge to determine the answer after getting more information.

The message conveyed by this and other examples is that there are not always simple answers to questions of this sort and that care should be taken rather than going with the first notion that pops into one's head.

International Trade Laws

This page on International Trade Controls provides another example of how GE's code of conduct works. On the left is a general statement that international trade laws are important. On the right are two sections: What to do, and What to look out for.

For example, GE personnel should be on the alert for evasive, reluctant, or unsatisfactory answers by customers to questions about end use, locations, and the like.

Suggestions of this sort help make the GE employee an active participant in the effort to assure that GE does not get into legal trouble or otherwise violate its principle of "unyielding integrity." Thus, the code of conduct is not merely a collection of rules that the employees are expected to memorize and follow slavishly. It is a device for developing moral competence, the ability to recognize ethical problems and to determine how best to respond.

In the GE Community

Every code of conduct should address the workplace environment in some way. GE calls that section "In the GE Community."

As with the section on Working with Customers and Suppliers, the document uses the device of posing questions designed to get the reader thinking.

Active engagement rather than passive assimilation is the mode more likely to bring about buy-in.

The question I pulled out here asks whether a disabled employee is entitled to be accommodated if she must attend an offsite meeting. What do you think? Is this the kind of thing that has an unambiguous answer or are we back in the world of "it depends?"

As you can see, it is hard to ignore questions like this. They tend to nag at us until we find the answer.



In this case, the answer is Yes. Reasonable accommodations should be made to provide access and facilitate full participation in the meeting, or alternative arrangements should be made for the disabled person.

Assessing GE's Code of Conduct

The Spirit and The Letter is one of the best of the traditional forms of a code of conduct that we have available. It stands out among other reasons because it avoids jargon and legalese. It is easy to read, engaging, focused on particular needs of General Electric, and comprehensive.

These are all the result of hard work by talented people from different specialties. It would not surprise me to learn that General Electric invested more than \$100,000 in employee time and out-of-pocket expenses to put this document together.

As we shall see when we get to American Flatbread's Philosophy, the small company does not need to incur this kind of expense to fashion the centerpiece of an ethical culture. But it does take conscious effort.

In terms of the basic objectives of a code of conduct, The Spirit & The Letter satisfies the first three prongs – assure compliance with the law, promote goodness, and prevent misconduct – well. The fourth objective – set priorities and achieve balance among the values and interests – is not addressed much at all.

This is not surprising because very few codes of conduct deal with this fourth objective. The literature on codes of conduct has not identified this objective as one that companies need to focus on. We will see it come to the fore as we turn in part 3 to Johnson & Johnson's *Credo*.



What is a Code of Conduct? Johnson & Johnson's *Credo*

Johnson & Johnson's *Credo*

Johnson & Johnson's *Credo* is one of the oldest policy statements setting value priorities for the conduct of business in use by any public corporation still in existence. It was originally



promulgated in 1944 by Robert Wood Johnson II when the company was taken public. But it was not something the Johnson thought up and then tried to put into practice. Rather, he and the company had been practicing the precepts of their *Credo* for over a decade before.

Strictly speaking, the *Credo* is not a code of conduct at all. Rather it is more like a constitution or manifesto, a declaration of principles that became the compass for decision-making within the company.

The content of the document was carefully thought out when it was originally drafted and has been revised and improved over six decades since. Let's take a look at its four sections.

First Responsibility is to Those Who Use the Products

We believe our **first responsibility is to the doctors, nurses and patients, to mothers and fathers and all others** who use our products and services.

In meeting their needs everything we do must be of high quality.

We must constantly strive to reduce our costs
in order to maintain reasonable prices.

Customers' orders must be serviced promptly and accurately.

Our suppliers and distributors must have an opportunity
to make a fair profit.

Johnson & Johnson's first responsibility, as declared by the *Credo*, is to those who use its products: doctors, nurses, patients, mothers, and fathers.

OUR CREDO

We believe our first responsibility is to the doctors, nurses and patients, to mothers and fathers and all others who use our products and services. In meeting their needs everything we do must be of high quality.

We must constantly strive to reduce our costs in order to maintain reasonable prices.

Customers' orders must be serviced promptly and accurately.

Our suppliers and distributors must have an opportunity to make a fair profit.

We are responsible to our employees, the men and women who work with us throughout the world.

Everyone must be considered as an individual.

We must respect their dignity and recognize their merit.

They must have a sense of security in their jobs.

Compensation must be fair and adequate, and working conditions clean, orderly and safe.

We must be mindful of ways to help our employees fulfill their family responsibilities.

Employees must feel free to make suggestions and complaints. There must be equal opportunity for employment, development and advancement for those qualified.

We must provide competent management, and their actions must be just and ethical.

We are responsible to the communities in which we live and work and to the world community as well.

We must be good citizens—support good works and charities and bear our fair share of taxes.

We must encourage civic improvements and better health and education.

We must maintain in good order the property we are privileged to use, protecting the environment and natural resources.

Our final responsibility is to our stockholders. Business must make a sound profit.

We must experiment with new ideas. Research must be carried on, innovative programs developed and mistakes paid for.

New equipment must be purchased, new facilities provided and new products launched.

Reserves must be created to provide for adverse times. When we operate according to these principles, the stockholders should realize a fair return.

Johnson & Johnson

Notice that this first section does not stop with this straightforward declaration. It spells out key implications of that basic statement for the work of the company. The products must be of high quality and produced at reasonable prices. Orders should be filled promptly. And note the concern for suppliers and distributors, without whom the company cannot succeed. They must have an opportunity to make a fair profit too.



Responsibility to Employees

We are responsible to our **employees**,
the men and women who work with us throughout the world.
Everyone must be considered as an individual.
We must respect their dignity and recognize their merit.
They must have a sense of security in their jobs.
Compensation must be fair and adequate,
and working conditions clean, orderly and safe.
We must be mindful of ways to help our employees fulfill
their family responsibilities.
Employees must feel free to make suggestions and complaints.
There must be equal opportunity for employment, development
and advancement for those qualified.
We must provide competent management,
and their actions must be just and ethical.

The next priority is the employees, the men and women around the world who make, sell, and ship the products out the door.

When you think about it, if the leaders of a business are truly concerned with providing high-quality products and services for the customers of the business, they will want to make sure that the people who do the work have a place of honor in the company's value system.



Here again, the *Credo* spells out in succinct form the implications of the general statement made in the first sentence. People should be treated as individuals, which is another way of saying in the words of Immanuel Kant that they must never be seen merely as means to an end but ends in themselves.

They must have a sense of security in their jobs. Remember, the tenets of this *Credo* go back to the 1930's, when jobs were scarce and those who had them were frequently treated as disposable commodities by the captains of industry. Robert Wood Johnson

would have none of that. We do not have time to go into the deep sense of corporate social responsibility that motivated Johnson when he crafted the first version of this *Credo*. Suffice it to say for now, however, that Johnson not only practiced what he preached but made extensive, time-consuming efforts to get other corporate executives to follow his lead.

The recognition that employees have families, while not unique to Johnson & Johnson, has been a central feature of its *Credo* from the beginning.

The statement that the actions of managers must be competent as well as just and ethical is also unusual. It has become widely recognized among human resource professionals that employees join companies and leave managers. This last sentence in the second section of the *Credo* recognizes the importance of making the power and authority that managers wield subject to ethical constraints.

Communities

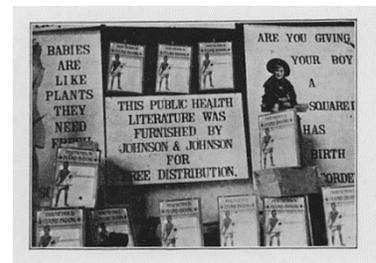
We are responsible to the **communities** in which we live and work
and to the world community as well.

We must be good citizens – support good works and charities
and bear our fair share of taxes.

We must encourage civic improvements and better health and education.

We must maintain in good order
the property we are privileged to use,
protecting the environment and natural resources.

The third focus of the *Credo* is on the communities in which the company's plants are located. General Johnson and others who have led the company realized early on that without the contributions and support of the people in the communities in which they produced medical supplies, the company would not long exist. Being a good corporate citizen is not only the right thing to do; there's also a necessary part of building a sustainable business.



The express statement that the company should bear its fair share of taxes for the common good is, if not unique, certainly unusual in a company with more than 100,000 employees worldwide.

The reference to the environment and natural resources expresses the insight that we have not inherited the earth from our parents; we are borrowing it from our children.

