

FOCUS

*The Moral Compass of
Companies: Business Ethics
and Corporate Governance as
Anti-Corruption Tools*

John D. Sullivan

Foreword by Georg Kell



Global
Corporate
Governance
Forum



Copyright 2009.
International Finance Corporation
2121 Pennsylvania Avenue, NW
Washington, DC 20433

All rights reserved.

The findings, interpretations, and conclusions expressed in this publication should not be attributed in any manner to the International Finance Corporation, to its affiliated organizations, or to members of its board of Executive Directors or the countries they represent. The International Finance Corporation does not guarantee the data included in this publication and accepts no responsibility for any consequence of their use.

The material in this work is protected by copyright. Copying and/or transmitting portions or all of this work may be a violation of applicable law. The International Finance Corporation encourages dissemination of its work and hereby grants permission to the user of this work to copy portions for their personal, noncommercial use, without any right to resell, redistribute, or create derivative works there from. Any other copying or use of this work requires the express written permission of the International Finance Corporation.

For permission to photocopy or reprint, please send a request with complete information to:

The International Finance Corporation
c/o the World Bank Permissions Desk
Office of the Publisher
1818 H Street NW
Washington, DC 20433

All queries on rights and licenses including subsidiary rights should be addressed to:

The International Finance Corporation
c/o the Office of the Publisher
World Bank
1818 H Street, NW
Washington, DC 20433
Fax: +1 202-522-2422

The Moral Compass
of Companies:
Business Ethics and
Corporate Governance as
Anti-Corruption Tools

John D. Sullivan

Foreword by Georg Kell

Global Corporate Governance Forum
Focus 7

ACKNOWLEDGEMENTS

I am deeply indebted to Jose Cruz-Osorio and Aleksandr Shkolnikov for the many discussions that led to the issues and ideas reflected in this publication. I am also grateful to Ghita Alderman and Philip Armstrong for providing valuable feedback and comments on previous drafts and to Michael J. Kelly for editing the text.

I wish to provide special recognition to the participants of the International Consultation, *The Role of the Private Sector in Ethics and Corporate Governance in the Fight Against Corruption* — sponsored by the Global Corporate Governance Forum (Forum) and the Center for International Private Enterprise (CIPE), held in Paris, France, March 3, 2008 — whose insights, comments, and contributions helped to finalize this *FOCUS* publication. Special thanks are due to: Abdesselam Abourdrar, Christopher J. Ailman, Soji Apampa, Igor Belikov, Jermyn Brooks, Wilson Carnevalli Filho, Patrick Chisanga, Tawfik Diab, Badri El Meouchi, Jesus P. Estanislao, Karugor Gatamah, François Georges, Ola Peter Krohn Gjessing, Noke Kiroyan, Dominique Lamoureux, Willem A. Landman, Ernst Ligteringen, Brady K. Long, Olajobi Makinwa, Edward O'Keefe, Adalberto Palma Gomez, David Pitt-Watson, Michael H. Rea, Viviane Schiavi, and Friso Van der Oord.

TABLE OF CONTENTS

Acknowledgements	ii
About the Author	iv
Foreword by Georg Kell	v
Chapter 1: The Corporate Governance and Anti-Corruption Nexus	1
A. Introduction.....	1
B. A Definition of Corruption	6
C. A Definition of Corporate Governance	9
D. The Business Case for Fighting Corruption.....	12
Chapter 2: Corporate Ethics as a Culture of Doing Business.....	16
A. The Evolution of Business Ethics as an Operational Nexus Between Corporate Governance and Anti-Corruption	19
Business Ethics.....	19
Business Ethics and Anti-Corruption	25
Ethics and Boards of Directors.....	25
B. Personal and Business Risks Stemming from Corruption	28
C. Building a Culture of Ethical Business Conduct: Codes of Ethics.....	29
D. Mainstreaming Ethics into Good Corporate Governance	36
E. Getting Started: Initial Steps and Decisions	38
Conclusion	42
Selected Internet Resources (For Further Reading)	45
Bibliography	49
Notes	55

ABOUT THE AUTHOR

John D. Sullivan is Executive Director of the Center for International Private Enterprise (CIPE), an affiliate of the US Chamber of Commerce. As Associate Director of the Democracy Program, John helped to establish both CIPE and the National Endowment for Democracy in 1983. Under his leadership CIPE developed a number of innovative approaches that link democratic development to market reforms including: combating corruption, promoting corporate governance, building business associations, supporting the informal sector, and programs to assist women and youth entrepreneurs. CIPE has implemented over 1,000 programs in more than 100 countries in partnership with think tanks, business associations, civil society groups, and educational institutions. More information including a list of current projects and publications can be found at www.cipe.org.

FOREWORD

Ethics, anti-corruption, and corporate governance practices figure today as mainstream considerations in business decisions about competitive advantage and financial performance. Ten years ago the story was altogether different. At best, these topics were acknowledged as marginal non-financial issues, and at worst, they were rejected or denounced as irrelevant to the core objective of profit maximization. Companies from all industries and of all sizes, and across all regions of the world, now readily embrace these topics as strategic components of their long-term business sustainability.

The shift of non-financial issues from marginal to mainstream components of business decision making is among the most positive developments that we can observe over the past decade or two. The implications of this shift, as well as of its evolving application, will be of fundamental importance to the future of global economic integration, national development and poverty reduction. As this *FOCUS* publication aptly illustrates, today we have a robust set of tools and practical guidelines for good corporate governance that did not exist a decade or two ago. Moreover, with the greater awareness and willingness by the corporate world to engage in this good governance agenda, there is growing global consensus — supported by international conventions and national legislative frameworks — on what standards, values, tools and policies constitutes good practices.

Global economic integration has been a driving force behind the rapid progress of developing and disseminating good corporate governance practices and standards. Investors, regulators, shareholders, directors, executives, and the media have all played important roles in this change process, especially within the context of emerging markets. As one concrete example, of the 6,000 companies and stakeholders that are adopting sustainable and socially responsible policies within the framework of the United Nations Global Compact since its creation in 2000, more than half are from emerging markets. As agents of change — and industry leaders — all these signatories recognize that managing non-financial issues based on shared responsibility and collaboration is not just central to their competitiveness and global brands, but even more importantly, to the modernization of the countries and societies where they operate. Improving good governance is a never ending challenge with unlimited room for innovation, but we are building and scaling up from a higher benchmark of corporate governance standards and ethical values that were absent a generation ago.

As this publication goes to print in February 2009, the world is facing a financial crisis of unprecedented global scale and reach. It remains unclear to what degree policy responses will transform the incentives that drive private enterprise. The biggest change observed so far is the leading role being assumed by governments to stimulate economies, create jobs, and make structural changes to the prevailing financial architecture. Such government intervention presents both risks and opportunities. The obvious risk is that national interests will trump market imperatives, competition and further global integration. On the opportunity side, however, greater government intervention has the potential to accelerate and support good efforts being made by the private sector through voluntary initiatives, particularly those that create incentives that explicitly promote and reward ethical corporate behavior and good governance. Thus, the private sector is and should be a stakeholder in the process of building and sustaining an effective transparency and accountability framework that prevents corruption and champions good corporate governance. This *FOCUS* publication reflects the good practices that companies and executives are implementing to build ethical business organizations. We are far from seeing universal and dramatic progress, but the gained lessons position us to address more effectively the challenges and dilemmas that corruption poses to individuals and the institutional framework of our countries and societies. From this vantage point, this *FOCUS* publication is a timely roadmap to both practitioners and policymakers who want to build on the progress and best practices achieved to date, rather than attempt to reinvent the wheel at a critical crossroads.

The bottom line is that corporate governance is an important part in curbing corruption and that all private sectors stakeholders — investors, shareholders, regulators, media, etc. — have a role to play in achieving this objective. This is particularly true of boards of directors whose members bear the ultimate responsibility for the moral ethics and integrity standards that underpins the culture of how a company conducts business. This fundamental point applies equally to any type of company, whether its operations are global, national or local, or whether its annual revenues are \$10 billion or \$1 million. The fight against corruption starts with leadership, the rule of law, and effective social, political and economic institutions. Such leadership requires a great deal of personal commitment, courage, and perseverance — guided by strong ethical values — to confront and end those corrupt practices that permit individuals to abuse positions of entrusted power for personal gain.

Our initial progress now places anti-corruption, business ethics and the sustainability agenda at the forefront of good corporate governance. It is the experience and lessons of this recent best practice that this *FOCUS* publication illustrates with comprehensive clarity. Its great merit lies in sharing, examining, learning and applying the best elements of this experience to a framework of good corporate governance. It is also an important contribution to a very small but growing body of literature on the linkages between corporate governance, business ethics, and anti-corruption. Our collective success in the next stage of anti-corruption efforts rests on our ability to foster the use of practical solutions, as offered throughout this publication, and encourage ownership and leadership. For private sector development to flourish, especially for the majority of companies that worldwide thrive in the small and medium scale sectors, anti-corruption efforts must be effective, vigilant and constant.

Georg Kell

Executive Director

United Nations Global Compact

“There is seldom just one cockroach in the kitchen”

WARREN BUFFET

Stanford Business Magazine, August 2008

CHAPTER 1: THE CORPORATE GOVERNANCE AND ANTI-CORRUPTION NEXUS

A. Introduction

It is widely accepted that corruption, be it corporate or political, petty or grand, has become a worldwide problem. This acceptance is attested to by the host of international conventions and efforts designed to stamp it out. However, opinions vary as to who ultimately bears responsibility for that corruption, how that corruption can be reduced, and who will take the lead in its eradication.

One thing though is clear — in dealing with corruption, there are no simple answers. Corruption has many faces and many moving parts. In some instances business can be a source of corruption, in others — it is simply a victim. Some governments only pay lip service to combating bribery, while others genuinely attempt to put in place transparent institutions. In some countries, citizens accept institutionalized corruption as the reality of day-to-day transactions, while in others they refuse to give up without a fight.

Corruption is a corrosive drain on public trust and on the legitimacy of public and private sector institutions. Its toll can be devastating to a national economy, particularly at a time when open global markets can rapidly reverse investment and capital flows if confidence and trust are compromised by revelations of systemic corruption. Corruption affects all types and sizes of business firms — from global conglomerates to Small and Medium-Sized Enterprises (SMEs) and co-operatives — each with varying degrees of resources and capabilities to deal with the consequences. It has the power to destroy firms and with them the livelihoods of stakeholders who depend on a company's success. This further dehumanizes and undermines the reputation of the private sector as a positive force for economic growth and development in poor countries.

Today, often on a daily basis, television and newspaper headlines are filled with corporate corruption scandals that range, from minor cases of individual corruption to multi-billion dollar corporate collapses that shock the conscience of society. It is ironic that this onslaught of media coverage shapes the public's negative image of the private sector, at a time when business standards of ethics, transparency, and accountability are perhaps at their strongest and highest level, and continue to evolve.

The private sector can be a force in developing solutions to the corruption problem, and companies around the world are taking charge. They are doing it in a multiplicity of ways. Some engage in collective action to reform the business climate to make it more transparent. Others push for ethical standards and fair practices in dealing with the government, as is the case with industry initiated integrity pacts. These private sector solutions to corruption however are not only external in nature and so many companies are also beginning to look inside, seeking ways to ensure that they are not unwittingly contributing to the climate of corruption. For example, and this is just one of the issues facing modern companies, how do you make sure that leadership calls for anti-bribery trickle down through the whole company, down to the last employee on the ground in a different country thousands of miles away?

One way of addressing this dilemma and others is the establishment of strong corporate governance. It is increasingly emerging not only as a tool that increases efficiency, improves access to capital, and ensures sustainability — it is also emerging as an effective anti-corruption tool. Simply put, on the day to day transaction level it makes bribes harder to give and harder to conceal. At the decision-making level, it injects transparency and accountability, so that it is very clear how decisions are made and why. And, underlying the very roots of corporate governance, and providing its moral compass, is ethics.

