

Untangling the Confusion Over Organizational Ethics

By Susan Liautaud

Stanford Social Innovation Review
Summer 2013

Copyright © 2013 by Leland Stanford Jr. University
All Rights Reserved

Untangling the Confusion Over Organizational Ethics

A wave of ethics transgressions underlines the importance of comprehensive ethics oversight for organizational success. BY SUSAN LIAUTAUD

LAST YEAR, 2012, was in many regards a step forward for proponents of ethical action. Roger Gifford, the Lord Mayor of the City of London, one of the world's financial capitals, declared business ethics a priority and critical to the City's economic success. François Hollande published a Code of Ethics within 11 days of becoming president of France. And the new Chinese premier, Xi Jinping, highlighted the ongoing danger of corruption to economic and social development as a central part of his election discourse.

Despite this focus on ethics among world leaders, overall, failed ethics was the leitmotif of 2012. The media, particularly in the United Kingdom, were rocked by ethical failings. At the BBC there were allegations that now deceased on-air personality Jimmy Savile had sexually abused hundreds of children. And at Rupert Murdoch's News Corp. there were charges that his now-defunct tabloid *News of the World* regularly hacked the phones of prominent people it was covering.

The business world saw numerous examples of ethical transgressions. Raj Rajaratnam, founder of Galleon Group, and Rajat K. Gupta, a former director of Procter & Gamble and former head of McKinsey & Co., were convicted of insider trading. And Barclays Bank, UBS, and Royal Bank of Scotland paid fines for their role in conspiring to manipulate LIBOR interest rates. Nonprofits haven't fared much better. The United States Navy Veterans Association is charged with scamming close to \$100 million from thousands of US donors. Pennsylvania State University was engulfed in a widespread coverup of a now convicted pedophile.

What is clear from these examples is that ethics oversight is essential to success for all organizations, whether corporate, non-profit, governmental, multi-lateral, or academic. Classic notions of governance, or the governance-accountability-transparency trio, are insufficient. Calls from world leaders are important but just the start. Regulation and self-regulatory efforts are essential, but they require ethics analysis in tandem. And last, although corporate social responsibility (CSR) has evolved into an important strategic tool, it too must operate within broader ethics oversight.

What does successful ethics have to do with governance, legal compliance, and CSR? The following framework suggests an approach to untangling the persistent confusion about this question.

First, let's take a step back and consider a real-world definition of ethics. My



working definition of ethics in my ethics consulting practice is “an ongoing determination of moral principles guiding conduct, taking into account all relevant information, values, and current and future impact on all stakeholders (including society at large).” Ethics first and foremost requires high-quality decision-making. Implementation of decisions and vigilant ongoing oversight of conduct must follow.

Now for the framework. Ethical rules do not dictate absolute right or wrong, but they are absolutely about determining right and wrong within the context in question. Ethics extends beyond governance, the law, and CSR but should be integrated into an organization's approach to all three.

Ethical standards do not guarantee perfection | Ethics does not seek or require perfection. For example, as acknowledged

SUSAN LIAUTAUD is founder of Susan Liautaud & Associates Limited, a London-based ethics consulting firm, and a visiting scholar at the Stanford Center on Philanthropy and Civil Society.

in the recently revised *Resource Guide to the U.S. Foreign Corrupt Practices Act*, neither the US Securities and Exchange Commission nor the US Department of Justice holds organizations or their leaders to a “standard of perfection.” Even outstanding ethics oversight does not protect completely against intentional wrongdoing—a rogue trader, such as UBS’s Kweku Adoboli, or minor accounting fraud. Nor does ethics guarantee good outcomes of all decisions. Ethics positions organizations and individuals to make decisions that, when we look back from a future point in time and irrespective of outcome, reflect good decision-making in accordance with the definition above. Ethics is about proactive efforts to prevent unethical behavior and to react swiftly, decisively, and transparently in case an ethics issue should arise. Take the example of HSBC, which in 2012 was accused of engaging in transactions with drug dealers and terrorists. David Bagley, the firm’s head of compliance, readily acknowledged HSBC’s ethical lapse in a statement to an investigating committee: “Despite the best efforts and intentions of many dedicated professionals, HSBC has fallen short of our own expectations and the expectations of our regulators.”

