41 Ethics and business

A Ethical behaviour

Ethical behaviour is doing things that are morally right. **Ethics** (countable noun) are moral beliefs about what is right or wrong. **Ethics** (uncountable noun) is the study of this. **Ethically responsible** companies want to do the right thing in areas such as:

- employment and **community**: they want to pay attention to things that affect all people, not just their employees, in the areas where the company has its offices, factories and activities.
- the environment: they want to conduct business in ways **that protect the environment** to ensure that the air, rivers etc. are not **polluted** and plant and animal life are not **endangered**. (See Unit 43)
- winning new business: they want to get business without engaging in **corrupt** behaviour, for example offering **bribes** – money given to someone so that they behave **unethically**.

Companies want to be seen as good **corporate citizens**, with activities that are beneficial not only for their **stakeholders** – their employees, shareholders and so on – but for the community and society as a whole.

B Accountability and transparency

Ethical corporate behaviour includes **accountability** – the idea that companies are completely responsible for what they do and that people should be able to expect them to explain their actions. **Transparency** is explaining this behaviour in a way that can be understood by outsiders, and not trying to hide anything. Companies may say that they demand high levels of **probity** and **integrity** – complete honesty – from their employees, and that they do not tolerate any form of **misconduct**.

C Corporate social responsibility

Companies have long had **codes of ethics** and **codes of conduct** saying how their managers and employees should behave. Now they are looking at these issues in more systematic ways. They are designating executives to oversee the whole area of **corporate social responsibility** (CSR).

41.1 Read the article relating to the ideas in A, B and C opposite. Then say if the statements below are true or false, identifying the phrase or sentence from the article that confirms your answer. (The first one has been done done for you.)

How to become good in all areas

Few companies are clear about how to manage what can be an amorphous collection of internal initiatives and external relationships on social, environmental and ethical issues. Probity and responsibility must be embedded in a company's culture, strategy and operations from the top down. But how can this be done? A new guide from Business for Social Responsibility, a US non-profit research and advisory organisation with 1,400 member companies and affiliates, attempts to answer this by taking the reader step by step through the process of designing a corporate social responsibility management system.

Only a handful of companies have a full CSR management system in place, says the organisation, which advises its members on how to make responsible practices integral to their strategy and operations. Its corporate members, mainly in the US and Europe, have combined annual revenues of nearly $2,000bn (£1,300bn) and employ 6m people. They include ABB, British Airways, Coca-Cola, Ikea, Unilever and Wal-Mart. The scandals in the US have underlined how "corporate responsibility taskforces" and codes of conduct are not enough on their own and can sometimes be a smokescreen.

"Creating and building a successful CSR management system is a complex, long-term project for any company," says the report. "It involves a shift in the way a company conducts business and can be likened to implementing other large-scale change initiatives such as total quality management."

The guide runs through basics such as who currently has responsibility for CSR in the company, why a better management structure might improve things and what "hot-button" issues (child labour, drug pricing) face different sectors. It encourages companies to think hard about their stakeholders, what their concerns are, how credible and influential they are and whether they are a potential long-term partner or a liability.

Financial Times

1 Most companies have clear, coherent policies on social, environmental and ethical issues.
false – Few companies are clear ... social, environmental and ethical issues.
2 If a company behaves with probity, it has high ethical standards.
3 Business for Social Responsibility has a coherent approach to designing a corporate social responsibility management system.
4 It's simple for a company to add a CSR management system to its day-to-day business.
5 Codes of conduct are enough to ensure ethical behaviour.
6 The guide says that a company's stakeholders should all be kept happy so that they are all retained by the company over the long term.

41.2 Complete the sentences, with expressions from A and B opposite.

1 The company was accused of giving .... to local officials in order to allow their products into the country more quickly.
2 The company has supported several projects in the local ...., where its factories are situated.
3 Voters demanded that there should be greater .... in the election process so that they could understand it fully.
4 Following the scandals of Enron, Worldcom and others, there is greater emphasis in business schools on the teaching of ....

Over to you

Think of a particular ethical issue that concerns you. Write a letter to an organization asking what its policy is on this issue.

44 Corporate governance

A Board organization

Corporate governance is the way a company is organized and managed at the highest level. This can have a critical influence on the company's performance and behaviour.

A company's **board of directors** includes:

- **executive directors**: the **chief executive** and other senior managers such as the finance director.
- **non-executive directors** or **non-execs**: outsiders with management experience who are invited to sit on the board, bringing their expertise and an outside view. Large investors in the company like pension funds may also have **seats on the board** so that they can influence how the company is run.