The ethical behavior of companies is rarely recognized as a cornerstone of good corporate governance. Yet, in many ways, ethics underlies much of business behavior, whether it is at the board or staff level, and regardless of a company's geographic location, size, or industry. The moral underpinnings of the decision-making processes can be observed not only in a large company from an OECD (Organization for Economic Co-operation and Development) country doing business in its own back yard but also in a small business from a developing country engaged in regional trade. Still, while ethics underlies much of what we do, the actual ethical performance of individuals and the companies they represent differs among and between countries, often significantly; and these variations can in large part be explained by the differences in political, economic, and social institutions.

Often, business and ethics are viewed as two separate worlds. Yet, sustainable business, as many early thinkers of today's economic theory have argued over the centuries, is defined by the ability of companies to do repeat transactions with their customers. Customers need to feel that they are treated fairly and honestly. This in turn, depends much on the quality of institutions, such as contract

enforcement, rule of law and property rights, as well as, business ethics — moral guidelines of behavior. In places where institutions are weak, ethics plays a much more fundamental role in facilitating repeat business transactions and, as such, a sustainable private sector.

Moreover, ethics, as a concept and as a practice, extends far beyond individual business transactions — it underlies much of our daily life as private citizens. The Universal Declaration of Human Rights has over time established a global consensus on the applicability of universal moral principles across all types of cultures and nations. These principles are now reflected in today's landmark documents of business ethical behavior: OECD Anti-Bribery Convention; UN Convention against Corruption; World Economic Forum's Partnering Against Corruption Initiative-Principles for Countering Bribery; Transparency International's (TI) Business Principles for Countering Bribery; International Chamber of Commerce Rules of Conduct to Combat Extortion and Bribery; and the UN Global Compact Principle 10 on Anti-Corruption, among others.

Ethics in the business world is not only about global conventions and statements — it is also about meaningful actions and the personal commitment to raise ethical standards (see Table 1). The corporate sector is replete with examples of firms that profess strong ethical cultures on paper but become unraveled by corrupt behavior. Having a strong sense of ethics is not a guarantee that a company will always do the right thing. But the opposite is also true: many companies have started from poor reputations and set new benchmarks of corporate ethics. The key component underlying much of what the best ethical companies do is leadership. Leadership — made visible through actions, commitment, and examples — sets the moral tone that emanates from the top of a company and that translates ethical principles into the concrete behavior expected from all persons acting on behalf of a company.

An important factor in dealing with corruption is the establishment of strong public and private regulating institutions. Differences in institutions between countries are one of the reasons some countries are more corrupt than others. TI's Bribe Payers Index data, for example, suggests a positive relationship between the weakness of a country's market and democratic institutions on the one hand and the likeliness that companies from that country will pay bribes to get business deals. This *FOCUS* publication looks closer at how different institutions and leadership practices come together to create ethical companies and reduce corruption.

Table 1. Corporate Governance-Ethics Matrix

In the following matrix we identify the likely scenarios that corporate stakeholders will face in the presence of a strong or weak environment in either corporate governance or ethical culture. Each scenario presents opportunities for corporate leaders to move to the ideal bottom right-hand quadrant, namely by becoming an exemplar for how to build an ethical organization and become an industry leader for good corporate governance practices.

		CORPORATE GOVERNANCE FRAMEWORK	
		WEAK	STRONG
ETHICAL	WEAK	Focus on Overcoming Systemic Corruption	Focus on Building an Ethical Organization
	STRONG	Focus on Improving Corporate Governance Framework	Focus on Compliance, Disseminating Best Practice Experience

Good corporate governance practices cannot be imposed by fiat, even if promulgated by the highest levels of leadership. Similarly, companies will find it hard to comply with corporate governance regulations if there are no initiatives to improve the overall legal and regulatory climate in a country. Nor can corporate governance exist in a vacuum. Ethics, morals, and values (internally) and institutions (externally) guide how corporate governance is developed and implemented to benefit not only businesses themselves but societies as a whole.

In short, the existence of sound corporate governance standards does not guarantee a corruption-free environment. Often, exposed corruption is a

Timetable of Key Milestones in Business Anti-Corruption Efforts

U.S. Foreign Corrupt Practices Act passed	U.S. Sentencing Commission issues Federal Sentencing Guidelines (revised 2004)	Cadbury Report on Corporate Governance in UK issued	TI established	South Africa King Report on Corporate Governance issued (revised 2002)	TI Corruption Perception Index (CPI) launched	World Bank Anti-Corruption Strategy issued (revised 2007)
1977	1987	1992	1993	1994	1995	1996

Exposed corruption is a manifestation of weak corporate governance practices.

manifestation of weak corporate governance practices, with unethical behavior at the root of the scandal.

But exposed corruption can also be a positive sign — the measures to expose and prevent it are working. Overall, corporate governance by itself should not be regarded as a panacea or an automatic cure for all corporate ills. However, if bolstered by the values and behavior engendered in genuine ethical organizations with sound governance standards, corruption becomes the exception rather than the rule.

This *FOCUS* publication targets private sector stakeholders who want to reduce a company’s risk and vulnerability to corruption. It aims to provide guidance and recommendations for integrating ethics programs into corporate governance mechanisms to safeguard against corruption. The publication sheds current thinking on the dynamics between corporate ethics, corporate governance, and anti-corruption, and examines the business case for countering corruption. The primary aim of this *FOCUS* publication is to help business leaders meet the ethical challenge in the context of fierce global economic competition and not fall into the trap, and ultimately vicious cycle, of corruption.

The rise of worldwide democracy, accountability, and transparency has reduced the tolerance for corrupt behavior, and raised governance standards for both companies and nations as a whole. For companies, ethical values are proving to be the missing link between the integrity of business operations and strict adherence to free-market incentives. Hence, the moral compass analogy, as noted in the title of this *FOCUS* publication, is an apt metaphor to signal that leadership is ultimately responsible for setting the course by which business operations succeed or fail in meeting the moral expectations of society and the financial goals of investors.

OECD Convention on Combating Bribery adopted	OECD Principles of Corporate Governance issued (revised 2004)	TI Bribery Payers Index (BPI) launched	Sarbanes-Oxley Act passed	TI Business Principles for Countering Bribery launched	UN Convention Against Corruption enters into force	UN Global Compact Principle 10 adopted
1997	1999	2000	2002	2003	2003	2004

B. A Definition of Corruption

Transparency International's (TI) definition of corruption is succinct and yet comprehensive: "the abuse of entrusted power for private gain." TI's simple definition encapsulates a number of key elements:

- It applies equally to all three sectors of governance: private, public and civil society;
- It refers to both systemic and individual abuses that can range from dishonesty to illegal and criminal activities;
- It covers both financial and non-financial benefits;
- It points to the importance of governance systems in controlling and regulating how authority is exercised; and,
- It highlights the inefficient costs associated with corruption, the diverting away resources from their intended use.

Systemic corruption is by far the most damaging and the one that is most difficult to analyze and prescribe solutions. Its effects are well documented in the literature but it can still be too difficult to isolate the complex web of variables and factors that account for its damaging effects on:

- Undermining property rights,
- Weakening the rule of law,
- Limiting private sector growth,
- Eliminating incentives to invest,
- Debilitating institutional capacity, and
- Delaying economic and political development.

Equally damaging to society is what Kaufmann (2000) defines as "state capture", particularly in the context of transition economies where companies make payments to government officials to shape legal and regulatory environments that help them create and maintain market control.

THE COSTS OF CORRUPTION

Costs of corruption on the country level are well documented in a variety of studies. They can be briefly summarized as:

- **Resource misallocation.** Resources that could be put to productive uses are instead devoted to corruption. Firms waste time and resources on rent-seeking — cultivating relationships with officials and spending on bribes. Officials make biased investment decisions that do not serve the public interest, and taxpayers swallow the cost.
- **Lower investment.** Foreign and domestic investors are scared off by unpredictable costs. Rampant corruption signals to potential investors that the rule of law, and thus property rights, are very weak in the country, making an investment there a risky proposition. Lower investment means lower growth.
- **Reduction in competition, efficiency, and innovation.** Rent seeking means that favored companies do not compete on market signals alone, while new firms face high barriers to entry. Consumers end up paying in terms of higher prices, lower quality, and limited product offerings.
- **Unresponsive policies and poor administration.** Lawmakers in corrupt systems use their powers to help rent-seekers, not the citizenry as a whole. Bureaucrats are not held accountable for their performance and actually have incentives to delay services in order to extract bribes.
- **Lower employment.** By forcing businesses into the informal sector, creating barriers to entry, and increasing the costs of doing business, corruption essentially reduces private sector employment, because firms are less likely to grow. Small businesses are hit especially hard.
- **Exacerbated poverty.** Corruption lowers the income potential of the poor because there are fewer private sector opportunities. It also limits their access to quality public services such as healthcare and education.

As easy as it may be to identify the direct and indirect costs of corruption identified above, it is very difficult and practically impossible to put a reliable price tag of the costs they impose on society. Very few estimates exist, particularly of the impact at the global level. In 2004, using economic data from 2001-02, when the size of the world economy was just over US\$30 trillion, the World Bank estimated the cost of bribery at US\$1 trillion per year worldwide. This amount — which represents a small portion of total direct and indirect costs — reveals not only the crisis proportion of corruption but also the significant benefits to be gained from committed anti-corruption actions.

The art of crafting preventive and punitive measures for a corruption-free environment remains a central topic in the literature. Preventive measures involve working through a country's legal framework and a society's moral norms to eliminate corruption incentives. Examples of these preventive measures include the quality of procurement laws, business regulations, codes of conduct, freedom of information legislation, and independent oversight mechanisms. Punitive measures, on the other hand, are the post-facto prosecution and application of specific sanctions to acts of corruption, with the intention to generate untenable costs that deter future corrupt behavior.

Recent literature on corruption has decisively discredited earlier cultural and moral arguments that attempted to explain the existence of corruption in developing countries. The 1970s entertained popular notions that endemic corruption plaguing many of these nations was a natural byproduct of the culture and moral fabric of its society. Since then, the corruption literature has proven that corruption is independent of culture, as it can be found with equal manifestation in the most advanced economies and liberal democracies, and in all types of cultural and moral beliefs. The 1985 work by John T. Noonan, *Bribes*, is considered a classic work that refutes the "culturally determined" argument of corruption, showing that no culture throughout civilization's long history condones bribery.

Another key contribution of the corruption literature in the last decade has been the development of more rigorous indicators to measure corruption and to use this as a means to formulate policy prescriptions that tackle its root causes. Ten years ago such indicators were scarce and very rudimentary. Today, the World Bank's Worldwide Governance Indicators (WGI) project, *Governance Matters VII: Governance Indicators 1996-2007*, is a classic reference. It covers 212 countries, 35 different data sources, and 6 governance dimensions, one of which is "controlling corruption". WGI validates a salient finding from the time-series data: on average, the "controlling corruption" dimension shows hardly any positive movement for both developed and developing nations, which is not the case for the other five governance dimensions measured by the report. The policy implication of this finding confirms knowledge drawn from experience: it is very difficult to eliminate and control corruption. However, a second salient finding is what the authors refer to as the "300% development dividend", namely that better governance (the aggregate of the six dimensions) translates to a three-fold increase in per capita income in the long run. So improving governance matters to the fight against corruption and, more generally, to broadening the opportunities to escape poverty.

Additionally, the 2006 Transparency International (TI) Corruption Perceptions Index, which measures 163 countries, reveals that nearly half of all countries scored below 3 out of a possible 10 points, indicating that half of the world is faced by widespread corruption. The 2006 TI Bribe Payers Index, which examines the propensity of companies from 30 leading exporting countries to bribe abroad, offers a similar stark picture. Bribery from the world's corporate titans is common despite the existence of international anti-bribery laws criminalizing such practice. Also, surveys of business executives repeatedly show that companies fail to win new business because of bribery by competitors. Executives further point to the worrying actions of companies that use complex business networks to conceal and spread corruption, in effect "outsourcing" bribery and unethical behavior.