Shareholders

Our final responsibility is to our **stockholders**.
Business must make a sound profit.
We must experiment with new ideas.
Research must be carried on, innovative programs developed
and mistakes paid for.
New equipment must be purchased, new facilities provided
and new products launched.
Reserves must be created to provide for adverse times.
When we operate according to these principles,
the stockholders should realize a fair return.

When Robert Wood Johnson took the company public in 1944, he was by far the largest shareholder. This last segment of the *Credo* makes clear that no one in the company and no shareholder should look on it as an ATM, an Automatic Teller Machine. It is not merely a device for squeezing as much money out of people and resources as possible.

This final section acknowledges the truth that a company must make a profit in order to conduct the business properly. In this case, research and development, state-of-the-art production facilities, and cash reserves are all necessary to achieve the purposes for which the company was started in the first place. As Robert Packard, cofounder of Hewlett-Packard, put the matter several decades after this *Credo* was originally written, "Profit is not the proper end and aim of management. It is what makes all of the proper ends and aims possible."

At the time this *Credo* was first issued, Johnson remarked, "If we put the customer first and follow through on our other responsibilities, I assure you that the stockholders will be well served. And don't forget, I am the largest stockholder."⁴¹

At the time the company went public the initial offering price for a share of stock was \$37.50.

"An investor who purchased 100 shares for \$3,750 in 1944 and held the stock would see it grow, with stock splits, to 224,848 shares valued at about \$12 million by 1999, not counting dividends."⁴² Not a bad deal for a company that deliberately put other stakeholders ahead of shareholders when it prioritized its values and an enviable record in our present age of short-term profits achieved at the expense of long-term viability.

What is a Code of Conduct? American Flatbread's Philosophy

American Flatbread

Having written ethical standards that guide the work of a company is not something only big companies can afford or need. To illustrate this point, we turn now to American Flatbread, a small company started 25 years ago with nothing but a few pizzas sold to a local grocery store. It now has over 100 employees, restaurants and baking facilities in three states, and well over 100 grocery stores in which its products are bought by grateful customers throughout the country.



American Flatbread's Philosophy

From the beginning, George Schenk, the founder of American Flatbread, wanted to assure not only that they did things the right way but that they also did the right things. The American Flatbread philosophy has been a labor of love that forms the nucleus of the company's ethical thinking and, Schenk believes, has been a key to its success.

It is similar in content and effect to the Johnson & Johnson Credo; but it has a different form entirely.

It begins with the truism that "food is important," going on to say that what we eat and how it is grown intimately affects our health and the well-being of the world.

Food Remembers

In a play on words, the Germans say, "Man ist was man ißt." You are what you eat. Because food is fundamental, it must be grown and prepared with care, with awareness of the interconnections between what is done to produce it and the impacts of that activity on the well-being of all.

The food remembers, George Schenk says. It remembers the farmers who grew it, the people who picked it, the distance it traveled, and how it was treated.

American Flatbread is a return to bread's roots, an endeavor not to mass-produce bread but to explore the possibility of how good bread can be. This endeavor began in the small kitchen of Gladys Ford in a cabin by a clean, cold lake in the Northeast Kingdom of Vermont. Her small kitchen held – and still holds – a "Home



Comfort" wood-fired cook stove, and that is how her grandson George was introduced to the joy and art of cooking with wood fire.

Ingredients

The first responsibility of American Flatbread, therefore, is to start with good ingredients. Thus, they choose organic flour and tomatoes and locally grown meats, vegetables, and cheeses.

And they rely on a local network of farmers and other producers, again realizing the connection between the communities in which they operate and the quality and sustainability of their products.



Mission Statement: Creating a pleasant, fulfilling and secure workplace.

All of which serves as a kind of preamble to American Flatbread's mission statement.

It starts with a pleasant and fulfilling workplace.

When George Schenk incorporated his business in 1990, the first thing he did was to write a mission statement, much like Robert Wood Johnson did for Johnson & Johnson in 1944.



It was an employee-centric mission statement. George had come from work experiences in which he felt there was insufficient attention given to the genuine needs of the employees. During his work in restaurants in the early 80's, it was common for apprentices to be paid poorly with no fringe benefits other than one meal a day. No sick leave, no vacation, no retirement plans. Nothing. George had a private commitment that if he ever took on the role of an employer, he would not create crummy jobs or crummy work environments. He found the environments degrading. They were thoughtlessly designed. Put in the back corner without windows. He wanted to try to have the work experience of a professional cook evolve. He took that seriously.

As a result, at American Flatbread, the people who do the dishwashing and food prep are the most honored in the company. These are the guys who make the bread day in and day out. You could be excused for reading the word "bread" with a double meaning in that sentence.



Thus, the first objective in American Flatbread's mission statement is to create a pleasant, fulfilling and secure workplace.

In 2006 American Flatbread was named one of Ten Best Places to Work in Vermont as the result of an independent assessment process administered by Best Places to Work in Vermont .com.

Environmentally conscious



The second item on American Flatbread's mission statement is environmental consciousness. The company is committed to packaging its products in recycled paper, using non-toxic inks. It also extends its environmental awareness to marketing and distribution,

Trust and Respect

Acting in a trustworthy manner and respecting those with whom we work are parts of the foundation of a morally responsible business. Putting these values in the mission statement underscores American Flatbread's commitment to building a business that attracts good people and nurtures healthy relationships at work.



Supporting Sustainable Agriculture

American Flatbread buys over \$1 million of food every year. 40% of it comes from farmers and other suppliers in the area. For example, they get their mozzarella not from far-away Italy, but from Saputo in Swanton, Vermont. They use 100% organic flour.

The leadership at American Flatbread clearly understands that the company depends on as well as contributes to an agricultural system that makes good food possible. Not content to let Adam Smith's invisible hand do its work alone, American Flatbread takes a proactive approach to improving sustainable agriculture and to supporting local growers. Here the mission statement commits the company to use its buying power to give preference to the needs of people worldwide as well as to maintaining a healthy ecosystem for the flora and fauna so crucial to our well-being.



Being an Educational Resource to the Community



This prong of the mission statement reveals an awareness of the company's interconnectedness within a series of communities. It is recognition of the need to give back; but it also expresses the importance of building an understanding within the community of the importance of good food. American Flatbread reaches out to

schools and participates in community gatherings to share what its employees have learned about the value of eating right.

Being a Good Neighbor

Shortly before his 40th birthday in 1992, George Schenk decided to bake a cake for everyone. Before the party, however, Hurricane Andrew, a class 5 storm, made landfall on the coast of South Florida. George started to feel hedonistic in an environment in which there were people without shelter. Instead of baking a giant cake, therefore, he decided to give away \$4 from every pizza sale to the Hurricane Andrew victims, thereby learning how his flatbread could be a vehicle for reaching out and bringing his own community together and helping beyond it.



Not long thereafter, the company institutionalized the idea of Benefit Breaks. Not all of them were for national disasters. They started doing stuff for local schools and the local church. What was interesting was that the particular church was the iconic Congregational Church, which was a centerpiece of advertising for the Chamber of Commerce and others. They were trying to raise money to fix the steeple, an expensive asset of the entire community.

So American Flatbread chipped in too and Schenk wrote about it in that week's menu dedication. Environmental organizations have benefitted as well.

A Two Way Street

Being a good neighbor is a two-way street. In 1998, the property flooded, and they had to close down the bakery immediately. Everything the water touched had to be replaced. The business could easily have gone under water too.

But the community rallied. 100 people volunteered to help them dig out and rebuild.



Instead of being closed for a month, which might have ruined the company, they were back up in a week. A customer from Florida called and had two tons of kiln dried wood delivered. People came out of the woodwork. All these years, George had imagined themselves as a contributor, a giver. As he put it, "In this moment of need, people were willing to help us. It is a wonderful example of the profound strength of acting together. Had we been acting alone, we would have been left alone."

Having a Good Time

It never hurts to remind ourselves that we should have a good time. Enjoy the ride. Be involved in meaningful, fulfilling work that you can enjoy. Contribute to making your workplace a fun place to be.



Creating Long-Term Financial Security

Like all sustainable business ventures, American Flatbread needs to have strong financials. The company's relationship with its bankers is analogous to that with outside investors. It has allowed the company to grow and to take seriously the promise to repay those loans.

To manage this side of the business – and area in which Schenk, like many



entrepreneurs, had the least training – he brought in a financial expert. This person was more expensive than anyone else, but she paid for herself in money saved and in the growth her work made possible.

