

SMITH ANDERSON

The Ethical Organization: Current Thinking and Best Practices

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“Some of what you read will be so consistent with your intuitive senses that it will look and feel familiar... but in our experience, much of corporate America’s response has been to pay superficial attention...”

Some of what you read may be so counter-intuitive as to be difficult to accept... do not dismiss that which makes you feel uncomfortable or which challenges your assumptions.”

Michael G. Daigneault
President, Ethics Resource Center

1.0 Reasons Your CEO Will Focus on an Ethics Initiative

The Big Question: Can we afford to invest in an ethics initiative? Won't it put us at a disadvantage to our competitors?

The Answer: Yes and no. Current thinking is that you cannot afford not to adopt an ethics initiative if your goal is long-term success. The reason – Competitive Advantage:

Consumers will focus on the values behind the brand name. Whether in the services or manufacturing sector, companies can win an edge with consumers if they can project an image of trust into their names.

Employees want to work for companies whose leadership they trust and whose values and way of doing business they respect.

Investors will demand greater corporate governance and accountability.

Business partners will enter into alliances with companies that enhance the venture’s public reputation and will not be willing to risk their reputations by participating with partners whose ethics are questionable.

Government agencies, nongovernment watchdogs, the media and the Internet will play a vital role in keeping the pressure on to make ethics an indispensable element to a successful relationship with the company’s stakeholders. “The fact is that the Internet makes us totally open – there

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is nowhere for corporations to hide.” Alan Hassenfeld, Hasbro, Inc. Chairman and CEO.

- Historically, ethics initiatives were triggered by U.S. Federal Sentencing Guidelines for Organizations, or actual or close-call ethics crises at the company or in the industry.
 - Sarbanes-Oxley will trigger more emphasis on ethics initiatives.

2.0 Best Practices

2.1 Using Best Practices

- Best practices are not one size fits all. What works for one organization may not work for another.
- **Bottom line question: What is the likelihood that this best practice will produce the specific desired result within your organization given its culture, resources, goals, priorities and other circumstances?**
 - To determine whether another organization’s “best practices” will work for your company, consider your organization’s culture, resources, goals and priorities, and compare them to the organizations whose best practices you are considering.

2.2 Commitment and Accountability

- Board of Directors. The organization’s Board ultimately has the responsibility for setting and monitoring the organization’s values. Sarbanes-Oxley will place more emphasis on this element.
 - The values buck stops with the Chairman.
 - Every stakeholder must associate the Chairman with the organization’s commitment to its values program.
 - The Board should establish selection criteria for CEO candidates that enhance the likelihood of selecting an individual suited to fulfill the organization’s ethical obligations, and should design compensation and performance review systems that further these goals.

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- **Management.** The Board and CEO cannot manage the daily implementation of the programs. This must be delegated to an executive who possesses, and is seen as possessing, authority on par with the CFO, General Counsel or other direct reports of the CEO.
 - Ideally, this person reports to both the CEO and Chairman.
 - Select ethics officers with care. Persons who employees associate with the status quo or wrongdoing can be detrimental to the program.
- **Biggest Challenge: How to make the CEO's commitment a reality?**

2.3 Compliance v. Values-based Programs

2.3.1 Generally

- **Decide on which approach is best for your organization.** The practices and components of each may be very different. Failure to understand the difference may lead to the creation of a compliance program that is wrongly billed as a values-based program, which may lead to expectations from stakeholders that are unfulfilled.
 - A **compliance program** emphasizes the avoidance of regulatory and legal exposure and focuses on officially enforceable, and somewhat more objective standards – laws, regulations, policies, procedures.
 - A **values-based ethics program** emphasizes basic principles for living the organization's values beyond the concerns for legal or regulatory exposure in whatever context or challenge presented. The success of these programs relies more on employee perception, support and ownership.
- **Advantages of a Value-based Ethics Program**
 - No program or code will ever cover every challenge employees will face. Employees who understand the organization's values will be better able to make appropriate decisions, even when faced with a new and complex challenge.