C. A Definition of Corporate Governance

As Sir Adrian Cadbury explained in the seminal 1992 Report on Financial Aspects of Corporate Governance (popularly acknowledged as the "Cadbury Report"):

"Corporate governance is the system by which companies are directed and controlled....Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting."

In order for an effective relationship to be maintained between the providers of capital and company managers, high levels of trust must exist between the two groups. For sufficient levels of trust to occur, four overarching corporate governance principles need to be in place:

- **Transparency:** Directors must make clear to the providers of capital and other key stakeholders why every material decision was made.
- **Accountability:** Directors should be held accountable for their decisions and account to shareholders by submitting themselves to appropriate scrutiny.

- **Fairness:** All shareholders should receive equal consideration by the directors and management with a sense of justice and avoidance of bias or vested interests.
- **Responsibility:** Directors should carry out their duties with honesty, probity, and integrity.

With corruption being understood as an outcome of poor governance, the definition and practice of corporate governance is increasingly expanding beyond its traditional understanding of legal rights and obligations. In the 1999 Corporate Governance Overview report of the World Bank, Sir Adrian Cadbury further qualifies his “traditional” definition cited above:

“Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals...the aim is to align as nearly as possible the interests of individuals, corporations and society.”

Ethics and moral norms now set a new benchmark for choosing to “do the right thing” in business practices. Corporate scandals of excessive fraud, greed, dishonesty, and bribery have slowly turned the tide so that today corporate codes of ethics are the norm rather than the exception. This evolution is only a few decades old but its principles are reflected in current definitions of corporate

governance and solidly codified in the OECD and UN international conventions against bribery.

Ethics and moral norms now set a new benchmark for choosing to “do the right thing” in business practices.

ETHICS, MORALS AND VALUES — THE INTERRELATIONSHIPS

One challenge for the business community, particularly those operating in a multicultural or multinational environment, has been to find a source or standard that can anchor an ethics code, independent of national culture or local issues. To put these kinds of considerations into context, it is useful to take a step back and look at the historical development of ethics in business practice.

From the time of the earliest civilizations, public authorities, philosophers, and business leaders have been concerned with ethics. The term ethics comes from the Greek *ethikos*, which has several meanings. First, ethics can be thought of as dealing with what is good and bad, with moral duty and obligation. Second, ethics can be seen as a particular set of moral principles or values. In some settings, these ethical standards are unique to a particular culture, while in others, they might be part of the common cultural heritage of all nations, such as the Universal Declaration of Human Rights. Third, ethics can be thought of as the principles of conduct governing an individual or a group. That is, a professional ethics standard such as business ethics, banking ethics, more recently accounting or advertising ethics. Fourth, ethics is also traditionally a branch of philosophy, and is related to the development of the ideas of a market economy.

Many of the original philosophers of markets, such as Adam Smith and David Hume, were quite concerned with establishing an ethical foundation or a moral code to govern commerce. The feeling that these philosophers shared and the legacy that they have left, is that in order to guarantee the orderly transactions within a market system, some standard, some objective utilitarian standard of behavior, needs to be established in order to ensure that markets could perpetuate over time. In a sense, this is a reversal of the traditional Latin or Roman concept of *caveat emptor*, or “buyer beware”.

When one establishes this type of ethical code, the goal is to establish the grounds for fair dealing between buyer and seller, borrower and lender, investor and company.¹ Over the centuries, philosophers and leaders have attempted to set out both ethical values and general guides for codes of conduct. They generally took great care to try to establish some independent or objective standard from which these codes could be derived.

(CONTINUED NEXT PAGE)

The first recorded comprehensive ethical guide was the *Code of Hammurabi* developed in C. 1780 BCE and running to some 282 directives, the Code became the foundation for the Kingdom of Babylon. Although many of the provisions in the Code, such as those regulating slavery, will be seen as unethical by modern standards, the code did establish a set of rules making commerce and civilization possible. As such, it is often referred to throughout the Middle East.

Other ancient civilizations developed codes or principles of their own, including the “Analects of Confucius” (C. 500 BCE), the “Ten Commandments” of Moses, and the *Koran*. Each of the civilizations where these principles were developed sought to establish codes of conduct and principles to ensure that societies could be held together. From the time of the ancient Greeks through the Enlightenment, philosophers, scholars, and others have attempted to create ethical systems, based on general principles, to guide behavior.

The works of philosophers such as Aristotle and Immanuel Kant are cited in American business schools today. Articles published in business schools² give future business leaders grounding in the moral dilemmas that philosophers have considered on over the centuries, by packaging it in a practical guide so that business leaders begin to think about ethics as a set of principles and guidelines for behavior rather than a set of simply rigid rules. The business world is beginning to recognize one of the key challenges facing business in a multicultural world — to develop ethical guidelines that are meaningful to employees from a wide variety of cultural and geographical backgrounds.

D. The Business Case for Fighting Corruption

From a strictly empirical point of view, the evidence remains both minimal and elusive for making an irrefutable business case for ethical business behavior. Experience, however, shows that companies that adhere to ethical standards perform better financially in the long run than those without such a commitment. Academic research and case studies, which are just beginning to take systematic interest on this topic, largely support this finding.

The dearth of evidence is largely due to the fact that ethics has been regarded as an intangible factor in financial performance. Two U.S. scholars, Joshua Margolis and James Walsh, found that from 1973-2000 only 95 academic studies appeared on the relationship between Corporate Social Responsibility (CSR) and financial performance. And though conflicting articles exist to prove both a positive and negative correlation between ethical companies and financial performance, such data does not detract from the accumulated practical knowledge that corporate ethics programs play an important part on a company's bottom line.

EXISTING FACTS AND FIGURES ON THE VALUE OF ETHICAL BEHAVIOR

Although ethical behavior is considered more as the right thing to do than a calculation of whether it leads to higher business profits, numerous attempts have been made to estimate the financial value of ethical behavior and good corporate citizenship. There are quantitative and perception studies, all fraught with methodological flaws since there are no reliable indicators with which to measure the financial gains of business ethics. But despite methodological compromises, all tend to support the intuitive knowledge that entrepreneurs gain from business experience: integrity is the foundation of sustainable business and contributes to greater shareholder value. Two researchers (Margolis and Walsh, 2002) analyzed 95 studies produced over a 30 year period examining the link between social and financial performance, and found a strong positive correlation between ethical and financial performance. Perception surveys also reveal consistently across different countries, cultures, and industries the belief that ethical companies are more successful than those that are not, particularly over the long run. It may be difficult to accept the value of business ethics without precise figures, particularly in a managerial age that is accustomed to using precise metrics for decision making and managing operations. However, the business world is filled with case studies of corporate collapses and severe financial losses stemming from weak or in-existent corporate ethical cultures. The opposite is also true: plenty of qualitative evidence demonstrates that ethical behavior pays off over time with brand and corporate reputation, customer and employee loyalty, and just as important, overcoming crisis situations that place the company's survival in jeopardy.

More recent studies are providing strong evidence that good corporate governance and business ethics policies lead to increased business success. Two McKinsey surveys — *Global Investor Opinion Survey (2002)*, and *Global Survey of Business Executives: Business and Society (2006)* — interviewed over 200 institutional investors who collectively manage approximately US\$2 trillion in assets, and 4,238 executives (more than a quarter being CEOs) from 116 countries, respectively. The first survey revealed that investors are willing to pay a premium for companies that demonstrate high governance standards: average premiums of 12-14% in North America and Western Europe, 20-25% in Asia and Latin America, and over 30% in Eastern Europe and Africa. Interestingly, the second survey showed that whereas more than half of all executives employ public relations and lobbying as strategies to manage social and political challenges, a larger proportion believe that more effective strategies are to be found in developing ethics policies and increased transparency about the risks of products or processes.

Similarly, two studies from the UK Institute of Business Ethics — *Does Business Ethics Pay? (2003)* and *Does Ethics Pay? (2007)* — based on a comparison of FTSE 250 companies established a strong positive relationship between business ethics and financial performance. In comparing companies that demonstrated a commitment to business ethics with those that did not, and using the existence of a code of ethics as a proxy for such commitment, the first 2003 study found that overall the companies with codes of ethics performed better against 4 different measures of financial performance: Economic Value Added, Market Value Added, stable Price/Earning Ratios, and Return on Capital Employed. In

Best-practice companies can be proactive agents of change, simply by voluntarily agreeing to raise their standards of business ethics.

2007, this study was revisited by going a step further: companies that were implementing ethics training programs were compared with those that professed only a commitment to business ethics (the better performers from 2003 study). Consistent with the 2003 results, the second 2007 study

revealed that companies that took steps to implement its declared ethical values financially outperformed those that did not go beyond a declaration of commitment to business ethics. Additionally, Kaufmann, Kraay, and Mastruzzi (2005) find that global companies have the means and the power to shape the business climate where they operate. Best-practice companies can be proactive agents of change, simply by voluntarily agreeing to raise their standards of business ethics.

Companies like human beings do not exercise consistent moral behavior. But with growing transparency and accountability in a globalized economy, ethical organizations acquire sound business sense in the competitive marketplace. In Chapter 2 we explore the dynamic of the ethical organization acting with greater responsibility and integrity toward customers, community, and stakeholders, both internal and external. We will also present current best practice tools to build an ethical organization, where doing business harmonizes financial success and social progress.

CHAPTER 2: CORPORATE ETHICS AS A CULTURE OF DOING BUSINESS

The legal and regulatory framework within a national context sets the minimum standards of acceptable conduct in doing business, and reflects what society holds as fair and appropriate behavior by all types and sizes of firms. Thus, compliance with national laws is the starting point for doing the right thing by private sector organizations. Company executives, and the board of directors that provide oversight over management decisions, rely on a battery of internal policies, guidelines, regulations, and governance mechanisms to meet their compliance obligations. With increasing frequency, these governance systems transcend the minimum floor established by law and reflect the higher level of business ethics aspired to by companies. The variance of ethical performance found across companies covers a spectrum ranging from merely complying with legal requirements to setting new standards for responsible business behavior.

BENCHMARKING COMPANIES' ETHICAL PRACTICES

The 2007 World's Most Ethical Companies (WMEC) global ranking from *EthiSphere* Magazine recognizes companies that use ethical leadership as a profit driver, and that exemplify the best practices across 30 separate industries. The 91 recognized companies emerged after editors screened more than 5,000 companies against 9 ethical leadership criteria: governance, citizenship, internal systems, legal and regulatory, innovation, executive leadership, industry leadership, perception and reputation, transparency. The criteria are representative of the major issues that are leveraged by visionary leaders to build an ethical organization. And though some may not agree with *EthiSphere's* methodology, by recognizing current best practice the WMEC shows the path to be traveled by competitors who want to catch up and surpass the leaders.

The codes of conduct of the four highest ranked companies can be accessed at the following links:

Standard Chartered: www.standardchartered.com/documents/code-of-conduct/sc_codeOfConduct_010405.pdf

Thrivent Financial for Lutherans: www.thrivent.com/aboutus/codeofconduct/

Computer Associates: www.ca.com/us

Sun Microsystems: www.sun.com/aboutsun/sbc/SunStandardsBusinessConduct.pdf

Building ethical organizations is no easy task, but a commitment to such an ideal reflects a broader understanding of private sector enterprise, where meeting the core purpose of maximizing profit is in balance with the broader interests of society. This principle is reflected in the expanded definition of corporate governance given by Sir Adrian Cadbury, as covered in chapter one, and also captures the broader corporate commitment to the sustainability³ agenda.

The regulatory framework in advanced market economies can be very comprehensive in the demands it places on a firm's disclosure, reporting, and corporate governance requirements. Stringent requirements go a long way in creating robust checks and balances on inappropriate business behavior. However, even under ideal conditions, such regulatory environment is never enough to safeguard against corruption.