In some countries such as Germany, there are two boards. Above the **management board** is a more senior **supervisory board**.

B Separation of roles

Another key issue in corporate governance is whether the most senior job in a company should be split into two or not. Should the roles of **chairman/chairwoman** and **chief executive** be held by one person, or should there be a separation of these two roles?

Some people say that these two functions should be separated in order to avoid concentrating too much power in one person's hands. Supporters of combining the two roles, however, say that this gives the company stronger leadership.

C Rewards for success (and failure)

Also important are **executive remuneration** or **compensation**. Top executives are **rewarded** for success in the form of high salaries and **share options** (BrE) or **stock options** (AmE): the chance to buy shares in the company cheaply. These highly-paid executives are often called **fat cats** by their critics. Executives say in their defence that share options are one of the **incentives** that can make them perform better.

But they may also be 'rewarded' for failure, with high **severance payouts** or **payoffs** when they leave the company following poor performance.

Executive pay is becoming an increasingly sensitive issue – for example, executive pay in the UK has risen three times faster than average pay in the last five years. Company boards may appoint a **remuneration committee** to make decisions in this area. And in the UK there are proposals that shareholders should have the right to vote on executive remuneration.

44.1 Two articles have been mixed up. They contain expressions from A, B and C opposite. Which paragraphs make up each article? (The paragraphs are in the correct order. Article 1 contains four paragraphs; the first is a. Article 2 contains four paragraphs; the first is b.)

a

Article 1: Corporate safeguards go back to the board

A large majority of top executives in Britain have given the thumbs down to proposals designed to strengthen the role of non-executive directors in the boardroom. A survey by the Confederation of British Industry showed that 82% of FTSE-100 chairmen feel that their role would be undermined by proposals contained in the Higgs report released in January.

b

Article 2: Rewards for failure are too high, says Lord Mayor

The City needs to tighten up its standards of corporate governance to restore public and investor confidence, according to the Lord Mayor of London, Gavyn Arthur. It was unacceptable for failure to be almost as well rewarded as success and for executives to take decisions designed to trigger short-term share options rather than act in the long-term interests of the company.

c

"We have to have an ethos where the long-term stability of the company is what matters most; where it is bad form and seen to be bad form to be taking actions to generate short-term benefits and share options." Mr Arthur is expected to use a keynote speech at a dinner to be attended by Trade and Industry secretary Patricia Hewitt this month to highlight the need to bolster credibility.

d

The report from Derek Higgs, a former investment banker, called for an enhanced role for non-executive directors, as part of a stream of proposals designed to prevent an Enron-type scandal in the UK. Specifically, the Higgs report called for an independent non-executive director to chair the nominations committee, which nominates people to join the board, splitting the functions of chairman and chief executive, and the appointment of a senior independent director to liaise with shareholders.

e

Ms Hewitt has already announced a review on the issue of rewards for failure. However, last month Labour blocked an attempt by Tory MP and former Asda boss Archie Norman to change the Companies Act to allow directors to challenge executive payoffs.

f

But in the CBI survey, most chairmen believed that the Higgs proposals would undermine their position and lead to divided boards and therefore hamper the way they run their businesses. "What the chairmen are saying is that they need to have unified boards, especially in difficult economic times," said Digby Jones, the CBI director-general.

g

Chairmen of the FTSE-100 companies can also argue that corporate governance in the UK already meets high standards, building on past milestones such as the 1992 report by Sir Adrian Cadbury in 1992 and Sir Ronald Hampel in 1998. Be that as it may, Enron and WorldCom changed the corporate landscape. Those mammoth scandals led to major reforms in the US, notably the Sarbanes-Oxley law, which had the creation of an accountancy oversight board as its centrepiece. Once the US started overhauling corporate governance practices, the rest of the world was forced to go some way to meeting these new best practices.

The Guardian

h

Mr Arthur argues that the current situation cannot be allowed to persist. "I can't bear to see failure being almost as well rewarded as success. It is morally wrong for those who have destroyed their company to walk away with an obscenely large payout. It does a disservice to investors and to public confidence."

The Guardian

Over to you

What is the attitude towards highly-paid executives in your country? Imagine that you are a shareholder in an organization that has recently awarded a large pay increase to its CEO. Write a letter to the organization's head of corporate social responsibility (see Unit 41) asking them to justify this increase.