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- Operational efficiency. Avoids the “How far can I go before I break the rule mentality?” Values are more fundamental and ingrained into the thought process. “Every action, initiative, program and project must match our company’s values.” Judy Streeter, Senior Vice President, Marriott International Inc.
 - Allows employees to make better, ethical choices in a dynamic, changing work environment.
 - Positive brand effect of reputation for being an ethical organization.
 - Studies show that ethics programs are most effective when perceived by employees to be “values-driven” rather than simply compliance driven and that values-based programs were most effective in reducing unethical behavior, strengthening employee commitment, and making employees more willing to deliver bad news to managers.
- **Before an ethics initiative can be developed, the organization must be clear on what its values are and clearly define those values, beliefs and ideals.** The result must be a statement that clearly communicates what the organization believes is right and good, how the organization will treat its employees, how the employees will treat each other, how employees will treat customers and how the organization contributes to society.

Tips:

- Selected approach must be congruent with the organization’s needs, goals and resources.
- Ask why the organization needs a particular type of program (compliance v. ethics v. compliance/ethics) and how that approach best fits the organization.
- Build on, and honor, what already exists in the outline. This can reduce resistance by managers and employees.
- Make the business case by listing ethical lapses at other companies and the costs incurred.

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2.3.2 Integrating Ethics and Compliance Programs

- Compliance programs are often springboards for values-based ethics programs. The transition does not decrease the compliance element but rather adds the values component.
- Active participation of CEO and other leadership and leadership communication is more critical to the success of a value-based than to a compliance-based program. See 2.5 Leadership

2.4 Topics to be Covered

- Content will be driven by the purpose and objective of the initiative.
- The program must adapt to changing circumstances and demands and track global issues, current thinking and varying priorities among stakeholders.
- Common topics, include:
 - Legal compliance
 - Ethics and business conduct: beyond the law as applies to all stakeholders – employees, suppliers, vendors, customers, stakeholders, community, society
 - Corporate social responsibility: giving back to the community
 - Human rights standards: privacy, diversity, freedom of association
 - Labor standards: compensation, dispute resolution
 - Health, safety and environmental standards: safe and environmentally friendly facilities, products, processes
 - Sustainable development: economic growth with long-term commitment to environmental protection and social equity
 - Anti-bribery, anti-corruption
 - Good governance: Sarbanes-Oxley will place more emphasis on this element.

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2.5 Leadership

Successful leaders are individuals who set for themselves and those around them a moral compass, a sense of ethical purpose in all that they undertake.

America's business leaders need not only to commit themselves to ethics as a central principal for their professional lives, but also to make that commitment known – to employees, stakeholders, customers and all others who need to be aware that ethics are a crucial aspect of business decisions.

Norman R. Augustine
Former Chairman, Lockheed
Martin Corporation

- Visible commitment from the CEO and senior executives is a must.
- Perception can become reality. How employees view their leader's ethics will shape the work environment.
- If you want it done, make it a priority.

2.5.1 Tips for CEO and Senior Executive Communications

- Continual and consistent internal and external communication is a must, especially to maximize the opportunity for a competitive advantage through an ethics initiative.
- Communicate why ethics is an important core business issue and what the organization expects of all employees and partners.
- Be actively involved in creation and management of program. Participate in training sessions. Make ethics a regular component in speeches and presentations.
- In communicating business decisions to employees and other stakeholders, openly discuss the "ethical" reasons for the decision as well as other reasons. Require direct reports and other managers to do the same. This will increase the likelihood that employees will consider ethics in making decisions.

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- Acknowledge ethics issues involved in the situation at issue and how the resolution addresses those issues.
- Talk about the ethics success stories and make them company legend.