Ultimately, building an ethical organization has to do more with individual leadership and organizational commitment than about mere compliance with formal processes or systems. The exercise of such leadership is often referred to as "setting the tone at the top and its significance applies equally to both internal and external stakeholders. As it is with trust, it takes long-term organizational efforts and investments to build a corporate ethical culture but it only takes a second of poor judgment or bad luck to undermine it beyond repair. Thus, any exceptions to the ethical standards and values that are internally promulgated will generate apathy and undermine all efforts. Externally, any scandal, no matter how trivial it may appear, can instantly destroy the progress made through years of hard work and invested resources.

The best way to protect the ethical culture of an organization is to actively promote it, practice it, train in it, update it, and make it real and visible to external and internal

stakeholders. In other words, the development of an ethical culture results from the continual and ongoing corporate commitment to integrate and align a company's ethical standards with business strategy and operations. In turn, such process is institutionalized through the implementation of a comprehensive ethics program whose various elements are elaborated further below. Managers, the board, and

The best way to protect the ethical culture of an organization is to actively promote it, practice it, train in it, update it, and make it real and visible to external and internal stakeholders.

staff at all levels must exemplify through behavior and decisions the values and standards defined in an ethics program, even to the degree where leadership in

particular is seen to “eat, drink and sleep” ethical behavior.

Good corporate governance and concrete ethical standards are strong allies to help companies navigate the mine fields of corporate corruption.

Senior executives have the paramount responsibility to embed ethical behavior into the culture of the company.

By leadership, boards and CEOs can build an ethical organization and become the benchmark to be

emulated by competitors, industry peers, and the private sector in general. Such visible commitment helps keep the organization on track to progress from just having a firm commitment to business ethics to creating an organizational culture where ethics is a central consideration in business decisions across all layers of a company. The perceived and observed behavior by senior management sets the tone throughout the company, it establishes the commitment and reputation of anti-corruption initiatives, and it shapes the identity of the company.

To an ethical organization, ethics is about doing business right, not an issue of compliance. In practice this means that to uphold its ethical philosophy, at times a company must stand ready to lose business before compromising its values. However, by having in place a comprehensive ethics program that is aligned to its business strategy, a company can rely on institutional checks and balances that will help it make the right decisions when faced with challenging ethical dilemmas. Good corporate governance and concrete ethical standards are strong allies to help companies navigate the mine fields of corporate corruption. We now turn our attention to the nexus of these two interdependent components.

A. The Evolution of Business Ethics as an Operational Nexus Between Corporate Governance and Anti-corruption

Business is often perceived as the cause of corruption. While this can certainly be the case, the business community is rarely thought of from another perspective — as a real victim of corruption and even less so as a solution. To control corruption in the private sector context, a variety of legal and regulatory tools are often proposed — some more effective than others. While such tools are important in creating a climate where companies behave according to principles of transparency and fair competition, they nonetheless require another dimension for anti-corruption initiatives to be truly successful. That dimension is business ethics which exemplifies the underlying nature of individuals to act in a positive manner. Business ethics, in some sense, can be thought of as a means of ensuring that individuals working in organizations act in a positive way consistent with rule of law and other principles underpinning market economies and democratic governance.

Business Ethics

Given the new mandates on business, firms find themselves pressed to develop strong codes of ethics to guide the behavior of board members, managers, and employees. Multinational companies are also being required to set standards for those in their supply chains — in some cases setting higher standards than the laws of the countries in which they do business. There are many different factors that companies, especially financial companies, need to take into account when developing their own code of ethics as part of a general corporate governance guideline.

In this sense, business ethics is an attempt to set out a standard by which all of the employees of a firm can know what is expected of them. But it is also an attempt to encourage employees, managers, and board members to think about and make decisions through the prism of some shared set of values. What then are the sources from which these values can be derived?

Laws and regulations of the countries in which companies operate constitute one of these sources. However, it is important to recognize that companies are no longer simply limited to national law. A set of international conventions, such as the anti-

Business ethics is an attempt to set out a standard by which all of the employees of a firm can know what is expected of them.

bribery convention of the OECD, have to be taken into account. National laws in many countries are seeking to harmonize with these international standards. In the area of corporate governance, there are the OECD guidelines on corporate governance, and many countries are beginning to require corporate governance codes as a condition of doing business and to widen the regulatory standards for voluntary, self-regulating standards of conduct that exceed the minimum prescribed requirements of law.

Another area that is driving the development of corporate governance and business ethics codes is the notion of corporate social responsibility and corporate citizenship, or sustainability, which is emerging as the preferred term in the business community. Sustainability involves building a decision-making system that takes into account not only internal operating procedures, but also the impact of corporate behavior on its stakeholders — employees, investors, and communities.

One starting point to consider in developing initiatives to strengthen business ethics is the difference between bright lines and values. This is a relatively new distinction. Bright lines are those standards that attempt to set out specific and very finite rules which companies and individuals cannot break. The sources or guidance on these bright line rules can start with, for example, the OECD Anti-Bribery Convention, which can be translated into national laws and rules on an anti-bribery standard.

Although bright line rules are often very specific, every individual company still needs to develop accountability practices to ensure that employees are indeed following these rules. Transparency International, for example, has produced a handbook to help companies develop an entire internal practice to enforce such initiatives. Sarbanes-Oxley, the famous U.S. corporate governance law, also requires documentation standards of accountability for handling funds and assets.

In terms of general guidelines for behavior, there are a number of different sources for business ethics programs. Historically, one of the more prominent is that developed by Reverend Leon Sullivan, which began with the anti-Apartheid movement in South Africa and has since evolved into a global set of principles (GlobalSullivanPrinciples.org). Reverend Sullivan's principles have been adapted and expanded by the United Nations' Global Compact into 10 principles. The U.N. Global Compact is an unprecedented effort to coalesce the business community around common principles and contribute to global development through good business practices and business leadership.

The 10 principles in the U.N. Global Compact go considerably beyond the bright line rules and deal with the larger issue of values. Another similar set of principles was developed by the Caux Round Table, an organization where business leaders from different countries came up with a set of general principles for business behavior. There is another set of guidelines developed by the OECD: the OECD Multinational Corporation Guidelines. They go even further, attempting to encourage or mandate corporate behavior in a variety of areas, ranging from the environment to contributions to society and providing leadership in developing a nation.

The principles cited above, and others, go considerably beyond the bright line rules. In this sense, they revert back to the concept of ethics as a code to guide proper behavior, as a code to guide decision-making in doing business, and as standards that bring out and merge into the sustainability agenda.

INTERNATIONAL INITIATIVES AGAINST BRIBERY AND OTHER FORMS OF CORRUPTION

Caux Round Table (CRT) Principles for Business

Developed in 1994 by a network of business leaders committed to “moral capitalism”, the CRT Principles are an important expression of corporate values meant to create ethical awareness and lead to responsible and ethical corporate behavior. The CRT Principles are regarded as a process to build consensus within the business community of shared values that should be present in a culture of business ethics. The CRT Principles are available in 12 languages.

<http://www.cauxroundtable.org/principles.html>

Extractive Industries Transparency Initiative (EITI)

This example of an Integrity Pact was launched in June 2003 after first being announced by UK Prime Minister Tony Blair in October 2002. It advocates the verification and full publication of company payments and government revenues from the exploitation of oil, gas, and mineral resources. It seeks to improve governance through greater transparency and accountability in the extractive sector.

<http://eitransparency.org/>

(CONTINUED ON NEXT PAGE)

International Chamber of Commerce (ICC) Rules of Conduct and Recommendations to Combat Extortion and Bribery

The 2005 edition of the ICC Rules is the latest revision to the original issue made in 1977. The ICC Rules are a self-regulating instrument for international business, calling on firms to voluntarily adhere to a set of integrity rules that limit bribery and promote competition on a more level playing field. The 2005 Rules introduce key policy recommendations to support national and international initiatives that fight corruption. The ICC Rules are available in English, French and Spanish.

<http://www.iccwbo.org/policy/anticorruption/id870/index.html>

OECD Convention on Countering Bribery of Foreign Public Officials in International Business Transactions

Adopted in November 1997, the OECD Convention is a legally-binding treaty to all the 30 OECD member countries and 7 additional non-member countries (Argentina, Brazil, Bulgaria, Chile, Estonia, Slovenia and South Africa) that have ratified it to date. The OECD Convention is considered the premier global instrument to counter the supply side of bribery (those who pay), with notable results in the adoption of national anti-bribery laws, the creation of special investigation units at national levels to prosecute bribery, and the elimination of bribes as tax deductions. The OECD Convention is available in English, French, Spanish, Portuguese, Italian, Chinese, and Russian.

http://www.oecd.org/document/21/0,3343,en_2649_37447_2017813_1_1_1_37447,00.html

Transparency International (TI) Business Principles for Countering Bribery

The Business Principles, first introduced in 2002, offer detailed guidance and practical tools to help companies implement the type of anti-bribery programs that meet the legal obligations imposed by the OECD and UN Conventions, and to benchmark the effectiveness of existing anti-bribery programs. The Business Principles are a best practice model of many other existing standards and guidelines, which companies can adapt to their particular context and needs. As of 2008, TI issued an edition of the Business Principles that is tailored to the resource capacities and size of SMEs.

http://www.transparency.org/global_priorities/private_sector/business_principles

Transparent Agents and Contracting Entities (TRACE)

TRACE is a business solution to the costly and uneven process of due diligence and anti-bribery compliance by companies. TRACE pre-vets third-party agents and other commercial intermediaries who gain TRACE membership after passing an extensive due diligence review process and committing to rigorous transparency standards for their commercial transactions. As a result, TRACE is a time and cost effective compliance solution to both intermediaries and companies that make use of their services. TRACE recently launched BribeLine which is an anonymous reporting site dedicated to the demand side of bribery (those who request bribes).

<http://www.traceinternational.org/>

UN Convention Against Corruption

The UN Convention is the first legally-binding treaty that is global in nature. It was adopted in October 2003, entered into force in December 2005, and as of January 2008 has been ratified by 107 countries. The UN Convention covers provisions for prevention, criminalization, asset recovery, technical assistance, and international cooperation. The provisions cover a broad range of corruption acts (for example, bribery, embezzlement, money laundering, abuse of functions, trading in influence, and obstruction of justice,) and apply to both public and private sectors. The UN Convention is available in all six UN official languages.

<http://www.unodc.org/unodc/en/treaties/CAC/index.html>

UN Global Compact-Principle 10

Introduced in June 2004, Principle 10 adds the anti-corruption dimension to the Global Compact's framework of 10 principles for good corporate citizenship. It is a voluntary initiative that recognizes the direct role played by companies in fighting corruption through the application of universally-accepted values codified in the UN declarations on human rights, labor, the environment, and more recently the UN Convention Against Corruption. It calls on companies to share experiences and best practices and to collaborate on collective-action initiatives that create transparent business practices.

http://www.unglobalcompact.org/Issues/transparency_anticorruption/index.html

(CONTINUED ON NEXT PAGE)

World Bank Institute Fighting Corruption Initiative

This website was developed in June 2008 by the World Bank Institute to serve as an anti-corruption resource for business. It explores and details the constructive role that business can play in fighting corruption and how this can be done jointly with other companies and stakeholders.

<http://info.worldbank.org/etools/antic/index.asp>

World Bank Stolen Asset Recovery (StAR) Initiative

Launched September 2007 in partnership with the UN, the StAR Initiative is designed to help developing countries recover stolen assets from corrupt leaders and channel their recovery to national development objectives. Conservative estimates calculate the annual flow of illegal funds at US\$40 billion. StAR advocates a legal framework that makes it easier to repatriate stolen assets, thus eliminating safe havens and reducing the incentives for high-level embezzlement that undercuts development and poverty reduction.