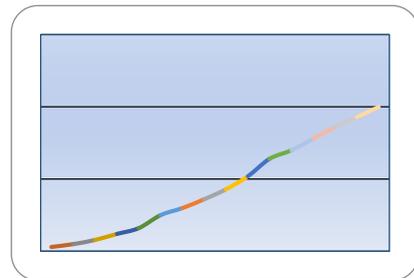
Profit may not be the primary end of business, but no responsible business – whether for-profit or non-profit – can continue to be a benefit to its stakeholders if it ignores this crucial aspect.

There's Nothing Flat about American Flatbread's Growth

In the beginning, there was George, his partner, and one other employee.

Today, the company has over 100 full-time equivalent employees.

American Flatbread began as a backyard experiment at a dinner party and has evolved into a franchising organization that feeds thousands of people every day with thoughtfully baked bread made with locally and organically grown foods.



George's dream is over 20 years old, and is growing healthier by the day, because more and more people are sharing the dream.

Wrapping it All Up

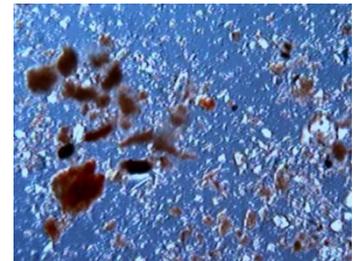
George Schenk sums up the value of his mission statement with the following words:



“When I first started this I thought I was getting into the pizza making business. Then I thought that I was in the materials moving business. Finally, I realized that I am in the human being business. It’s the place we have to come to. These businesses are just people doing things. If it’s not good for them, then it’s probably not good for the business or society.”

Soil That’s Alive

Another way to think of intentional ethics in an organizational setting is to draw an analogy to soil. Organic soil is alive with nutrients, bacteria, and micro-organisms that enable plants and vegetation to grow. If the soil is healthy, the growth will be too.



This is a microscopic snap shot of organically cared for soil.

Soil That’s Dead

When we rely on pesticides, herbicides, and artificial fertilizer, however, we kill the bacteria and micro-organisms that live in the soil and enable growth.

We can get a green lawn in the short run. But once we stop putting in the artificial stuff, the lawn will turn brown. And by using pesticides and herbicides, we expose dogs, cats, and small children to harmful chemicals.



Similarly, we can get short-term results by command and control techniques in disregard of the well-being of the employees and others. But when a better offer comes along – when we can’t pay them an extraordinary salary – they will take the alternative. The soil we develop through such artificial, disrespectful means will not sustain the organization.

Measuring Goodness: Moral Accounting in the Corporate Context¹⁵

It is oft remarked that you cannot manage what you do not measure. When we manage business processes, we endeavor to intervene in ways that affect outcomes. But if we cannot somehow assess differences in outcomes, how can we know whether our management efforts are effective? They could even be counterproductive. We don't measure for the sake of measurement. We measure for the sake of improving management – and performance.

We may not often think of ethics as something that can have different performance levels, something a corporation can be better or worse at doing. But a moment's reflection makes it clear that just as some individuals are more ethically reliable than others, the same holds true for businesses as well. To an extent

The first step in measuring goodness is to identify the parameters of a corporation that indicate the level of goodness – ethical health-- it has at any given moment in time. A parameter is a measurable aspect of a system. Blood pressure, pulse, temperature, blood cell count, and weight are all parameters of the human body. Income, expenses, depreciation, assets, and short- and long-term debt are financial parameters. Ethical parameters are those factors of a company that clue us into the ethical condition of the company.

To measure goodness in a company, we must determine **what**, **how**, and **when** to measure and **what to do** with the results. Of the different possible categories, employee satisfaction, employee health and safety, diversity, and ethics knowledge and practice provide valuable information about the ethical health of the company.

Employee Satisfaction

For my money, the most telling measurement of corporate ethical health is employee satisfaction. This single metric indicates whether employees feel acknowledged and respected for the contributions they make, whether they feel abused or exploited, whether they are engaged productively in their work, whether they feel a sense of purpose and alignment with the company mission, and whether they are comfortable working with suppliers and customers. All of these conditions are directly related to the degree to which the culture of the company places high value on doing the right thing and conducting business from an attitude of respect. Employee dissatisfaction is to corporate well being as [silent inflammation](#) or high blood pressure is to the human body. Unless we pay specific attention to it, its deleterious effects may not be apparent until they have caused significant damage.

¹⁵ © 2010 Michael Palmer, *Ethics By Design*

How to measure the level of employee satisfaction is not as challenging as one might imagine because several good tools already exist for the purpose. A simple, inexpensive method that helps small organizations stay on top of this metric is to give each employee a red, green, and yellow marble, one of which they drop into a jar at the end of the day, indicating whether the day went well (green), poorly (red), or so-so (yellow). The supervisor of that group can get an instant read of how things are going, keep track over a week or so, and address the results in staff meetings to find out more about what is working well and where problems exist. Another method is to use the [Gallup Q12](#) survey form.

Employee satisfaction should be measured frequently. Executives who manage by walking around may get a sense of the level of employee engagement; but they really need a more objective measure. Survey instruments such as the Gallup Q12 provide an annual snapshot. Using the three-marble method provides more up-to-date information.

Employee Health and Safety

Closely related to employee satisfaction, employee health and safety is another indicator of how well the corporation achieves the goal of universal respect. A morally responsible company will not expose its employees to avoidable health and safety risks. Of course, every company has a financial incentive to reduce such risks in order to keep insurance premiums low. But as history shows, where immediate financial impact is the only concern, some companies could conclude that the costs of reducing health and safety risks outweigh in the short term the costs of higher workers' compensation premiums. Companies that act on such short-term cost-benefit analyses disrespect their employees – a disrespect that shows up in higher levels of injury and illness.

To measure employee health and safety, we can keep track of work days missed for illness, accidents on the job, and how well employees comply with safety procedures (wearing hard hats, etc.). If employees routinely have an annual physical check up, the results could be compiled anonymously. Other anonymously collected and stored data might include the percentage of employees who smoke cigarettes, the number who are overweight, and the number who have chronic conditions (asthma, allergies, high or low blood pressure, etc.). Mental health and drug and alcohol abuse levels can be monitored – again without identifying individuals – by keeping track of how many people make use of employee assistance programs.

Diversity

A workforce consisting of a diverse mix of people with different personality styles, of both genders, of different ages, who come from different cultural and educational backgrounds enriches the corporation in ways too numerous to discuss here. Most of us

tend to hire and promote people who are like us – particularly, people who mirror our cognitive styles. To counter such inbreeding, corporations must take proactive steps to promote diversity. The degree to which they succeed in integrating people of different personality types and from different backgrounds into the work and power structure of the corporation is another indicator of its ethical maturity.

Measuring diversity well requires more than simply counting up the number of people who can be assigned to different categories. It also involves assessing the operational and power make up of the firm. Thus, to measure integrated diversity we would want to look at diversity among new hires, among senior management, across departments, on committees, in our turnover statistics and reasons for leaving, length of employment, in promotions, and more. Assessing the cognitive styles of all employees at least once, using an instrument such as the [Meyers-Briggs Type Indicator](#) or the [Jackson Personality Inventory](#), is another way to assure that not all the linear thinkers are huddled together on a project that needs some fuzzy creativity.

Ethics Knowledge and Practice

Many companies would be able to provide little more in the form of ethics measurements than the number of employees who had attended an ethics workshop or signed the company's code of conduct. But such statistics tell us next to nothing about the actual level of ethics knowledge and practice in the corporation. As Mark Brown put it, "[H]ow does one construct an ethics analytic that detects minor problems so that they can be easily corrected before someone goes to jail, gets fired, or is up on the front page of a newspaper?"

Brown recommends collecting data in five categories:¹⁶

1. Employee Knowledge of Right and Wrong
2. Perceptions about what really goes on (the real values)
3. Ethics Policies and Procedures
4. Employee behavior
5. Outcomes

To measure the first category, the company can start by developing a questionnaire that is tied directly to the specific laws that govern the corporations business (e.g., Foreign Corrupt Practices Act, Sarbanes Oxley, anti-discrimination statutes, etc.) and to its code of conduct or other ethical policies, using short synopses of case material that present

¹⁶ Mark Graham Brown, *Beyond the Balanced Scorecard: Improving Business Intelligence with Analytics* 114 (New York: Productivity Press, 2007).

ethical questions. The law-related questions should be tailored to elicit the particular knowledge that employees at different levels and in different departments need to know. For example, manufacturing employees have little reason to be well-versed in anti-bribery statutes, but sales people do. And everyone needs a minimal level of laws covering sexual harassment and different forms of discrimination.