2.5.2 Actions speak louder than words. Be a role model.

- Align your own behavior with the standards set.
- See 2.7 Practicing Values/Being a Role Model

2.6 Corporate Communications

- External Communication
 - Consider developing an integrity website highlighting the company's values policies or publishing an annual integrity report covering topics such as employee and customer privacy, compliance with workplace ethics regulations, environment, human rights, etc.
 - See Lockheed Martin website materials (App. A).
- Recruiting the Right Stuff
 - Lay the groundwork for hiring employees who fit into a values-based culture by communicating those values in the recruiting process.
 - Use behavior-based interviewing designed to assess the candidate's fit with the culture and assess how he or she would react in difficult situations.
- Internal Communications
 - Use constant communication about values in form of newsletters, online stories, posters, formal and informal meetings.
 - Engage in two-way dialogue with employees about values, BUT seek employee input only if you plan to acknowledge and address it. Failure to do so, leads to employee cynicism about the program.

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2.7 Practicing Values/Being a Role Model

- Starts with the CEO and senior leadership.
- “Every action, initiative, project and program must match our company’s values.” Judy Streeter, Senior Vice President, Marriott International Inc.
- Practicing values is important. The 2000 National Business Ethics Survey conducted by the Ethics Resource Center reported that when employees see ethical values applied frequently at work, they:
 - Feel less pressure to compromise ethics standards
 - Observe less misconduct
 - Are more satisfied with their organization’s response to reported misconduct
 - Are more satisfied with their organizations
 - Feel more valued as employees.
- Peer pressure is a significant factor in an ethics initiative breakdown.
 - When employees have an ethical dilemma, they take it to a peer or first-line supervisor. These individuals need to be in a position to explain the specific actions that the organization’s values require.
 - Where there is pressure, there is observed misconduct. The 2000 National Business Ethics Survey conducted by the Ethics Resource Center reported that 71% of pressured employees observed misconduct in their organizations while only 24% of non-pressured employees observed misconduct.
 - First line managers report the most pressure
 - Most pressure is from internal sources (management, supervisor or co-workers)

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- More than 1/3rd of surveyed employees believed that, if they report misconduct, management would view them as troublemakers and co-workers would view them as snitches.
- When a problem is identified, fix it.
- Create whistleblower protections. Sarbanes-Oxley will place more emphasis on this component.

2.8 Ethics Policies and Codes

2.8.1 Start with Identifying the Company's Values

- Create a written statement on the organization's values, "This is what we believe is right, fair and good." It must set clear expectations integral to all operations – not an add-on after all important decisions have been made. Make it a written pledge for all employees at all levels of the organization.
 - The statement should address how the company will address adherence to its values and ethics, how employees will be rewarded for adherence, and how deviations will be addressed. Include whistleblower protections and sources where additional guidance may be found.
- Integrate values into the organization's mission and vision statements.

2.8.2 Involve Employees Early

- Develop the policies and codes after dialogue with employees at all levels of the organization.
 - Must address full range of ethical dilemmas that employees are likely to face and be updated regularly to address new challenges as they arise.
 - Internalize branding messages. The external marketing message means nothing if employees don't experience it in the workplace.

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- Use employee focus groups to provide feedback on draft policies.
- Make the policies and code a living document. Update annually with input from employees at all levels of the organization. Use annual sunset and formal re-adoption procedures.

2.8.3 Leadership

- Reviewed and promulgated by the Board of Directors.
- Publicly endorsed by CEO and senior leadership.

2.8.4 Communication

- Communicate it clearly and frequently inside and outside the company.
 - Consider sharing the code with business partners, suppliers, shareholders and other stakeholders and placing it on the company's web site.
- Condition employment on employees reading and signing the policies at hire and each year, but keep in mind that this is not enough. What is written must be communicated in company decisions and actions and lived every day. Failure to do so can create skepticism and cynicism among employees.

2.8.5 Drafting

- Content/substance must be driven by the purpose and objectives of the code and, in some cases, laws and regulations, the particular industry and stakeholder concerns.
 - Be sure it is consistent with the latest laws and regulations. Sarbanes-Oxley will impact content.
- Consider an introductory letter from senior leadership addressing why and how the code has been developed and how it will benefit the company and employees.