<http://go.worldbank.org/3YS2F1LUU0>

World Economic Forum-Partnering Against Corruption Initiative (PACI)

PACI was launched at Davos in January 2004 by the CEOs from the construction, engineering, energy, metals and mining industries. Through PACI, over 120 companies have adopted zero-tolerance policies against bribery and committed themselves to implementing rigorous anti-corruption programs.

<http://www.weforum.org/en/initiatives/index.htm>

Business Ethics and Anti-corruption

Over the past several decades we have witnessed profound changes in the way business operates in countries around the world. One of the more notable areas is the business community's treatment of corruption-related issues. The private sector has become one of the leaders in global efforts to curb corruption, developing landmark and far-reaching transparency and accountability standards as well as mechanisms to enforce them. While ethical codes play an important role in driving transparency and accountability reforms, other initiatives that extend beyond internal rules have also made their mark in combating corruption.

As noted earlier, one of the sources from which ethical values can be derived is the laws of countries in which companies operate. At the same time, the quality of laws and regulations (as well as their enforcement) has a direct bearing on the levels of corruption in a particular country. The World Bank's *Doing Business* survey of more than 100 countries, for example,

clearly showed that heavy business regulation and procedural complexities in the judiciary are associated with higher levels of corruption. The Heritage Foundation/*Wall Street Journal* annual Index of Economic Freedom also illustrates well that higher degrees of economic freedom

are correlated with lower corruption. What one can derive from looking at the *Doing Business* survey and the Index of Economic Freedom is that corruption is directly related to the enabling environment issues. In that sense, efforts to establish the rule of law, strengthen the protection of property rights, and improve the quality of regulations become crucial in anti-corruption reform. Such efforts are also crucial in improving ethical standards.

Efforts to establish the rule of law, strengthen the protection of property rights, and improve the quality of regulations become crucial in anti-corruption reform.

Ethics and Boards of Directors

As noted in the NYSE listing requirements, it is very important for companies and banks to develop their own ethics program. Simply adopting a code of ethics or a code of corporate governance with a companion code of ethics is not sufficient. In fact, the Conference Board conducted a recent study of business ethics around the world and the role of boards of directors in carrying out board oversight of

ethics programs.⁴ The Conference Board identified the following elements as being representative of the role of the board and of ethics programs in a cross-section of countries:

- Codes of conduct
- Communication of standards through training
- Methods to encourage employees to report possible violations to management
- Enforcement mechanisms through investigation and discipline
- Oversight and review to achieve ongoing improvement

The development of the federal sentencing guidelines by the U.S. Sentencing Commission several years ago is one element in encouraging the adoption of ethics programs by American companies. These sentencing guidelines are intended to guide a company in dealing with employees who have engaged in bribery or broken the law under the U.S. Foreign Corrupt Practices Act. Doing so is important especially for the management, because the company as a whole can be punished for violations. The sentencing guidelines, in that regard, were intended to give courts some direction in terms of when to consider the company itself responsible for the action of its employees.⁵ The guidelines take into considerations company actions in:

- Establishing ethics and compliance standards and procedures,
- Appointing high-level persons to oversee ethics and compliance,
- Taking due care in the delegation of substantial discretionary authorities to individuals,
- Effectively communicating standards and procedures to all employees and agents through training and also through printed and electronic materials,
- Monitoring and auditing the operation of the ethics and compliance program and establishing a retribution-free means, (e.g., a help line) for employees to obtain information about standards and procedures and to report possible wrongdoing,
- Consistently enforcing discipline of employee violations, and
- Responding promptly to any wrongdoing and remedying any program deficiencies⁶

These guidelines from the Federal Sentencing Commission have been one of the drivers behind the development of ethics programs in the U.S. Moreover, as noted in the ethics resource list provided earlier, and in the elements identified by the

Conference Board, they have also spread worldwide. In fact, the Conference Board carried out a survey of companies across the world and found that not only were these elements quite common, but in many countries ethics programs were actually established by board resolution. In the United States, 66 percent of American companies established the ethics program as the result of the action of the board of directors, while in Japan, 96 percent took a similar stance.

Similarly, one of the key things that boards of directors must do in the wake of the U.S. Federal Sentencing Guidelines and the broader trends internationally is to develop ways of monitoring compliance and ensuring that codes of ethics, where they exist, are not simply a standard put on the company's web site, but communicated and implemented throughout the company. One of the ways to do that is by carrying out program audits.⁷

Complementing program audits is the concept of directors' ethics training. Many multinational companies are now routinely putting on ethics training programs for their directors. The subjects covered include:

- Fiduciary duties
- Corporate opportunities
- Principal regulations governing company business
- Personal liability
- Corporate law
- Stock exchange regulations
- Insider trading
- Business secrets
- The employee training program⁸

The role of the board of directors, therefore, is seen as central to establishing and maintaining a corporate ethics program, and by corollary is a central feature in the

The role of the board of directors, therefore, is seen as central to establishing and maintaining a corporate ethics program, and by corollary is a central feature in the overall subject of corporate governance guidelines and codes.

overall subject of corporate governance guidelines and codes. This trend can be expected to continue, driven both by national legislation, international conventions, and the expectations of investors.⁹

B. Personal and Business Risks Stemming from Corruption

For companies, the costs of corruption can be broadly summarized in two categories: personal risks and business risks. While business risks are frequently discussed in the corruption context, personal risks may not seem very obvious, albeit very important in ensuring that individuals behave in an ethically responsible manner.

Personal risks of engaging in corrupt dealings are important to consider when making the case for ethical behavior — both on the board level and throughout all levels of a company. The reality is that regardless of a country of origin or operation, corruption is illegal and by engaging in a corrupt behavior, even in countries with weak rule of law, individuals break the law and thus put their own future at risk.

In addition to criminal sanctions that individuals may face, they also have to deal with professional risk. Being implicated in corrupt transactions may ruin careers, whether you are a board member, a regional director, or a plant manager. Getting individuals to recognize ramifications of corruption on the personal level is essential in ensuring that business measures to reduce corruption are actually followed through by all employees and are not discounted as directives that have little bearing in day to day running of business operations.

For business, engaging in corruption or not putting anti-corruption measures in place has several implications, including:

- Legal liability
- Reputation risk
- Increased costs of doing business
- Limited access to capital
- Debarment from tenders

Making the case for “why” corruption should be addressed for companies from, and operating in, developed markets while important is not always necessary — they are

already subject to domestic regulation, international conventions, ethical pressures, internal guidelines and structures, as well as long-term sustainability strategies that all put a greater emphasis on “how” corruption should be addressed. In many of the emerging markets, however, the “why” is still very important, as companies may feel that corrupt environments, poor governance, and bad regulations put them at the disadvantage if they do not pay bribes.

This is particularly true in the context of collective action — in weak rule of law environments where you can’t rely on a legal system to ensure ethical behavior, there are few guarantees that other market players will behave transparently and fairly. Thus, while a company may attempt to follow the law, behave according to ethical principles, and avoid paying bribes, it may not have the tools to ensure that others stick to similar practices. These pressures are magnified when competitors are not so much concerned with long term development and are rather interested in short-term extraction of government rents through bribery and favoritism. Solving this collective action problem is one of the key challenges in reducing private sector corruption in emerging markets.

it is important to recognize that a code of ethics is not the only tool available to pursue a company’s ethical objectives.

Finally, another dimension to consider is the fact that corruption may take different forms. While bribery, for example, may denote a company’s desire to sidestep regulations and secure a favorable deal, extortion on the part of government officials presents a whole different set of problems. Simply put, companies and individuals subject to extortion face a difficult dilemma, where on the one hand they are not actively seeking to pay bribes which are illegal, but on the other hand they may be forced to comply especially if there are business or personal risks involved.

C. Building a Culture of Ethical Business Conduct: Codes of Ethics

Corporate citizenship and low-risk company ethics profiles start with a corporate code of ethics. As business ethics have evolved and the scope of business issues has expanded over the past decade, codes have become the rule rather than the exception at most companies. The term codes of ethics is used here synonymously

with other common terms such as codes of business standards, declaration of business principles, standards of conduct, and similar variations. Irrespective of the term employed by any given company, it is important to recognize that a code of ethics is not the only tool available to pursue a company's ethical objectives. Though it tends to be the most common first approach in fostering an ethical business environment, if a code is employed as a single instrument, its benefits will be limited and of minimal reach. The danger rests in that members of an organization may develop a false sense of protection because they believe that the code of ethics absolves them from having to use personal discretion or individual judgment about what is right and wrong. Or if employees perceive a discrepancy between professed values and actual behavior, a code can be counterproductive and lead to apathy and mistrust, particularly if executive leaders and board members are seen to be exempt from the organization's ethical standards.

A code of ethics outlines the values and beliefs of an organization and ties them to an organization's mission and objectives. Specifically, it codifies the standards of ethical behavior expected of all employees and the values to which all members of an organization commit themselves to uphold when conducting business with internal and external stakeholders. As such, the code of ethics becomes a yardstick by which to measure the ethical performance of a company.

A good code not only describes an operational process and regulates the behavior of managers and employees, but it also sets long-term goals, communicates the company's values to the outside stakeholders, and motivates employees giving them pride in working for a company with clearly articulated, unequivocal values of conduct and operation. The value of a code of ethics is that it is more than simply a statement of a company's moral beliefs. A well-written code is a true commitment to responsible business practices in that it outlines specific procedures to handle ethical failures. Codes of ethics today address a variety of issues including work environment, gender relations, discrimination, communications and reporting, gift giving, product safety, employee-management relationships, involvement in the political sphere, financial practices, corruption, conflicts of interest, and responsible advertising.

Codes of ethics fall into two major types of categories, as illustrated in Table 2 below with the corresponding strengths and weaknesses for each of the two forms: aspirational or directional codes.¹⁰ In general, the process to develop and implement codes of ethics follows a series of considerations and decisions, which for illustrative purposes, can be grouped into the following six phases:

- **Purpose:** what objectives will the code of ethics serve and toward what end state will it be employed? Usually to answer such questions, companies conduct an ethical risk assessment as a means to decide how to get from the existing state to the desired ethical organization;
- **Form:** will the code be more directional or aspirational in form, or a hybrid of the two?
- **Formulation Process:** once the purpose and form is determined, the next critical step is to determine by which process the code of ethics will be formulated, particularly with respect to the consultation and consensus-building process with stakeholders to be affected by the code of ethics;
- **Content:** entails the written expression of values, standards, prohibitions, sanctions, and all other ethical dimensions that will form part of the company's ethical culture;
- **Tone:** the tone with which the code is written and communicated plays a very important role in its effectiveness. The tone can range from a prohibitive to a more positive one that is supportive of its purpose; and
- **Implementation:** ensures that the code of ethics becomes real in practice and across all business operations, not a one-time effort that remains a written expression destined for a glassed showcase.

Table 2: Aspirational vs. Directional Code of Ethics

	ASPIRATIONAL CODE	DIRECTIONAL CODE
STRENGTHS	<ul style="list-style-type: none"> • Concise document • Staff have discretion to apply corporate values 	<ul style="list-style-type: none"> • Specific guidance • Easy to enforce
WEAKNESSES	<ul style="list-style-type: none"> • Lack of specific guidance • Open to interpretation 	<ul style="list-style-type: none"> • Complex documents • Hard to remember • Little room for discretion

Originally seen as a set of policies designed to manage daily issues in the workplace, ethics codes have grown into extensive documents that address a variety of issues and serve as corporate complements to the extensive regulatory and societal pressures on business to behave in an ethical manner. A code of ethics, therefore, can imply high upfront costs in order to meet the expanded functions that it currently serves. For companies that must watch their bottom lines, such as SMEs, the costs of a code, especially if it requires the implementation of a comprehensive organizational ethics program, the initial investments may seem prohibitive in relation to short-term benefits. Over time, however, the initial cost may turn into positive investments for the company brand, reputation and trust. Nevertheless, it goes without saying that a code of ethics is never a substitute for a poor business plan, nor will it protect an organization from major lapses of ethical misconduct.