The Ethics Resource Council has developed a survey that measures perceptions of ethical behavior in the workplace, which could easily be adapted for use in each corporation. The ERC survey measures **perceptions** of

- Misconduct at work
- Employee engagement
- Transparency and accountability
- Top management's behaviors related to transparency
- Accountability at all levels of management
- Appropriateness of compensation levels
- The strength of ethical cultures
- Pressure to cut corners
- Whistleblowing
- Retaliation against those who report misconduct

Measuring ethics policies and procedures – the deployment of programs designed to ensure ethical behavior – involves initially determining which programs the company has in place. For example, which of the following programs are in place or under development:¹⁷

- Oversight and support
- Compliance officer and office (Is there an ethics officer and a support staff?)
- Code or other ethics policies (Does the company have written code of ethics and related policies? How comprehensive and current are they?)
- Internal reporting (metrics used to evaluate performance in the area of ethics and compliance)

¹⁷ Borrowed from Mark Graham Brown, *supra*, at 117.

- Education and training
- Internal controls and corrective actions (systems and processes to prevent problems and correct them when they occur)
- Periodic program assessment

Measuring ethical behavior is probably the most challenging part of a good ethics metric. When people really screw up, we find out about it. But it thousands of times that people make correct ethical decisions will likely go unnoticed because there is not – nor should there be – anything extraordinary about them. Still, there are some creative ways to statistics here as well. For example, in one company, whenever coworkers somebody engaging in inappropriate behavior, they point it out and the miscreant must put a dollar into a box. At the end of the month, managers add up the dollars. It is also possible to develop a system for keeping track of and rewarding courageous or extraordinary ethical decisions.

Measuring outcomes is the final sub-category in ethics knowledge and practice. This refers to records compiled about events that are directly tied to ethical behavior. For example, one company collects data in the following categories:

Negative Outcomes:

- Violations of regulations related to ethics (number and severity)
- Whistleblower reports (number and severity)
- Negative press coverage concerning ethics issues
- Internet chat room/blogs concerning ethics
- Lawsuits
- Employee complaints
- Dismissals for ethics problems

Positive Outcomes:

- Commendations
- Awards
- Positive press coverage
- Support of charity and community groups

- Benchmarking off your own ethics program by other companies

The categories of measuring goodness discussed up to now concern mostly the internal state of the company's ethics health. It is also important to measure how responsible the company is with respect to its impact on people, entities, and the ecosystem outside the corporation.

Over the past 20 years, the [Global Reporting Initiative](#), the [B Corporation Certification Process](#), [AccountAbility](#), Vermont Businesses for Social Responsibility's [SR Journey](#), and others have developed off-the-shelf systems for assessing the degree to which a corporation is living up to its responsibilities to outsiders. For example, the Global Reporting Initiative assessment tool is a detailed set of standards for use in creating an annual report for stakeholders on the company's socially responsible activity, collecting as much information as an annual consolidated financial statement.

What's It Worth?

Every business—even a non-profit—is a business after all, which means that it must not only achieve its basic mission; it must also function smoothly and do well financially. A bankrupt business helps no one. So how much does it cost to run a socially responsible business? How much are we giving up in real dollars to do the right thing?

Starting with the 1995 book, *Corporate Responsibility And Financial Performance*, scholars, scientists, and investment advisers have engaged in serious studies of the relationship between CSR and financial performance. *The SRI Advantage* was published in 2002. Geoffrey Heal's book, *When Principles Pay*, came out two years ago this month. The lesson is that investors would do well to seek out funds whose managers use CSR as a selection criterion. This is not just about screening out companies that make objectionable products like cigarettes. Rather, it's about finding companies with the CSR advantage.

Well, it turns out that we aren't losing anything. To the contrary, numerous independent, scientific studies have established beyond dispute that socially responsible businesses do better financially and function more efficiently, with happier, more engaged employees, than do those run by the Gordon Gekko's of the world.

Several independent studies have concluded that moral responsibility is positively related to better financial performance and is associated with several bottom-line benefits. For example, a study by McKinsey & Company, the giant management consulting firm, reached the conclusion that environmental, social, and governance programs create shareholder value. The public relations firm Golin Harris has studied the impact of socially responsible practices on the comparative brand strength of various companies. Here too the cream rises to the top. A growing segment of the

consuming public prefers, all else equal, to do business with companies they perceive as socially responsible.

Failure to attend to the ethical health of the company has comparable negative effects. The Gallup Organization, which is at the forefront of measuring employee engagement, has found that the percentage of U.S. employees who are *actively* disengaged ranges between 15 and 20%. In Gallup terminology “being actively disengaged” is the same as not being there at all. Their bodies are physically there but little else. The lost productivity cost to the U.S. economy is between \$287 and \$370 billion annually. And that does not count the costs stemming from fraud, theft, and sabotage – not to mention employees who “go Postal” – that all come right off the bottom line.

With all this positive financial performance, one would think investors would be cherry picking the best companies for their portfolios. Sure enough, the smartest are doing just that. Trillium Asset Management has been selecting for social responsibility with great benefit for its clients for 20 years. Formed in 1982 by the late Joan Bavaria, Trillium gets its name from the three-petal flower, focusing on Ecology, Equity (social justice), and Economy. Bavaria was a co-founder of CERES and the Social Investment Forum. Having proven the social investment model, Trillium now has offices in Boston, Durham, and San Francisco.

Innovest is a recent entrant in the social investment community. Founded and inspired by Matthew Kiernan, whose recent book, *Investing in a Sustainable World*, tells the Innovest story, Innovest’s funds have been outperforming most mutual funds for years.

Warren Buffett made billions for himself and fellow investors by purchasing and holding stock in well-run but undervalued businesses – known as value investing. The next Warren Buffett may well succeed by making similar investments in socially responsible companies. Or Henry David Thoreau put it, “Goodness is the only investment that never fails.”

The Sarbanes-Oxley Act: An Overview¹⁸

The Sarbanes-Oxley Act ("SOX") is binding only on public corporations that are subject to regulation by the SEC. However, Governance, Risk, and Compliance ("GRC") professionals recommend that non-regulated corporations (including non-profit corporations) carefully consider complying with several of its general provisions for several reasons:

- SOX expresses widespread thinking about best practices to follow in corporate governance and financial management.
- As large and medium-sized corporations begin adapting their internal controls and processes to SOX, its provisions will become *de facto* standards of governance.
- Interaction with suppliers and contracting firms and agencies will be smoother as parties begin to expect that those with whom they do business will be in synch with the new regulatory environment.

The Sarbanes-Oxley Act is the most important securities law since the Securities Laws of 1933 and 1934.

Senator Jon Corzine
December 2002

All provisions of SOX have implications for an ethics and compliance program – not the least because violations of most are both violations of the law and unethical.

SOX also contains two sections that directly apply to the development of ethics programs in organizations.

Private companies that do business with the federal government should give special consideration to using the SOX standards. Doing so will tend to distinguish such companies as particularly responsible and forward-thinking corporations.

SOX is divided into 11 sections or "Titles," not all of which have relevance to non-regulated corporations. This memorandum summarizes those of potential value to small and medium-sized enterprises ("SME's") and make note in passing of the other sections.

This article is not an exhaustive discussion of SOX. A copy of the complete text of SOX is included with the resource materials for this section. Numbers in parentheses refer to sections of the law.

¹⁸ © 2010 Michael Palmer, *Ethics By Design*

Title I. Public Company Accounting Oversight Board

Accounting Oversight Board. Section 1 sets up the Public Company Accounting Oversight Board ("Accounting Oversight Board") as a non-profit corporation. Its purpose is to supervise the auditing of public corporations. Accounting Oversight Board is required to register, inspect, discipline, and adopt auditing, ethical, independence, and other standards for public accounting firms. (Sec. 102-105)

Title II. Auditor Independence

Audit firms may not provide the following non-audit services to clients that are publicly traded:

- bookkeeping;
- financial system design and implementation;
- appraisal/valuation services, fairness opinions, and contribution-in-kind reports;
- actuarial services;
- internal audit outsourcing services;
- management functions or human resources;
- broker/dealer, investment adviser, or investment banking services;
- legal services and expert services unrelated to the audit; and
- any other service that the Accounting Oversight Board determines is impermissible. (Sec. 201)

Other non-audit services may be provided only if the client's audit committee approves them in advance.