Ethics exceeds governance | Organizations should integrate ethics into governance. Ethics does, however, extend beyond standard governance procedures (conflict of interest policies, board evaluation, or auditor rotation), formalized regulatory codes (the Sarbanes-Oxley law in the United States, or the UK Charity Commission regulatory work), or voluntary efforts (Independent Sector Checklist for Accountability). Recent research I conducted among senior leaders of for-profit and nonprofit organizations in the United States, the United Kingdom, and France suggests a widespread view that the board chair has primary responsibility for ensuring ethics oversight. The chair is crucial to ethics oversight, in part because the chair has the most regular contact with the CEO and CFO, primary responsibility for CEO review, control over the board agenda and functioning, and a responsibility to set standards and serve as a model. Nevertheless, ethics is the entire board’s and management team’s responsibility, not just the board chair’s.

Ethics exceeds the law | Even the strictest compliance with law yields only a baseline standard in decision-making and not best practice or first-in-class ethics. As the chairman and former CEO of a global technology company recently told me, legal exhaustion from excessively prescriptive law often erroneously leads to unjustified comfort that the law guarantees *both* the law and ethics. Codes of ethics and related policies in all sectors should require full compliance with all applicable laws and regulations as the starting point, not the standard for the organization.

Ethics oversight improves legal analysis. Rigorous ethics oversight spotlights unregulated “gray area” practices that might lead to new or expanded regulation or shareholder or donor outcry (as with the nonprofit provisions of Sarbanes-Oxley, for example). Ethics can also lead to voluntary efforts to raise standards—such as the Pearl Initiative, a private-sector-led effort developed in cooperation with the United Nations Office for Partnerships to improve business ethics and governance in the Middle East.

Sometimes even strict legal compliance leads to a reputation for unethical behavior. The writer of an op-ed in the *Financial Times* (“Politicians Can Only Do so Much”), for example, cites Margaret

Hodge, chair of the UK House of Commons public accounts committee, as accusing Starbucks, Amazon, and Google of “immoral” but not “illegal” behavior as a result of payment transfer arrangements to other countries in an effort to reduce taxes. Similarly, UK banking leaders criticized Goldman Sachs for proposing (legally) delayed bonuses to benefit from reduced UK tax rates starting in April 2013, a proposal the company subsequently retracted. Lack of clarity in interpretation of laws sounds ethics alarm bells.

Ethics exceeds CSR | CSR is separate from ethics but must integrate the company’s ethics oversight. CSR has evolved from employee-based programs, to justifiable marketing expenses, to most recently a matter of corporate strategy with C-suite and board oversight. CSR is now even woven into issues such as competitive advantage. GlaxoSmithKline’s board chairman, Sir Christopher Gent, for example, also holds the title of chairman of the CSR committee, positioning CSR oversight at the highest level.

For some companies, social responsibility is a core business model. Unilever’s CEO, Paul Polman, insisted in a company report that “the needs of citizens and communities carry the same weight as the demands of shareholders.” Companies with outdated business models may face increasing regulation and public reaction notwithstanding formal CSR efforts. The normalization of sustainable development and New York City Mayor Michael Bloomberg’s effort to ban super-sized soft drinks (recently overturned by a judge) offer two examples.

The mix of corporate unethical behavior and CSR is rampant even among highly respected organizations. Standard Chartered Bank, despite its renowned vision program, recently tussled with New York state regulators over its alleged handling of funds from Iran. And GlaxoSmithKline has paid hundreds of millions of dollars in fines for pharmaceutical sales bribery but boasts of its drug initiatives in developing countries.

One of the reasons for these dichotomies is that many CSR program leaders focus on the benefit to the corporation and even society but fail to demonstrate high ethics standards within the programs themselves. They should start with asking whether CSR activities could potentially do harm or create new risk to the intended beneficiaries. Other leaders neglect the longer-term analysis of the extent of commitment required to ensure that CSR programs are not disruptive. In addition, funding CSR activities with revenue generated by unethical behavior—for example, investment bank revenue from conflict-of-interest-ridden deals or questionable trading practices (unless one believes that funds are ring-fenced and accepts ring-fencing as a solution)—raises ethical questions. Solid organizational ethics integrates CSR into ethics oversight just like any other area of the business. Moreover, just as businesses need to integrate ethics into CSR, nonprofit organization beneficiaries of CSR must also consider the ethics of the corporate donor or partner.

In short, ethics overlies governance, the law, and CSR. It is integral to all of these considerations and to overall organizational success. With ongoing prioritization of ethics oversight, along with governance, legal compliance, and CSR, let’s hope that 2013 yields more positive stories about ethics opportunities than it does scandals about ethics failure. ■