45 Ethical investment

A Controversial products

George Unwin is a fund manager for an **ethical investment fund**:

'People and organizations who put their money into our fund want us to invest it in ethical ways. We want to avoid companies that have a bad record on social and environmental issues. We particularly want to avoid certain sectors – tobacco, arms manufacturers, and nuclear power or uranium producers. So we put our clients' money into funds that do not invest in these activities.

In selecting companies to invest in, we look closely at how they are managed. We are particularly interested in issues of **corporate governance**. We believe that well-managed companies make better investments.' (See Unit 44)

B Socially-responsible investment

There is more and more relevant information about ethically run companies that people can put their money into. In the UK, **FTSE4Good**[1] is an **index** of **ethically managed companies**. In the US, they have the **Dow Jones Sustainability INDEXES**[2] – **DJSI World and DJSI Stoxx**, containing companies which are run in a way that takes account of the long-term interests of society and the environment. This concept, known as **corporate sustainability**, is defined by DJSI in these terms:

strategy: integrating long-term economic, environmental and social aspects into their business strategies while maintaining global competitiveness and brand reputation.

financial: meeting shareholders' demands for sound financial returns, long-term economic growth, open communication and transparent financial accounting.

customer and product: fostering loyalty by investing in customer relationship management, and product and service innovation that focuses on technologies and systems which use financial, natural and social resources in an efficient, effective and economic manner over the long term.

governance and stakeholder: setting the highest standards of corporate governance and stakeholder engagement, including corporate codes of conduct and public reporting.

human: managing human resources to maintain workforce capabilities and employee satisfaction through best-in-class organizational learning and knowledge management practices, and remuneration and benefit programs.

The **FTSE4Good** and **DJSI indexes** give the overall value of the share prices of the ethical firms, and we can compare the performance of individual firms against them.

This is part of the movement towards **socially responsible investment** (**SRI**).

(See Units 43 and 50)

[1] www.ftse4good.com

[2] www.sustainability-index.com

45.1 Complete the article, which contains words from A and B opposite, with a–e below.

Analysts look at new factors

'COMPANIES that follow better social and environmental policies are simply better run,' according to Matthew Kiernan. This is a controversial view. Socially responsible investment has come a long way and gained (1) ....

The research process which Mr Kiernan and his colleagues have developed at Innovest is aimed at identifying what he describes as the 'intangible value' of a company, the factors that are not captured in a traditional balance sheet and which explain the difference between a company's market value and its asset value.

While the concept of 'intangible value' is not an original one, Mr Kiernan believes Innovest's research process brings a new (2) ....

'The conventional wisdom still in many quarters is that social and environmental issues are either irrelevant or even harmful to the financial performance of companies,' Mr Kiernan says. 'Our argument is that financial reporting in fact shows (3) ....

Hence his conclusion that companies following better social and (4) ....

As further evidence of the link between socially responsible behaviour and enhanced profitability, Mr Kiernan cites South African mining companies, some of which have recently announced their decision to provide retroviral drugs to workers suffering from Aids. 'The cost of Aids is estimated to add \$4 to \$6 an ounce to the price of producing gold,' he says. 'Giving drugs to your workforce may be a good PR gesture, but it will also reduce your production costs and (5) ....

Mr Kiernan, however, is certainly prepared to promote his own values. 'We are trying to put sustainability issues in the mainstream,' he says. 'I will die a happy man when the Innovest sustainability rating is turned to as quickly as a price/earnings multiple.'

Financial Times

a environmental policies are better run. In defence of this argument, Mr Kiernan refers to independent analysis by QED International demonstrating that a portfolio of shares tilted towards Innovest's preferred stocks would have outperformed the S&P 500 by nearly 29 per cent between December 1996 and December 2001.

b rigour and depth to its analysis. The material is aimed more at analysts and company boards than at shareholders with a conscience, the traditional audience for companies carrying out a 'social audit'.

c only the tip of the iceberg. Mainstream financial analysis captures only a very small part of the competitive dynamic of a company, and it's what's going on below the surface that accounts for success or failure.'

d contribute to the bottom line.' He goes on to cite 3M which, he says, has saved more than \$900m (£600m) over the last decade from pollution prevention programmes.

e visibility through the FTSE Good Index launched last year. But many investment managers remain unconvinced that green credentials show up positively in a balance sheet.

Over to you

Do you agree with the argument in the article that ethically run companies are more profitable than those without corporate social responsiblity policies (see Unit 41)?