The client's audit committee must approve all auditing services and non-auditing services in advance.

The lead audit partner and the reviewing audit partner of the auditing firm must rotate at least every five years.

The audit firm must provide timely reports to the audit committee on:

- all critical accounting policies and practices used in the audit;
- all alternative treatments of financial information within generally accepted account principles (GAAP) discussed with management, the ramifications of using such alternatives, and the treatment preferred by the audit firm; and

- other material written communication between the audit firm and management. (Sec. 204)

Under SOX an audit committee is a committee of the board responsible for overseeing the accounting and financial reporting processes of the corporation and the audit of the corporation's financial statements.

The audit firm may not perform any audit service for a corporation if a CEO, Controller, CFO, CAO, or person in an equivalent position was employed by the accounting firm and participated in an audit of the corporation during the past year.

Title III. Corporate Responsibility

Under SOX, the national securities exchanges and associations may not list any corporation that is **not** in compliance with the following requirements:

- the corporation's audit committee is responsible for the appointment, compensation, and oversight of the company's audit firm, and the audit firm reports directly to the audit committee;
- each member of the audit committee is an independent member of the board, (and to be considered independent, may not accept any consulting advisory or other fee from the company other than compensation for service as a director or committee member, or be an affiliated person of the company or any subsidiary);
- the audit committee has procedures for receiving, retaining, and responding to complaints regarding accounting, internal accounting controls, or auditing matters, and for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters;
- the audit committee has the authority to engage independent counsel and other advisors; and
- the audit committee is appropriately funded to pay the audit firm and the fees of any advisers employed by the committee. (Sec. 301)

In addition, the SEC must promulgate rules requiring the principal executive officer and the principal financial officer to certify in each 10-K and 10-Q that

- the officer has reviewed the report;
- the report does not contain any untrue statement of a material fact or

- omit to state a material fact and is not misleading;
- the financial statements contained in the report fairly present the corporation's financial condition and results of operations;
 - the officers are responsible for establishing and maintaining internal controls; have designed such internal controls to ensure that material information relating to the public corporation is made known to the officers; and have evaluated and reported on the effectiveness of the company's internal controls;
 - the officers have disclosed to the auditors and the audit committee all significant deficiencies in the corporation's internal controls and any fraud involving any employee having a significant role in the company's internal controls; and
 - the officers have indicated in the report whether or not there were significant changes in internal controls or other factors that could significantly affect internal controls after they were evaluated, including any corrective actions with regard to significant deficiencies and material weaknesses.

Improperly Influencing the Audit. An officer or director or person directed by an officer or director may not, without thereby violating the law, act contrary to any rule promulgated by the SEC prohibiting actions to fraudulently influence, coerce, manipulate, or mislead an independent auditor in connection with an audit of the corporation's financial statements. (Sec. 303)

Repayment if Bonuses and Profits. SOX requires any CEO or CFO of a public company that has issued an accounting restatement due to the material non-compliance of the company with any financial reporting requirement under the securities laws, to reimburse the company for:

- any bonus or incentive-based or equity-based compensation received for the 12-months after issuance or filing of the erroneous financials, and
- any profits from the sale of the corporation's securities during that 12-month period. (Sec. 304)

Insider Trading During Pension Fund Blackout Periods. SOX prohibits directors and officers from trading in the corporation's stock during pension fund blackout periods. (Sec. 306)

Professional Responsibility for Attorneys. SOX requires the SEC to issue rules of

professional conduct for attorneys practicing before the SEC in the representation of public companies, including rules requiring an attorney to report evidence of a violation of the securities laws or breach of fiduciary duty by a company employee or agent to the issuer's chief legal counsel or CEO, and if such officer does not take appropriate action, to the audit or other committee or the board. (Sec. 307)

Title IV. Enhanced Financial Disclosures

Periodic Reports. The company must promptly report matters having a significant impact on the company's financial statements, including off-balance sheet transactions and pro forma financial information; and for further SEC review and actions regarding special purpose entities. (Sec. 401)

Prohibition on Personal Loans. An issuer may not directly or indirectly make a personal loan or other "extension of credit" to a director or executive officer, with grandfathering of existing loans provided there is no material modification to any term of any such loan; additionally, the Act also provides a limited exception for loans made by public companies engaged in the consumer credit business and certain bank loans. (Sec. 402)

Enhanced Disclosures if Insider Trading Activity. The company must promptly report sales of issuer securities and related derivatives by directors, executive officers, and shareholders owning more than 10 percent of any class of the issuer's equity securities. (Sec. 403)

SEC Rules on Management Assessment if Internal Controls. The SEC must make rules that require an issuer's annual report on Form 10-K to contain a report by the company's management acknowledging its responsibility for maintaining an adequate internal control structure and procedures for financial reporting, and assessing the effectiveness of such structure and procedures. Also requires the audit firm to attest to and report on management's report on the issuer's internal controls. (Sec. 404)

Ethics Code for Senior Financial Officers. SOX mandates that the SEC require each issuer to disclose in a periodic report filed with the SEC whether it has adopted a code of ethics for senior financial officers, and if not, why. Also mandates the SEC to require public companies to promptly disclose on Form 8-K any changes in or waiver of such ethics code. (Sec. 406)

Audit Committee Financial Expert. The SEC must require each issuer to disclose whether or not its audit committee has at least one member who is a "financial expert" as defined by the SEC; and if not, to explain why. (Sec. 407)

Enhanced SEC Review of Issuer Disclosures. The SEC must conduct regular and

systematic reviews of periodic filings by public companies, including a financial statement review, based on factors set forth in the Act or determined by the SEC at least once every three years. (Sec. 408)

Real-Time Disclosures of Changes to Financial Condition or Operations. Covered corporations must provide rapid, current disclosures of material changes in an issuer's financial condition or operations, in plain English. (Sec. 409)

Title V. Analyst Conflicts of Interest

Regulation of Analysts and Research Reports. The SEC must take action to better assure the objectivity of securities analysts and research reports on public companies. (Sec. 501)

Title VI. SEC Resources and Authority

Increased SEC Funding. This section appropriates additional funding for the SEC. (Sec. 601)

SEC Censures and Bars. The SEC may temporarily or permanently bar any person from practice before the SEC if the person is found after a hearing to be unqualified or lacking in character or integrity or to have engaged in unethical or improper professional conduct, or violated or aided and abetted the violation of the federal securities law or SEC rules or regulations. (Sec. 602)

Title VII. Studies and Reports

This Title requires the SEC and other federal agencies to conduct studies and issue reports on matters affecting the securities markets, as follows.

Studies by the Comptroller General regarding:

- causes and effects of the consolidation of public accounting firms (Sec. 701); and
- whether investment banks and financial advisers have assisted public companies in manipulating their earnings or disguising their true financial condition. (Sec. 705)

Studies by the SEC regarding:

- the role of credit ratings agencies, impediments to accurate appraisals, and conflicts of interest in such ratings agencies (Sec. 702);
- from January 1, 1998 to December 31, 2001, the number and nature of accountants, accounting firms, investment advisers, brokers, dealers,

attorneys, and other securities professionals found to have aided and violated or aided and abetted a violation of federal securities laws (Sec. 703); and

- SEC enforcement actions for the prior five years based on violations of reporting requirements and financial statement restatements, and identification of areas most susceptible to fraud or inappropriate earnings management. (Sec. 704)

Title VIII. Corporate and Criminal Fraud Accountability

Criminal Penalties Bar Altering Documents. Under SOX it is a criminal offense, punishable by fines or imprisonment of up to 20 years, for *any person* (i.e., not only a securities issuer) to knowingly alter, destroy, conceal or falsify a record, document, or object with the intent to impede, obstruct, or influence the investigation or administration of any matter within the jurisdiction of any U.S. agency or department (i.e., not only the SEC). (Sec. 802)

Penalties Bar Destruction of Audit Records. An accountant must keep audit work papers for five years and directs the SEC to prescribe regulations relating to the retention of relevant audit work papers and other documents created in or pertaining to an audit. Provides that violation of such SEC regulations shall be punishable by fines and up to 10 years imprisonment. (Sec. 802)

Federal Sentencing Guidelines Jar Obstruction of Justice and Criminal Fraud. The United States Sentencing Commission must review and enhance as appropriate the Federal Sentencing Guidelines relating to obstruction of justice through the destruction, alteration, or fabrication of documents to assure that such guidelines provide sufficient deterrence and punishment for such offenses. (Sec. 805)⁴