As a code of ethics becomes integral to business operations, it becomes crucial to implement its provisions with consistency across the whole company. As part of the ethical management systems that are put in place to safeguard consistency, it will entail hiring and promoting staff based on demonstrated integrity and ethical performance. Another critical action is providing safe reporting systems such as anonymous whistle-blowing hotlines to report risky or unethical behavior. Training on company values, standards, and compliance procedures is another essential element to ensure that employees adhere to and uphold the code's stated values and policies. Through training, the code's ideals take root by demonstrating their practical application. Training, supported through simulations and case scenarios, is helpful to employees in not compromising the company's integrity when faced with ethical dilemmas. In clarifying the risks involved from seemingly simple and common operating practices, such as how employees should engage with agents that fall short of the company's ethical standards, companies can greatly reduce their ethical risk profile. But if all the ethical management systems and procedures are not backed up by consistent enforcement and application of sanctions, codes will be largely ignored and ineffective in building an ethical organization.

Lastly, the overall ethical performance of the company must be monitored and reported to stakeholders if it is to be credible to a wide audience of stakeholders, customers, and the general public. Both internal and independent external verification of the company's ethical culture is necessary to verify, detect, and make appropriate corrections when necessary. If ethical standards are not being met, company reports should disclose the steps being taken to remedy the situation and ensure that standards will be met.

Regardless of the type of code adopted, care must be taken to ensure that it is an effective tool to promote and advance the company's ethics culture. By communicating its core ethical values through a code of ethics, a company helps create a corporate image that members of the organization can easily relate to and allows employees, customers, shareholders, and other stakeholders to have a realistic view of its corporate identity. Codes of ethics exist to encourage ethical behavior and to take pride in making ethical decisions. Most importantly, employees at any level of an organization must strive to uphold the standards put forth by the code of ethics, and top management should exemplify those standards. The commitment and leadership of top management largely determines if the code of ethics becomes a powerful or an ineffective tool in support of an ethical organization, as codes are of little benefit if the leadership ignores them.

DIFFERENT TYPES OF CODES OF ETHICS

Supply-chain Codes

One of the greatest benefits of corporate citizenship is that it can rationalize and improve a company's relations with its supply chains overseas regarding the quality of the products, labor practices, and the environmental impact of their activities. The growth of supply chain codes is most evident in supply chains involving consumer goods in emerging markets with weak regulatory environments selling to consumers in developed markets. In countries where labor laws are less stringent than international norms, the codes have the effect of creating higher labor standards and serve as a self-governing mechanism for the enforcement of laws governing working conditions and production standards.

Supply Chain codes fall into several broad categories:¹¹

Buyer Codes

Major companies use these codes in their supply chain as a prerequisite for purchasing consideration. The system is such that the buyer pays for internal monitors and independent auditors to review the supplier factories. Suppliers then must pay for any infrastructure upgrades or other improvements necessary to meet the code standards. The factories' labor standards are also taken into consideration. Once suppliers are selected, they are continuously monitored to make sure they are maintaining that standard.

(CONTINUED ON NEXT PAGE)

For buyers, the benefits of these codes are that they protect their brand from bad publicity and other civil attacks, and higher quality goods often result from the upgrades to the quality of the infrastructure and the labor force.

Agent Codes

Doing business abroad often requires the use of agents to facilitate everything from customs and shipping permission to finding business partners and arranging introductions with the proper authorities or business leaders. Companies, governments, and non-governmental organizations working with or through intermediaries abroad know this can be an area of risk as they are held responsible either legally or in the court of public opinion for the activities of these agents. Shielding companies from this risk is increasingly expensive as it involves a great amount of due diligence on the part of the organizations researching the background of the agent and verifying the soundness of their business practices. At the same time, intermediaries seeking to do business with large international companies can find the approval process to be laborious and slow, creating extra costs to doing business and causing opportunities to be missed.

Transparent Agents and Contracting Entities (TRACE), an international organization that addresses the void in working with intermediaries abroad, seeks to meet the needs of both parties in this process while creating a more ethical business environment. Principals are better protected and intermediaries are better served by this independent, non-partisan organization that undertakes preliminary vetting of agents, consultants, and subcontractors.

The process is simple. First, agents apply for membership with TRACE. They are then subjected to an extensive due diligence review, including a lengthy questionnaire, three business references, a financial reference, and a media search. Candidates are also required to have or adopt a code of conduct addressing bribes, kickbacks, and conflicts of interest and agree to annual ethics training provided by TRACE or by approved lawyers in their country. Once their files are completed, they are made available to a large number of companies — avoiding the need to replicate packages for each company. The requirements are the same for every requesting company or organization, resolving the “best practices” concern that others are undertaking more extensive due diligence.

TRACE member companies benefit by avoiding the timely documentation gathering process in support of an intermediary. Instead of months to vet a candidate, information is available upon request and updated annually. The process can be done in a day. TRACE is funded by member fees to cover the screening process and companies pay an annual fee or a per-report fee to have access to the due diligence voluntarily submitted by the members. Governments and non-governmental organizations pay only the cost of copying and postage for each report requested.

Factory Certification Schemes

Factories seek certification to prove that they have been proactive in addressing labor and infrastructure standards. The factory pays for the certification process, annual audits and any needed upgrades or actions required to remain certified. CERES Principles, the chemical industry's Responsible Care ISO 14001 is an example of such a process. These standards and certifications are typically sought out as a marketing and communication tool for factories to demonstrate their high level of standards and systems. Certification allows some factories to receive higher fees for their services as certification eliminates much of the risk for the buyer and often satisfies buyer codes, eliminating the buyer's oversight costs.

Other benefits to suppliers to certification or participation in buyers' codes would be more competitive contract bidding, higher productivity, innovation and quality, and declining employee turnover as health and quality of life issues improve for them. Examples include SA 8000 (labor), ISO 14001 (environment), and WRAP (labor). There are many others.

Other Types of Codes

The Base Code of the Ethical Trading Initiative (ETI), and codes from the OECD and other groups all serve as guidelines for companies and countries on appropriate standards. These codes typically do not have any monitoring or auditing programs, and their purpose is to provide guidance and best practices. Most codes cover ten points and represent principles corresponding to the International Labor Organization's Core Conventions including: forced labor, child labor, freedom of association, and collective bargaining, discrimination, health and safety, wages and

(CONTINUED ON NEXT PAGE)

hours of work. Key challenges for the codes are that they can produce inefficiencies and confusion for suppliers as each buyer has its own code of conduct and audit procedures. This confusion produces a barrier to entry for suppliers as it is unclear how to demonstrate high standards and compliance. The audit systems can vary from company to company and be very uneven in their rigor and application. This overlap and repetition can produce unnecessary burdens on both buyers and suppliers as buyers cover the cost of monitoring and suppliers have to allocate time and resources to ascertain and comply with a myriad of codes. A convergence of codes and procedures is needed to truly realize the benefits of the codes and certification programs.

D. Mainstreaming Ethics into Good Corporate Governance

Table 3 below demonstrates that it is never too late to start building ethical organizations and that initial steps are as important as those taken later to sustain the advanced systems that characterize the ethical culture of internationally recognized companies. For illustrative purposes — and for as wide an application as possible to the large spectrum of business types and sizes — Table 3 shows three levels of progression in building ethical organizations: starting from mere compliance, continuing to the systematic implementation of an integrated ethics program, and culminating with organizational leadership and innovations that set new standards and benchmarks of business ethics. The Level 1 is a defensive position, while Levels 2 and 3 are more proactive and offensive in nature, going beyond the requirements established by law or the benchmarks set by national best practices.

Table 3 is by no means exhaustive of the possibilities open to organizations committed to good corporate governance and business ethics.¹² It is not meant to be prescriptive nor to define a given set of progression levels. Table 3 simply attempts to illustrate the current spectrum of best practices by organizing it in a way that can be useful to a wide range of companies with varying levels of resources. Each company faces a unique set of contextual factors in which it operates, and it must adapt the existing best practice to fit with its own business strategy, corporate history, and appropriate level of organizational resources.

Table 3: Building an Ethical Culture — Every Step Counts

PRACTICAL ACTIONS

Level 1: Setting the Foundation — Complying with Legal and Regulatory Requirements

- Designated ethics officer responsible for all reporting and disclosure requirements established by law and regulations
- Written code of ethics in place, adopted by Board of Directors
- Internal and external stakeholders consulted on company's ethical performance

Level 2: Committed Engagement — Institutionalizing a Comprehensive Ethics Program

- Commission external company ethics assessment to determine risks and opportunities
- Active engagement of internal and external stakeholders to determine company ethics program
- Ethics Program is an integrated and systematic application of key inter-related components:
 - *Ethics structure at Board level providing strategic leadership (Perhaps an Ethics Committee or Sub Committee)*
 - *Ethics Office, with appropriate level of designated staff and resources*
 - *Communications strategy tailored to internal and external stakeholders*
 - *Safe reporting lines for ethical misconduct (anonymous whistle-blowing hotline)*
 - *Ethics training program at all levels of organization and key external stakeholders*
 - *Internal monitoring and audit systems to report on effectiveness of ethics program components*
 - *Reporting and disclosure of ethical performance to external stakeholders*
- Certification of company ethics officers

Level 3: Leading by Example — Setting New Ethical Standards

- External independent verification of ethics program and assurance of performance
- Leader in initiating collective action solutions or forming coalitions to fight corruption

E. Getting Started: Initial Steps and Decisions

From a practical standpoint, building an ethical organization entails a basic set of decisions and considerations by boards and executives. They apply to every company irrespective of size, governance structure, resource base, or level of commitment to business ethics. Two immediate overarching considerations enter the equation of building an ethical organization. The first relates to the internal process of developing a company's ethics framework. The second concerns external dimensions that may be changed or altered by introducing an ethical framework, such as how business will be conducted with stakeholders whose values are not aligned with the company's ethical culture.

THE BASIC BUILDING BLOCKS OF AN ETHICAL FRAMEWORK

Whether a company is starting from the beginning or with a head start, action and commitment builds on answers to four basic but critical questions:

- Does our company adhere in practice to a code of ethics?
- What type of code of ethics should we adopt?
- What process will generate wide buy-in for our company's code of ethics?
- What systems lead to a tangible and constant reinforcement of the values and principles espoused by our code of ethics?

Step 1: Choosing between rules-based and values-based codes of ethics

With respect to the internal process, the first step requires a decision between rules-based or values-based frameworks, which are reflected through corresponding codes of ethics. A *rules-based code of ethics* is a prescriptive and highly controlled process that defines specific rules about what is acceptable and unacceptable behavior. Its characteristic top-down process seeks to regiment behavior along clear boundaries within a company. Typically there is no latitude for interpreting the code's rules. Thus, in practice, prescriptive codes function on the basis that actions are safe if they are not listed within the code of ethics. Rules-based codes tend to be more prevalent in small companies and organizations that are less complex in structures and operations.

Values-based codes of ethics, on the other hand, act as guides to behavior in a more intuitive way. They seek to promulgate the principles and values that characterize a company's ethical culture. As such, it requires iterative communication between company and staff to continually align the values of the company to changing context and circumstances — whether these come from changes in the competitive environment or changing consumer preferences. Ongoing communication allows a company to clarify how values apply to the real world of doing business, and showcase examples that over time help employees understand the range of latitude and the construction of ethical principles.

An advantage of values-based codes of ethics is that they can be as short as one or two pages in length. They are easy to articulate, to circulate, and a short length makes it more accessible to employees. Difficulties, however, arise as a company increases in size and complexity. The larger the company, the harder it becomes to define ethics for all different types of people and cultures, and to interpret what is acceptable behavior from general principles. Also management must be willing to dedicate extensive resources and time to explain and clarify for all staff levels the code's values and principles, which can include “soft” delivery channels (such as role playing and theater) and more traditional channels (such as websites, newsletters, training, email, reports, etc.).

