



Best Practices

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Hard Times Spotlight Business Ethics

Most major US companies have an ethics officer, but as investors survey the wreckage of a deepening financial crisis that has exposed behavior ranging from risky to downright illegal, one might ask "What were they doing?"

From Bernard Madoff's alleged \$50 billion Ponzi scheme, to the subprime mortgage crisis, to lavish spending on the chief executive's office at Merrill Lynch, the past year has seen a crisis of confidence in business that cost investors \$6.9 trillion in US stock market value last year.

"The rising market covered a lot of sins and a falling market exposes one's nakedness," said Steve Priest, president of Ethical Leadership Group, a consulting firm that has worked with 50 of the biggest US companies and firms in 40 other countries.

"Investors don't trust the companies they're investing in," he said. "They don't trust the financial statements, they don't trust the audits, and they don't trust the bond rating agencies."

Lax lending standards left banks with too many souring loans and insufficient capital, contributing to the collapse of long-established Wall Street names like Bear Stearns and Lehman Brothers and prompting a \$700 billion US bank bailout.

Millions of ordinary Americans have seen their retirement savings hammered and hundreds of thousands have lost jobs.

All this should inspire companies to embrace the necessity for sound ethical practices. But experts in business ethics say not all companies have got the message.

"I don't think seeing dead bodies in the street always wakes people up," said Roy Snell, chief executive of the Society of Corporate Compliance and Ethics, which has 7,200 individual members who are compliance officers at companies ranging from small businesses to fast-food giant McDonald's. "I've watched this for 13 years. There are always people rationalizing it, saying 'Our people wouldn't do that.'"

Kerry Francis, head of corporate investigations at Deloitte Financial Advisory Services, co-authored a survey this month that showed 63 per cent of executives expect accounting fraud to increase during the next two years because of the recession.

“I do believe that fraud is always going to happen,” Francis said. “The human mind has this ability to rationalize away bad acts. It’s a sad commentary on the human being. That’s why there have to be controls put in place. You can’t have a business with its leadership saying ‘I trust my employees.’ You’ve got to have some kind of monitoring.”

Alex Brigham, executive director of The Ethisphere Institute think tank, said many companies paid lip-service to corporate ethics and compliance, maintaining such departments but sidelining them in major decisions. Brigham said that at crippled insurance giant AIG, rescued with \$150 billion of US taxpayer funds after bad mortgage bets nearly bankrupt it, Joseph Cassano, then head of AIG Financial Products, kicked the company’s compliance officer out of key meetings.

Brigham last month launched the “Business Ethics Leadership Alliance,” inviting corporations to commit themselves to a set of ethical standards and pledge to follow both “the letter and spirit” of the law to curb illegal behavior. Companies that have signed up and will submit themselves to Ethisphere’s audit include PepsiCo Inc, Wal-Mart Stores Inc, Dell Inc, General Electric Co and United Airlines, owned by UAL Corp.

Ethisphere has ranked major companies on their ethical standards for the past three years, and Brigham said there was a marked correlation between ones that had a strong commitment to ethics and transparency, and strong financial results. In the financial sector, he said three victims of the banking blood bath, Wachovia, Washington Mutual and Countrywide, received low scores, while relatively strong survivors, HSBC and Standard Chartered, scored highly on transparency and ethics. But such ethics rankings and prizes are not always reliable.

Just three months before massive fraud was exposed at Satyam Computer Services, an Indian outsourcing firm whose chairman admitted a \$1 billion fraud this month, it received an award from a group of Indian directors for excellence in corporate governance.

Priest, whose firm’s parent company Global Compliance operates whistle-blower hotlines for some 2,500 companies, said there had been a big spike in calls toward the end of 2008. Many companies did little more than “check the boxes” on ethics, he said, abiding by the letter of the law by publishing codes of conduct, without really changing the culture of a company or tackling wider ethical issues.

He said there was a wide gulf between how business defines “ethics and compliance” and how the public see it. “Executive compensation, sourcing, labor, unions, producing quality products, deceptive marketing, pricing, packaging; these are all fundamental concerns of consumers and the public, but very rarely addressed by ethics and compliance types,” he said.

Priest said people were always quick to blame greed in every scandal, but “greed is part of the fuel of the capitalist system. We’re never going to see a time when individuals or businesses all behave ethically and responsibly.”

Bill Lytton, who was hired as general council at Tyco International Ltd to clean up after then-chief executive Dennis Kozlowski and financial chief Mark Swartz stole more than \$150 million from the company, said the key to avoiding ethical disaster was good leadership by example.

He recalled that when he worked previously for GE, then-CEO Jack Welch publicly praised a manager who failed to reach his sales targets because he refused to pay a bribe to win a contract to build engines for a foreign airline. “Sometimes you want to be able to cite a good failure, somebody who didn’t make the numbers, but for all the right reasons,” Lytton said.

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