Protection for Whistleblower Employees Against Retaliation. Employees of public companies may seek reinstatement, back pay, and other damages if they are discharged, demoted, harassed, or subjected to other adverse action by their employer because the employee provided information to or otherwise assisted a federal agency, a member of a Committee of Congress, or a person with supervisory authority over the employee in an investigation regarding mail fraud, wire fraud, or securities fraud, or filed, testified, or assisted in a proceeding filed or about to be filed relating to alleged securities fraud. (Sec. 806)

Criminal Penalties for Securities Fraud. Any person who knowingly executes or attempts to execute a scheme to defraud or to obtain money or property from any person in connection with any issuer security or the purchase or sale of an issuer security may be fined or imprisoned up to 25 years. (Sec. 807)

Title IX. White-Collar Crime Penalty Enhancements

Enhanced Penalties for Mail and Wire Fraud. The maximum prison terms for mail or wire fraud is increased from five to 20 years. (Sec. 903)

Changes to Sentencing Guidelines for White-Collar Offenses. The United States Sentencing Commission must review and revise, as appropriate, the Federal Sentencing Guidelines for offenses set forth in the Act, to assure sufficient deterrence and punishment for such offenses. (Sec. 905)

Failure of Officers to Certify Financial Reports. All Forms 10-Q, Forms 10-K, and other periodic reports filed by public companies that contain financial statements must be certified by the company's chief executive officer and chief financial officer. Such officers must certify that the filed periodic report containing the financial statements fully complies with applicable securities laws and the information contained in the periodic report fairly presents, in all material respects, the company's financial condition and results of operations. The penalties for knowingly certifying a periodic report that does not comport with all the requirements includes a fine of up to \$1 million and of up to 10 years in prison. If the false certification is willful, the penalties increase to a fine of up to \$5 million and imprisonment of up to 20 years. (Sec. 906)

Title X. Corporate Tax Returns

This section states the sense of the Senate that federal income tax returns of a corporation should be signed by the corporation's CEO. (Sec. 1001)

Title XI. Corporate Fraud Accountability

Tampering with a Record or Impeding an Official Proceeding. SOX provides for fines and imprisonment of up to 20 years for any person who "corruptly" does or attempts to alter, destroy, mutilate, or conceal a record, document, or other object in order to impair its use in an official proceeding, or otherwise corruptly obstructs, influences, or impedes an official proceeding. [Note: This provision is not limited to public companies or securities-related proceedings; thus it could apply to persons affiliated with nonprofit organizations who engage in such prohibited acts.] (Sec. 1102)

Federal Sentencing Guidelines for Fraudulent Acts by Public Company Officers or Directors. The United States Sentencing Commission must review the sentencing guidelines applicable to securities and accounting fraud and related offenses and consider promulgating new guidelines or amending existing guidelines to enhance the penalties for officers and directors of public companies who commit fraud and related offenses. (Sec. 1104)

Retaliation Against Whistleblowers. SOX provides for the imposition of fines and up to 10 years imprisonment for any person who "knowingly, with the intent to retaliate" causes harm to another person (including interfering with employment or livelihood) because such person provides truthful information to a law enforcement officer relating to the actual or possible commission of any federal offense. [Note: This provision is not limited to securities-related proceedings or to persons associated with public companies; therefore, it could apply to persons affiliated with nonprofit organizations who engage in the prohibited conduct.] (Sec. 1107)

Setting Up the Project

Introduction and Overview

This section contains the following components:

- Lateral Leadership
- Project Management Tools & Techniques
- An Annotated Outline of Phases and Tasks in a Model Code of Conduct Project
- A Template for a Code of Conduct Project in pdf form
- A Project Kickstart Template for a Code of Conduct Project

The segment on lateral leadership shares some insights from a variety of sources on getting things done when you are not in charge. Often, those who head up a project to develop a code of conduct are nominally in charge, but they may not have sufficient positional authority simply to order others to contribute as needed. Lateral leadership is about developing and exercising the communication and persuasion skills necessary for success nonetheless.

The segment on project management tools and techniques provides some resources and guidance that can help the person managing the code of conduct project work efficiently and productively.

The annotated outline explains the phases and tasks included in the project template.

The template contains a standard outline that can be adapted to the needs of your particular organization.

The Project Kickstart template can be used with the software Project Kickstart to modify and manage the project.

Notes on Lateral Leadership

All experts on ethical business culture agree that top-level management must show and practice a strong commitment to a code of conduct or other ethical policy for it to be effective. A disconnect here is counterproductive, leading to a growth in cynicism and misconduct.

But the CEO does not need to run the project. That task can be assumed by the Director of Human Resources, someone from the General Counsel's office, or, indeed, anyone who has good communication and facilitation skills who is also committed to developing an ethical culture.

Whoever assumes responsibility for the project, however, will need the cooperation of others both within and outside the company. The *de facto* leader will need special skills to coordinate the efforts of the participants effectively.

Why? To begin, because collaboration is not easy. The various players bring different ideas, skills, goals, and needs to the process. Some will have definite thoughts on what the committee should be doing, while others will be adrift in a fog of confusion about the effort. Even rudimentary things, such as showing up for meetings punctually – or not – can affect how well the work proceeds. The person assigned the task of leading the project must somehow help everyone develop a work ethos and standard practices that move the project forward.

Collaboration on this kind of project can also be challenging because the person in charge often has no command authority. Everyone knows that the person in charge has little influence over pay, promotion, or job retention. That person's actual authority is limited no matter what the CEO may have said.

The person taking on the task needs, therefore, skills in lateral leadership, the ability to coordinate the work of others even when you're not in charge.

Ten Tips for Lateral Leadership

1. Don't wait for others to take the lead. You can suggest, cajole, propose, convene, and otherwise instigate an effort to develop a code of conduct program.
2. Look for allies.
3. Think about the purpose of the effort. Once you have become clear in your own mind about why a code of conduct program would be beneficial for the company, you will become a natural advocate for the project. By "natural," I mean that you will be able to talk about it in terms that are natural to you.

4. Know and respect the interests of colleagues on the project. Why would they want to help create a code of conduct program? What's in it for them?
5. Cooperate with others in setting goals.
6. Ask, don't assert. Instead of telling others what to do, use questions and suggestions, inviting them to identify how they can help with the joint effort. Remember Tom Sawyer. His classmates were paying *him* for the privilege of painting his famous fence.
7. Ask other participants to contribute their thoughts. This can stimulate a free-flow of ideas that moves everything forward. Empower others.
8. Devise a good process for finding solutions. We do not lead latterly by providing the solutions themselves.
9. Separate the people from the problem. Make it safe to talk about problems in the collaboration process. Don't personalize it. Blame methods not colleagues.
10. Keep an open mind. Your way could be best, but you may discover that the collective work generates a better process or result.

Rules for Brainstorming

Always follow two basic rules for brainstorming:

1. No one comments positively or negatively about the ideas or options generated during the brainstorming session.
2. No one is committed to an idea or option by virtue of having expressed it.

"If you want to have a good idea, have lots of ideas."