The choice among the two types of codes of ethics is rarely a clear division. Companies tend to favor a mixture of the two codes: it defines a core set of rules with examples of how they apply in different scenarios of a company's operations.

The company's "ten commandments" set the limits of what behavior is permissible or subject to sanctions across all levels of operations.

Step 2: Consultations with stakeholders affected by code of ethics

A code of ethics will impact and affect differently various staff groups. Therefore, its implementation requires extensive consultation with all groups to be affected by the code of ethics: directors, executives, managers, supervisors, employees, etc. It is important to identify these various constituencies and engage them in articulating the content of the code of ethics. Consultations with these various groups will help clarify which conduct and values are appropriate for regulation and legislation through a code of ethics, as well as identify tensions that may exist from different views or different groups on the understanding and application of ethical values. Consultations with all stakeholders helps forge a common identity around the corporate ethical framework, leading to a code of ethics that reflects company-wide consensus of shared values.

Step 3: Formal approval and implementation of code of ethics by board of directors

A critical step is the formal and public endorsement of the code of ethics by the board of directors, with accompanying decisions about the implementation process. At a core minimum, these decisions must clearly define who will be the delegated custodian of the code of ethics, and the actions to be taken to familiarize all staff with the code and its boundaries of what is acceptable and unacceptable behavior. Those who are entrusted with the code's implementation will introduce the systems and structures that can most effectively achieve the spirit of the code's values and principles. Key considerations at this level must address how implementation will be monitored and by whom, and whether violations of the code of ethics will remain confidential or publicly disclosed. These decisions do not have uniform answers nor easy solutions, but boards can ensure that the approach taken advances the desired ethical culture.

A key responsibility of the board is to align the code of ethics with the policies, mission, and strategy that the board itself sets for the company. Making such an alignment introduces a great degree of complexity. It deals with difficult questions to determine whether the code will apply to contractors and other business partners, and whether the company will continue doing business with those that do not

adhere to the framework embodied by the code of ethics. Given the difficulties to resolve such questions, the common practice is to limit the application of codes of ethics to staff only and to issue a “statement of business practice” aimed at external stakeholders. The statement of business practice is an externally focused document, laying out general principles by which a company will conduct business with other actors.

Step 4: Putting controls at different levels of organization

Control and monitoring mechanisms are meant to safeguard the effective implementation of the code of ethics, holding delegated guardians accountable to the board of directors, and also, indirectly, to all employees and external stakeholders. Operationally, both procedural and anonymous mechanisms are required. Anonymous hotlines to report violations, for example, are important tools to identify and close loopholes, introduce preventive measures, and sanction breaches in ways that motivate employees to respect rather than ignore the company’s ethical standards. Procedural mechanisms, on the other hand, such as the designation of an Ethics

Chief Officer, helps to ensure that a company’s ethical framework is synchronized with other critical policies and structures, such as internal audit, human resources, audit committee, risk management, compliance, disclosure, and sustainability practices.

A culture of business ethics is realized when it becomes a living part of the everyday work of staff at all levels in a company.

Overall, a culture of business ethics is realized when it becomes a living part of the everyday work of staff at all levels in a company. It becomes an integral part of a company’s DNA, defining the very nature of the company’s existence and how it conducts business internally and externally. This ultimate objective requires an ongoing process of adaptation to the evolving context of ethical standards, and of communication with staff and external stakeholders on a regular basis. A company cannot lose sight that its ethical framework must permeate all actions and operations, and that it must be applied on a consistent basis. The pursuit of a culture of ethics cannot be a one-time pronouncement nor can it fail to spell out implementation and accountability mechanisms, otherwise it breeds staff cynicism and contempt about the true nature of “doing the right thing” in business.

CONCLUSION

Anti-corruption attitudes have changed significantly over the past two decades. Corruption is no longer regarded as a subject to be avoided and is now widely condemned for its damaging effect on countries, industries, governments, and the livelihoods of individual citizens. More importantly, the view of the private sector in the corruption equation is changing. Companies are no longer viewed only as facilitators of corruption — they are increasingly recognized as victims and a valuable source of working solutions, and anti-corruption efforts seen as integral to good corporate governance,

Predictable, competitive, and fair economic environments free of corruption are central to sustainable business, economic growth and national development. It has been an easier task to raise this awareness than to reduce the corrosive effects of corruption, especially its worst manifestation of state capture. And though the challenge defies simple solutions, significant progress is being made. Today we have in place numerous international conventions and global collective action initiatives that set higher standards of transparency and accountability in corporate and public governance. More importantly, such standards are buttressed by a growing convergence of ethical values that set the tone for “doing the right thing” in both the public and private sectors.

Predictable, competitive, and fair economic environments free of corruption are central to sustainable business, economic growth and national development.

For companies, the challenge against corruption is complicated by the differences in the quality of institutions between countries. Businesses operating globally find themselves competing against companies and working with supply chains that have different governance structures, they face varying legal requirements and

a diverse quality of law enforcement, as well as different views of corruption and approaches to combat it. This creates many problems for those companies willing to remain accountable and transparent in environments with weak rule of law.

A central mechanism accounting for the quality and sustainability of a free and fair business environment, as well as a proven effective anti-corruption tool, is corporate governance. Corporate governance not only sets up a system of institutions that

govern the relationship between owners, investors, creditors, and managers, but also serves as a reform incentive towards global best practices of legal and regulatory frameworks. As an anti-corruption tool, corporate governance introduces standards and mechanisms of transparency, accountability, and compliance with laws and regulations, which over the long run exposes bribery and illegal behavior that makes corporate corruption unsustainable.

Underlying much of corporate governance is another key dimension — business ethics. Often viewed with skepticism, ethical behavior on the part of individuals, especially company leaders and decision makers, underlies much of what companies do and don't do in establishing good governance mechanisms and combating corruption. Ethics, in this regard, has to be thought of as a set of principles and values by which a company defines the very nature of its mission and operations, guiding the behavior of its board members, management, and employees at all staff levels. It is about leadership and organization-wide commitment to adapt and embody a company's ethical values in all decisions and operations, rather than to attempt to prescribe top-down rigid rules that will have no bearing on how a company functions on a day-to-day basis.

What companies need now are the working solutions that build around the idea of ethics and tie together corporate governance reforms and anti-corruption initiatives. The private sector alone cannot build economic prosperity or national development that is crucial to poverty alleviation. It must continue and expand its engagement with governments and NGOs in developing solutions and reforming company-level as well as country-level institutions. The triad of business, civil society, and governments will have to work together to devise and implement solutions that carry significant benefits for all.

“In my experience, a truly corrupt outfit diverts, distracts, and demoralizes. When the wrong things are being done, the right things don't get done.”

DOUGLAS MINGE BROWN
Stanford Business Magazine, August 2008

SELECTED INTERNET RESOURCES

(For Further Reading)

[Footnote: The internet offers a vast wealth of resource materials on business ethics, anti-corruption, and corporate governance. This guide lists only websites consulted in the preparation of the FOCUS paper and is not an endorsement nor an exhaustive list of available resources. It should be seen as related links to explore and conduct additional internet searches. All referenced websites are active links as of December 2008.]

Business Ethics:

Business Ethics at Knowledge@Wharton

<http://knowledge.wharton.upenn.edu/category.cfm?cid=11>

Business Ethics Magazine

<http://www.business-ethics.com/>

Business Roundtable Institute for Corporate Ethics

<http://www.corporate-ethics.org>

Compliance Week

<http://www.complianceweek.com>

The Ethical Blogger

<http://ethicalbloggerproject.blogspot.com>

Ethical Corporation

<http://www.ethicalcorp.com>

Ethics and Compliance Officers Association

<http://www.theecoa.org>

Ethics Institute of South Africa

<http://www.ethicsa.com>

Ethics Resource Center

<http://www.ethics.org>

Ethics World

<http://www.ethicsworld.org/>

Ethisphere

<http://ethisphere.com>

Globethics.Net

<http://www.globethics.net>

Institute of Business Ethics

<http://www.ibe.org.uk/home.html>

Markkula Center for Applied Ethics

<http://www.scu.edu/ethics>

Codes of Ethics:

Rio Tinto Statement of Business Practices

http://www.riotinto.com/resources/3608_corporate_publications.asp

Standard Chartered Code of Conduct

<http://www.standardchartered.com/sustainability/resource-centre/policies-and-procedures/en/index.html>

Thrivent Financial Code of Conduct

<http://www.thrivent.com/aboutus/codeofconduct>

Exploring the Business Case for Ethics:

ecoDA-Does Ethics Pay

<http://www.ecoda.org/conference2006.htm>

Ethical Investment Research Services

<http://www.eiris.org/index.htm>

The sdEffect

<http://www.sdeffect.com>

Social Investment Organization

<http://www.socialinvestment.ca>

Legal Dimensions:

Council of Europe Criminal Law Convention on Corruption

<http://www.conventions.coe.int/treaty/en/Treaties/Html/173.htm>

Guide to Sarbanes-Oxley Act

<http://www.soxlaw.com>

OECD Convention on Countering Bribery of Foreign Public Officials in International Business Transactions

<http://www.oecd.org/daf/nocorruption/convention>

Overview of Anti-Corruption Conventions, U4 Resource Centre

<http://www.u4.no/themes/conventions/intro.cfm>

U.S. Federal Sentencing Guidelines

<http://www.ussc.gov/2004guid/TABCON04.htm>

United Nations Convention Against Corruption

<http://www.unodc.org/unodc/en/treaties/CAC/index.html>

On-Line Libraries (access to full-text books and articles):

Open-Access Text Archive

<http://www.archive.org/details/texts>

Sustainability (including Corporate Social Responsibility):

Center for Social Innovation, Stanford Graduate School of Business

<http://sic.conversationsnetwork.org>

Corporate Responsibility Officer

<http://www.thecro.com>

Corporate Social Responsibility Center

<http://www.csrcenter.net/>

The Corporate Social Responsibility Initiative, Harvard University

<http://www.hks.harvard.edu/m-rcbg/CSRI>

European Academy of Business in Society

<http://www.eabis.org/>

International Association for Business and Society

<http://www.iabs.net>

SustainAbility

<http://www.sustainability.com>

International and Regional Initiatives and Organizations:

Caux Round Table

<http://www.cauxroundtable.org/>

Center for International Private Enterprise

<http://www.cipe.org>

Extractive Industries Transparency Initiative

<http://www.eitransparency.org/>

Global Corporate Governance Forum

<http://www.gcgf.org>

Global Reporting Initiative

<http://www.globalreporting.org>

International Chamber of Commerce

<http://www.iccwbo.org>

Transparency International

<http://www.transparency.org>

Transparent Agents and Contracting Entities (TRACE)

<http://www.traceinternational.org>

United Nations Global Compact

<http://www.unglobalcompact.org>

World Bank-Anticorruption Resources

<http://go.worldbank.org/QYRWXVH40>

World Bank Stolen Asset Recovery Initiative

<http://go.worldbank.org/3YS2F1LUU0>

World Economic Forum-Partnering Against Corruption Initiative (PACI)

<http://www.weforum.org/en/initiatives/index.htm>

BIBLIOGRAPHY

Arvis, Jean-François, and Ronald E. Berenbeim. 2003. *Fighting Corruption in East Asia: Solutions from the Private Sector*. Washington, D.C.: The World Bank.

Bardhan, Pranab. 1997. "Corruption and Development: A Review of Issues." *Journal of Economic Literature* 35, (September): 1320-1346.

Bliss, Christopher and Rafael Di Tella. 1997. "Does Competition Kill Corruption?," *Journal of Political Economy* 105, 51, (October): 1001-1023.

Campos, J. Edgardo, and Sanjay Pradhan, Ed. 2006. *The Many Faces of Corruption: Tracking Vulnerabilities at the Sector Level*. Washington, D.C.: The World Bank.

Campos, Nauro F. 2000. "Context is Everything: Measuring Institutional Change in Transition Economies, Volume I," *World Bank Policy Research Working Paper No. WPS 2269*, (January).