Thomas A. Edison

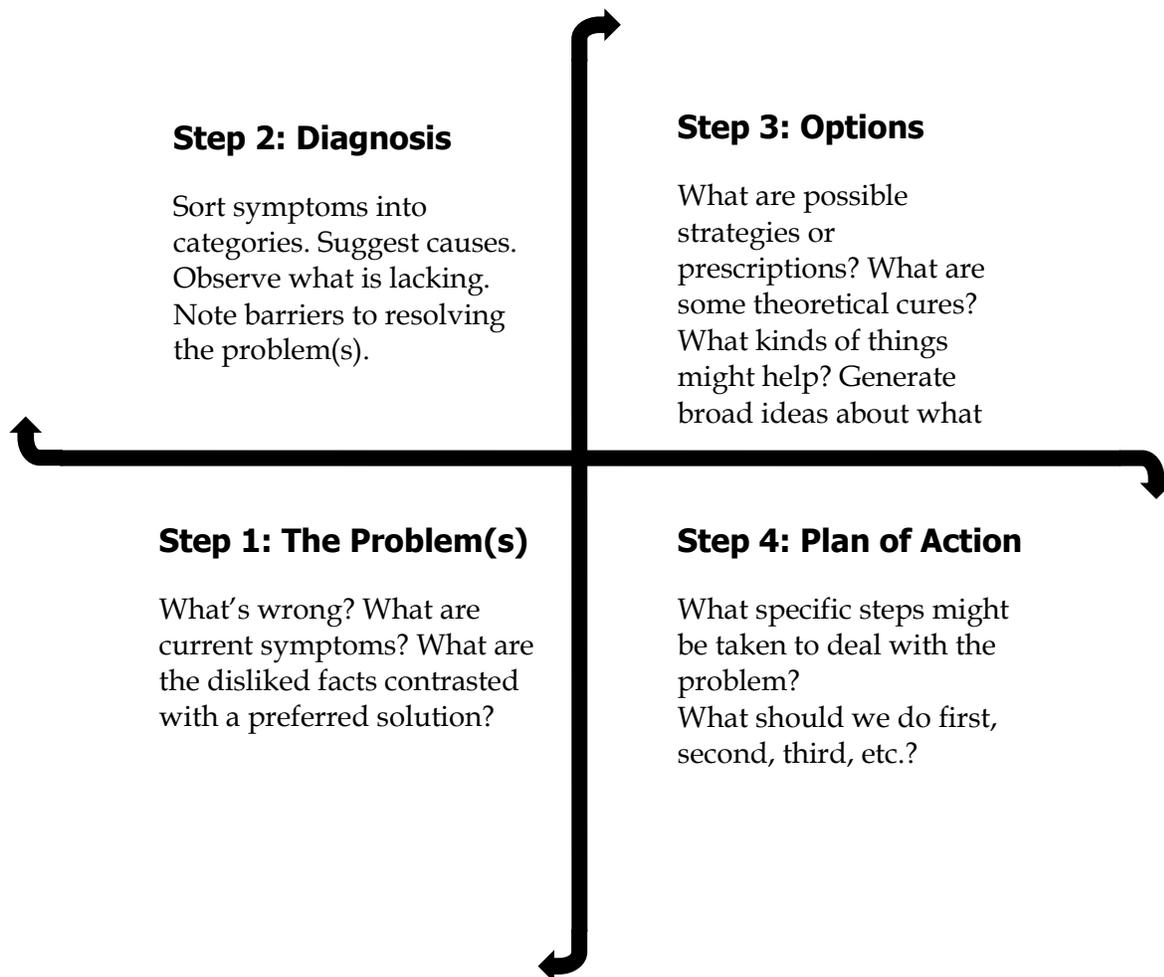
Failure to follow the first rule will squelch productive brainstorming.

Hearing criticism or praise of another idea causes people to clam up, thinking that their ideas are not good, not as good, unworthy, will be ridiculed, or will embarrass them.

This ego protection rule is necessary if you want to get good ideas.

Use the Four-quadrant Method of Problem Solving

THE FOUR BASIC STEPS TO INVENTING OPTIONS



This simple grid helps individuals and groups organize the diagnosis and treatment aspects of problem solving. It provides an orderly way to work through the problem. Often our tendency is to jump from step one to step four without first asking what is causing the problem and what types of solutions might be appropriate. Using this method helps assure that we do not leave out any of the steps in the analytical process and also assists us in organizing the information that we gather in useful ways.

Discuss Potential Decisions Using the Six-Part Method¹⁹

Like the four-quadrant chart, the six-part decision-making method helps focus group members on the decision under consideration in an orderly fashion. When they use it, groups do not jump helter-skelter from one topic to another, spending less time and producing better decisions. The facilitator's role is to make sure everyone speaks to the question on the table. The order of discussion is not rigid.

1. Gather and Assess Available Information (evidence, facts)

A famous recipe for Welsh Rarebit begins, "First catch your rabbit." Before you make a critical decision, make sure you have all the information you need.

This does not mean that you must have all possible information. You can't. Difficult decisions are difficult *because* we cannot know with certainty how things will develop in the future. We must estimate what the outcome will be based on what we can know now. And we don't have access to all the knowable information.

But the problem of imperfect information can be addressed. There are good ways to pull together what we have available to us at any given moment the project. By concentrating our energy on gathering and analyzing evidence, we are more likely to become aware of what we do not know and where we need more information.

2. Arguments Supporting the Proposed Course of Action

The Power of Positive Thinking. Wearing this hat, you marshal everything good that can be said about the proposed course of action. Let your optimism flourish. Count the benefits.

Explore the benefits. List all the good consequences that are likely to be the result of moving in the proposed direction. Anticipate the accolades and praise your group will receive if you say yes.

3. Arguments Against the Proposed Course of Action

Collect arguments against the proposed decision. Allow cautionary thinking to emerge. Give the nay sayers room to roam. Encourage the Devil's Advocates in the group to have their say. Try to see why it might not work. Highlight the weak points in a plan.

¹⁹ This method has been adapted from Edward de Bono, *Six Thinking Hats* (Boston: Little, Brown & Co., 1985).

When we allow the counterarguments to emerge, plans become tougher. You spot flaws and risks before you set sail. It is a way to prepare for problems.

List all the things that could go wrong. Anticipate the negative press coverage if the proposed course of action fails. Focus on things you don't want to think about.

4. How Do You Feel About the Proposed Course of Action?

What do you feel? What do you sense? What hunches or intuition do you have?

This phase of group decision making is all about emotions, gut reactions, intuitions. What bubbles up? It is the empathy hat – where we focus on what others feel. Here we should avoid evaluating, criticizing, or even commenting on the emotions that are expressed. They simply are.

It is important to get emotions to the surface when making critical decisions. Emotions provide subtle, nuanced signals about risks or benefits that we miss when we try to spell everything out in logical thought processes. When someone says, “You know, it just doesn't feel right,” explore that response. Dig deeper. What about it makes you uncomfortable? Emotions can be clues to the intensity of commitment people bring to a decision. If several people are expressing tepid emotions, there might not be enough energy available to get the job done. If strong emotions are in opposition, that could be a signal that caution is warranted.

The people making the *Challenger* launch decision might well have held off giving the go ahead if they had focused explicitly on the emotions the participants had in connection with the decision.

5. How Will This Decision Affect the Legitimate Interests of Others?

Values. Principles. Duties. Rules. Consequences.

In this phase, we focus on the moral dimension: what is morally justifiable and what not? How do we sort out the proper course? How should we prioritize principles and values when confronting moral dilemmas?

We are not accustomed to making this perspective explicit. It requires a skill set that our society has not cultivated. But it is at the heart of professional responsibility.

Put simply, when focusing on the interests of others, we ask whether we are about to do the right thing. And one way of answering that question is to inquire about the projected impact on the legitimate interests of others. In the *Challenger*

case, for example, everyone knew that a malfunction of the O-rings would likely lead to the deaths of seven astronauts. But no one made that fact explicit. Presumably, they all thought it was too obvious to be stated. To be sure, everyone – astronauts above all – knew that space shuttling was a dangerous undertaking, with extremely high risks for the people in the vehicle. But it would have helped to bring the potential for death into the discussion. Unless consequences of this nature are made explicit, we run the risk of glossing over them or not giving them the weight they should have in the decision.

6. Search for Creative Ways to Improve on the Proposed Decision

Let a thousand flowers bloom!

What other ways can we think about this problem? What alternatives could we think up? Have we considered all the possibilities? How can we see this problem differently?

In this phase, we want to ignite creative thinking. Freewheeling thought association is allowed. Brainstorm. Think outside the box. When the group has moved to this phase, no negative thinking or criticism is allowed. You want to come up with new, fresh ideas.

Using the six-part thinking method when confronting complex decisions involving high levels of uncertainty is no guarantee that groupthink and diffusion of responsibility will not creep into the process. But it is one countermeasure that will help.

ACBD and Other Ways to Get Better Results

ACBD stands for “always consult before deciding.” It means, as far as possible, make sure that you always consult someone who will be affected by you are proposing to do. ACBD counteracts the problem of group B having to carry out the decision of group A when B does not see wisdom of decision or may actually oppose it for good reasons.²⁰

Instituting the practice of assigning someone to play the role of Devil’s Advocate in every major decision might be helpful. Such a person basically keeps the Black Hat on throughout the process, thereby helping to make sure that undue optimism and biases do not blind group members to the potential folly of what they are about to do.

Letting a few days transpire between the making and the execution of a decision, where possible, might help avoid bad decisions as well. A *cooling-off period* of 1-2 days gives

²⁰ The ACBD rule is discussed at greater length in Roger Fisher and William Ury, *Getting To Yes: Negotiating Agreement Without Giving In* (2nd ed., New York: Penguin, 1991).

people a chance to mull over aspects of the decision that may have been neglected during the meeting.

Every organization should aspire to have written procedures about vital aspects of its operation. Decision making is no different. The written procedures might address some of the problems mentioned in this lecture and lay down steps to be taken to avoid them, at least with major decisions. These could include requiring the use of a devil's advocate or getting a key person who was not involved in the committee process to approve. Just as companies should have procedures in place to prevent fraud and theft (e.g., requiring two signatures on all checks for more than \$500), it is also wise to have procedures in place to avoid bad decisions.

The leadership of larger organizations might consider adopting policies about group decision making. For example, it could be company policy that everyone in the room has co-responsibility for the decision unless they expressly dissent. This would reduce diffusion of responsibility. Or, if decisions are made across departments or divisions, there might be a sign-off sheet that people in key positions must sign to indicate their approval (or dissent), thereby documenting who approved and who did not. The buck would no longer be homeless. The diffusion of responsibility might be substantially reduced.

Additional Resources

The psychology and practice of decision making have spawned a large amount of research and writing. Some of the more accessible and useful books in this field are the following:

- Irving Janis, *Groupthink: Psychological Studies of Policy Decisions and Fiascoes* (Boston: Houghton-Mifflin, 1982)
- Irving Janis, *Crucial Decisions: Leadership in Policymaking and Crisis Management* (New York: Free Press, 1989)
- John S. Hammond, Ralph L. Keeney, and Howard Raiffa, *Smart Choices: A Practical Guide to Making Better Life Decisions* (New York: Broadway Books, 2002)
- J. Edward Russo and Paul J.H. Schoemaker, *Winning Decisions: Getting It Right the First Time* (New York: Currency Doubleday, 2002)
- Edward de Bono, *Six Thinking Hats* (New York: Little, Brown & Co., 1999)
- Theodore C. Sorensen, *Decision-Making in the White House: The Olive Branch or the Arrows* (New York: Columbia University Press, 1963)

The topic of the responsibility of the organization as organization is also the subject of contributions by a wide variety of authors. Some useful works include:

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- Ronald R. Sims, *Ethics And Organizational Decision Making, A Call For Renewal* (Westport, CT: Quorum Books, 1994)[copy available at Questia.com]; see particularly chapter 4, "The Relationship Between Groupthink and Unethical Behavior in Organizations," p. 61-78.
 - Larry May, *The Morality of Groups: Collective Responsibility, Group-Based Harm, and Corporate Rights* (South Bend: University of Notre Dame Press, 1987)
 - William C. Frederick, *Corporation, Be Good! The Story of Corporate Social Responsibility* (Indianapolis: DogEar Publishing, 2006)

Endnotes

- ¹ Simon Webley and Kerry Hamilton, "How Does Business Ethics Pay: An Exploratory Look at the Ways Through Which Doing Business Ethically is Being Translated Into Corporate Financial Performance," *Institute of Business Ethics, London* (2004).
- ² James W. Carland, JoAnn C. Carland and Jason W. Carland, "Fraud: A Concomitant Cause of Small Business Failure," 5 *Entrepreneurial Executive* 135-161 (2000).
- ³ *Id.* at 139
- ⁴ [Employee Fraud, Theft Cost Firms \\$40 Billion Yearly](#) (SecuritySolutions.com December 30, 2008)
- ⁵ J.T. Wells, *Occupational Fraud and Abuse* (Austin, TX: Obsidian Publishing Co., 1997)
- ⁶ Tommie Singleton, Brett King, Frank M. Messina, and Richard A. Turpen, "Pro-Ethics Activities: Do They Really Reduce Fraud?" 14(6) *The Journal of Corporate Accounting and Finance* 86-87 (2003).
- ⁷ Fulbright & Jaworski, 6th *Annual Litigation Trends Survey Report* 12 (2009).
- ⁸ See, e.g., Francis Achampong, *Workplace Sexual Harassment Law: Principles, Landmark Developments, and Framework for Effective Risk Management* (Westport, CT: Quorum Books, 1999).
- ⁹ Sameera Khan, "Reducing Harassment Exposure: Employers Turning to Liability Cover, Prevention Efforts," 28 *Business Insurance* 3 (July 4, 1994).
- ¹⁰ "The Ethics Landscape in American Business: Sustaining a Strong Ethical Work Environment" 31 ([Society for Human Resources Management](#) and Ethics Resource Council, 2008).
- ¹¹ See Diane Vaughan, *Controlling Unlawful Organizational Behavior: Social Structure and Corporate Misconduct* (Chicago: University of Chicago Press, 1983).
- ¹² See "Shortcircuiting Problem with Guidant ICD Device," [Medscape Today](#) (May 27, 2005).
- ¹³ See Simon Webley and Kerry Hamilton, "How Does Business Ethics Pay: An Exploratory Look at the Ways Through Which Doing Business Ethically is Being Translated Into Corporate Financial Performance," *Institute of Business Ethics, London* (2004).
- ¹⁴ James K. Harter, Frank L. Schmidt, and Corey L. M. Keyes, "Well-Being in the Workplace and its Relationship to Business Outcomes: A Review of the Gallop Studies," in C.L. Keyes & J. Haidt (eds.), *Flourishing: The Positive Person and the Good Life* 217-218 (Washington DC: American Psychological Association, 2002).
- ¹⁵ GolinHarris, "Doing Well by Doing Good 2005: The Trajectory of Corporate Citizenship in American Business" at 2.
- ¹⁶ See [Is Wal-Mart Good for America?](#) Frontline Documentary (PBS, November 14, 2004).
- ¹⁷ See, e.g., Simon Webley and Kerry Hamilton, "How Does Business Ethics Pay: An Exploratory Look at the Ways Through Which Doing Business Ethically is Being Translated Into Corporate Financial Performance," *Institute of Business Ethics, London* (2004).
- ¹⁸ Dotty Schnure Interview, Green Mountain Power.
- ¹⁹ This conclusion is buttressed by Section 406 of the Sarbanes-Oxley Act, directing the SEC to promulgate rules requiring publicly held corporations to provide information about their codes of conduct in their annual reports or explain why they do not have such a program:

SEC. 406. CODE OF ETHICS FOR SENIOR FINANCIAL OFFICERS.

- (a) CODE OF ETHICS DISCLOSURE. — The Commission shall issue rules to require each issuer, together with periodic reports required pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reason therefor, such issuer has adopted a code of ethics for senior financial officers, applicable to its principal financial officer and comptroller or principal accounting officer, or persons performing similar functions.
- (b) CHANGES IN CODES OF ETHICS. — The Commission shall revise its regulations concerning matters requiring prompt disclosure on Form 8-K (or any successor thereto) to require the immediate

disclosure, by means of the filing of such form, dissemination by the Internet or by other electronic means, by any issuer of any change in or waiver of the code of ethics for senior financial officers.

(c) DEFINITION. — In this section, the term “code of ethics” means such standards as are reasonably necessary to promote —

(1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

(2) full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and

(3) compliance with applicable governmental rules and regulations.

(d) DEADLINE FOR RULEMAKING. — The Commission shall —

(1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules to implement this section, not later than 180 days after that date of enactment.

²⁰ See John A. Byrne, *Chainsaw: The Notorious Career of Al Dunlap in the Era of Profit-At-Any-Price* (New York: HarperBusiness, 1999).

²¹ Herbert J. Taylor, *God Has a Plan for You* 40-41 (Carol Stream, IL: Creation House, 1972).

²² *Id.* at 42.

²³ *Id.* at 40.

²⁴ *Id.* at 57-58.

²⁵ *Id.*

²⁶ *Id.* at 42.

²⁷ *Id.* at 43.

²⁸ *Id.* at 43-44.

²⁹ *Id.* at 44.

³⁰ *Id.* at 55.

³¹ *Id.* at 43-44.

³² Paul Heidebrecht, *God's Man in the Marketplace* 50 (Downers Grove, IL: InterVarsity Press, 1990).

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.* at 51.

³⁷ *Id.* at 51-52.

³⁸ Taylor, *supra*, at 44.

³⁹ F.W. Taylor, *The Principles of Scientific Management* 28-30 (Sioux Falls, SD: NuVision2007, originally published 1911).

⁴⁰ Jack Welch and Susie Welch, *Winning* 13-14 (New York: HarperBusiness, 2005).

⁴¹ Lawrence Foster, Robert Wood Johnson: The Gentleman Rebel 284 (State College, PA: Lillian Press, 1999).

⁴² *Id.*