Celentani, Marco, Juan-Jos Ganuza, and Jos-Luis Peydro. 2004. "Combating Corruption in International Business Transactions." *Economica* 71, 283 (Special Issue - August): 417-48.

Clarke, George R.G., and Lixin Colin Xu. 2002. "Ownership, Competition, and Corruption: Bribe Takers versus Bribe Payers, Volume 1," *World Bank Policy Research Working Paper No. WPS 2783*, (February).

Erickson, Moana M. and Roderick M. Hills, Ed. 2006. *Research on Corruption and its Controls: The State of the Art, Proceedings of a Workshop*. Washington, D.C.: The World Bank.

Gurgur, Tugrul and Anwar Shah. 2005. "Localization and Corruption: Panacea or Pandora's Box?," *World Bank Policy Research Working Paper No. WPS 3486*, (January).

Habib, Mohsin, and Leon Zurawicki. 2001. "Corruption in the Context of International Business: Conceptual and Methodological Issues." *Journal of Transnational Management Development* 6, 3-4: 167-80.

Haller, Dieter and Cris Shore, Ed. 2005. *Corruption: Anthropological Perspectives*. Pluto Press.

Harvard Business Review. 2003. *Harvard Business Review on Corporate Ethics*. Boston: Harvard Business School Publishing.

Heidenheimer, Arnold J., Michael Johnston, and Victor T. LeVine, Eds. 1997. *Political Corruption: A Handbook*. (Fourth Edition). New Brunswick, NJ: Transaction Publishers.

Heimann, Fritz F. 1997. "Combatting International Corruption: The Role of the Business Community." In *Corruption and the Global Economy*, 147-161. Edited by Kimberly Ann Elliott. Washington, D.C.: Institute for International Economics.

Hellman, Joel S., Geraint Jones, Daniel Kaufmann, and Mark Schankerman. 2000. "Measuring Governance, Corruption, and State Capture: How Firms and Bureaucrats Shape the Business Environment in Transition Economies, Volume I," *World Bank Policy Research Paper No. WPS 2312*, (April).

International Bank for Reconstruction and Development/World Bank. 2004. *World Development Report 2005: A Better Investment Climate for Everyone*, (January).

Johnston, Michael, and Sahr J. Kpundeh. 2002. "Building a Clean Machine: Anti-Corruption Coalitions and Sustainable Reform," *World Bank Institute Working Paper*, (January).

Kaufmann, Daniel, Aart Kray, and Massimo Mastruzzi. 2007. *Measuring Corruption: Myths and Realities*. World Bank Institute: Development Outreach.

_____. 2005. "Governance Matters IV: Governance Indicators for 1996-2004," *World Bank Policy Research Working Paper No. WPS 3630*, (2005).

_____. 2006. "Governance Matters V: Aggregate and Individual Governance Indicators for 1996-2005," *World Bank Policy Research Working Paper No. WPS 4012*, (September).

Kaufmann, Daniel. 2005. "Ten Myths about Governance and Corruption," *Finance and Development* 42, 3, (September): 41-43.

_____. 2005. *Click the Refresh Button: Investment Climate Reconsidered*. World Bank Institute: Development Outreach, March.

- Kaufmann, Daniel, and Pedro C. Vicente. 2005. "Legal Corruption," *World Bank Institute Governance Working Papers*.
- Kaufmann, Daniel, and Aart Kraay. 2002. "Growth Without Governance, Volume I," *World Bank Policy Research Working Paper No. WPS 2928*, (November).
- Kaufmann, Daniel, and Shang-Jin Wei. 1999. "Does "Grease Money" Speed Up the Wheels of Commerce, Volume I," *World Bank Policy Research Working Paper No. WPS 2254*, (December).
- Kaufmann, Daniel. 1997. "Corruption: the Facts." *Foreign Policy* 107, (Summer): 114-131.
- Kaufmann, Daniel, Joel S. Hellman, and Geraint Jones. 2000 "Seize the State, Seize the Day: State Capture, Corruption, and Influence in Transition," *World Bank Policy Research Working Paper 2444*, (September).
- Keefer, Philip. 2005. "Democratization and Clientelism: Why are Young Democracies Badly Governed?," *World Bank Policy Research Working Paper No. 3594*, (May).
- Kidd, John and Frank-Jürgen Richter, Ed. 2003. *Corruption and Governance in Asia*. New York: Palgrave Macmillan.
- Klitgaard, Robert, Ronald Maclean-Abaroa, and H. Lindsey Parris. 2000. *Corrupt Cities: A Practical Guide to Cure and Prevention*. Richmond, CA: Institute of Contemporary Studies.
- Klitgaard, Robert. 2000. "Subverting Corruption," *Finance and Development* 37, 2 (June): 2-5.
- _____. 1998. *Controlling Corruption*. Berkeley, CA: University of California Press.
- Leak, Tan Ah. 1996. "The Experience of Singapore in Combatting Corruption." In *Uganda International Conference on Good Governance in Africa: Empowering Civil Society in the Fight Against Corruption*, 151-158. Edited by Petter Langseth and Fiona Simpkins. Washington, D.C.: The World Bank.
- Lederman, Daniel, Norman Loayza, and Rodrigo Reis Soares. 2001. "Accountability and Corruption: Political Institutions Matter, Volume I," *World Bank Policy Research Working Paper No. WPS 2708*, (November).

Leiken, Robert S. 1996-1997. "Controlling the Global Corruption Epidemic." *Foreign Policy* 105, (Winter): 55-73

Mauro, Paolo. 1997. "Why Worry About Corruption?" *Economic Issues* 6. Washington, D.C.: IMF.

Margolis, Joshua, James Walsh, and Dean Krehmeyer. 2006. *Building the Business Case for Ethics*. Charlottesville, VA: Business Roundtable Institute for Corporate Ethics.

McKinsey & Company, in cooperation with Global Corporate Governance Forum. *Global Investor Opinion Survey: Key Findings 2002*.

Neild, Robert. 2002. *Public Corruption: the Dark Side of Social Evolution*. London: Anthem.

Noonan, John T., Jr. 1985. *Bribes*, London: Macmillan Press.

OECD. 2001. *Behind the Corporate Veil: Using Corporate Entities for Elicit Purposes*.

Oforu-Amaah, W. Paatil, Raj Soopramanien, and Kishor Uprety. 1999. *Combating Corruption: A Comparative Review of Selected Legal Aspects of State Practice and Major International Initiatives*, Washington, D.C.: The World Bank.

Olson, Mancur Jr. 1996. "Big Bills Left on the Sidewalk: Why Some Countries are Rich and Others Poor," *Journal of Economic Perspectives* 10, 2 (Spring): 3-24.

Paine, Lynn, Rohit Deshpande, Joshua D. Margolis, and Kim Eric Bettcher. 2005. "Up to Code: Does Your Company's Conduct Meet World-Class Standards?," *Harvard Business Review*, (December).

Pope, Jeremy. 2000. *Transparency International Source Book 2000*. Berlin: Transparency International.

Rose-Ackerman, Susan. 2002. "Grand' Corruption and the Ethics of Global Business." *Journal of Banking and Finance* 26, 9, (September): 1889-1918.

_____. 1997. "Corruption and Development." Paper prepared for the Annual World Bank Conference on Development Economics. Washington, April 30 - May 1.

_____. 1996. "Democracy and 'Grand' Corruption." *International Social Science Journal: Corruption in Western Democracies* 149 (September): 365-380.

_____. 1996. "When is Corruption Harmful?" Background paper for the World Bank's 1997 World Development Report, *The State in a Changing World*. Washington, D. C.: The World Bank.

Rose Ackerman, Susan and Andrew H. W. Stone. 1996. "The Costs of Corruption for Private Business: Evidence from World Bank Surveys." Washington, D.C.: The World Bank.

Shang-Jin Wei. 1999. "Corruption in Economic Development: Beneficial Grease, Minor Annoyance, or Minor Obstacle?," Volume I," *World Bank Policy Research Working Paper No. WPS 2048*, (February).

Spector, Bertram I., Ed. 2005. *Fighting Corruption in Developing Countries: Strategies and Analysis*. Sterling, VA: Kumarian Press.

Ugoji, Kaodi, Nicole Dando, and Lance Moir. 2007. *Does Ethics Pay? - Revisited*. London: Institute of Business Ethics, (July).

United Nations Global Compact Office. 2006. *Business Against Corruption: Case Studies and Examples*, (April).

_____. 2005. *Business Against Corruption: A Framework for Action*.

Webley, Simon, and Elise More. 2003. *Does Business Ethics Pay?*. London: Institute of Business Ethics, (April).

World Bank. 2006. *Strengthening Bank Group Engagement on Governance and Anti-Corruption*, 8. Washington, D.C.: World Bank.

_____. 1997. *Helping Countries Combat Corruption: The Role of the World Bank*. Washington, D.C.: World Bank.

NOTES

- 1** Paul Edwards. *The Encyclopedia of Philosophy, Volume 3*. Macmillan Publishing, page 83.
- 2** See for example John Hooker, *Ethics in Six Not So-Easy Lessons* (Carnegie Mellon, April 2001).
- 3** For a detailed discussion on sustainability, see *FOCUS #8, "Stakeholder Engagement and the Board: Integrating Corporate Governance with Sustainable Business Practices, 2009"* (forthcoming).
- 4** Ronald E. Berenbeim and Jeffrey M. Kaplan, "*Ethics Programs...The Role of the Board: A Global Study*" (The Conference Board, New York, 2004) page 12.
- 5** *Federal Sentencing Guidelines Manual* page 476-477. <http://www.ussc.gov/GUIDELIN.HTM>
- 6** Edward L. Pittman and Frank J. Navran, "Corporate Ethics and Sarbanes-Oxley," *The Wall Street Lawyer* (July 2003).
- 7** Ronald E. Berenbeim and Jeffrey M. Kaplan, "*Ethics Programs...The Role of the Board: A Global Study*" (The Conference Board, New York, 2004) page 21.
- 8** *Ibid.* page 31
- 9** See International Corporate Governance Network. <http://www.icgn.org>
- 10** Distinction between aspirational and directional codes is drawn from the *King Report on Corporate Governance for South Africa (2002)*.
- 11** "*Investing in Responsible Business — The 2003 Survey of European Fund Managers, Financial Analysts and Investor Relations Officers,*" A Deloitte, CSR Europe and Euronext Survey (November, 2003).
- 12** Table 3 draws upon and is consistent with the IFC Corporate Governance Progression Matrices for five types of companies (www.ifc.org/ifcext/corporategovernance.nsf/Content/CG_Tools). Also Willem Landman, CEO of the South Africa Ethics Institute, provided valuable inputs that are reflected in this figure.

OUR MISSION:

The Global Corporate Governance Forum is an International Finance Corporation (IFC) multi-donor trust fund facility located within IFC Advisory Services. The Forum was co-founded by the World Bank and the Organisation for Economic Co-operation and Development (OECD) in 1999. Through its activities the Forum aims to promote the private sector as an engine of growth, reduce the vulnerability of developing and transition economies to financial crisis, and provide incentives for corporations to invest and perform efficiently in a socially responsible manner.

The Forum sponsors regional and local initiatives that address the corporate governance weaknesses of middle- and low-income countries in the context of broader national or regional economic reform programs.

OUR FOCUS:

- Raising awareness, building consensus
- Disseminating best practices
- Sponsoring research
- Funding technical assistance and capacity-building

OUR DONORS:

- Canada
- France
- Luxembourg
- The Netherlands
- Norway
- Switzerland
- International Finance Corporation

OUR FOUNDERS:

- World Bank
- Organisation for Economic Co-operation and Development



Global
Corporate
Governance
Forum





Global
Corporate
Governance
Forum

2121 Pennsylvania Avenue, NW
Washington, DC 20433 USA
Tel: +1 (202) 458 1857
Fax: +1 (202) 522 7588
cgsecretariat@ifc.org
www.gcgf.org