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- What are the objectives – regulatory? guidelines for decision-making? further the company culture? inspire to higher levels of conduct?
- To whom does the code apply?
- Use simple and direct language. Translate into foreign language, if necessary. It needs to be understandable to employees at all levels.
- Consider using examples.
- Select a fitting and memorable name.

2.9 Ethics Training

2.9.1 Format

- Create a wide variety of innovative training formats that allow employees to be active participants: role plays, simulations, case studies, games, quizzes in addition to supervisor-led training and web/computer based training.

Example: Lockheed Martin developed an Ethics Challenge game based on Dilbert characters that required employees to think through and discuss ethics dilemmas.

2.9.2 Content and Objectives

- Focus on actual scenarios likely to be encountered by employees. This may vary among jobs.
 - Bottom line: Teach employees how to translate the policies into specific actions that support the policies.
- Arm employees with “integrity self-test” which allows them to assess their responses to any situation by the following parameters:
 - Is the action legal?

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- Is it consistent with the organization's business values and a winning situation for the company and its stakeholders?
 - How would you feel about your decision after your mother, friends and community learn about it in the media?
 - What would you do if you owned the company and were responsible for its actions?
- Train employees to identify incongruities between what the company says and does, and talk about them in staff meetings.
- Survey employees periodically asking for responses to typical ethical dilemmas and create the training program based on potential trouble spots revealed by the survey.
- Survey employees at all levels. Research shows that senior and mid-level managers are more positive about ethics than lower level employees and may overlook and fail to address issues encountered at lower levels.
 - Remember that pressure may be an important indicator of actual misconduct and it may be a less sensitive topic to survey.

2.9.3 Integrate ethics training into training on other training subjects.

2.10 Evaluate Ethics Program Success

- "What is measured is done." Stephen Potts, former Director, U.S. Office of Government Ethics.
- Determine whether employees are living the code and measure the difference it is making to employees, stakeholders, and the bottom line. Conduct these assessments on an ongoing and consistent basis.
 - Report help line activity numbers, patterns in issues raised, disciplinary action taken, actions to protect whistleblowers, training activity, internal assessments of employee perception of

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ethics program effectiveness, evidence of adherences or violations of company ethics standards.

➤ Key Questions

- Is the program aligned with the organization's mission and vision?
- Does the program fit well with the organization's systems, policies and practices?
- Does the program address leadership priorities and employee expectations?
- Is the program used regularly by all employees at all levels to help guide decision-making and actions?
- Is the program a central part of the organization's culture?
- Evaluate whether employees are retaining and acting on what they learned.
- Over time, focus on the ethics initiative generally shifts from building the program to operationalizing it.

2.11 Provide Vehicles for Ongoing Guidance and Support

- Research shows that the top two reasons employees do not raise ethics concerns/report misconduct are: (1) they do not believe anything will be done and (2) they fear retaliation.
 - While formal reporting mechanisms are important, corporate culture is even more important to getting employees to raise issues.
- Set up ethics help line to let employees anonymously raise ethical concerns that they do not feel able to discuss with their supervisors.
 - Consider using third party vendors to handle calls so that employees feel more comfortable raising sensitive issues.
 - Contrast these help lines with alert hot lines that allow employees to report possible violations.

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- Share actual internal case studies to illustrate how the policies were/should have been applied.
- Put whistleblower protections in place.
 - Hotline that allows anonymous reporting limits risk of whistleblower claims.
 - Sarbanes-Oxley will impact this element.

2.12 Ethics Investigations

- Consider using investigators who have prior operational experience who may have a broader perspective and sensitivity than investigators with only investigation experience.
- Be sure employees who report misconduct are told what to expect from the investigation and how decisions are made.
- Address the concerns of employees who are under investigation (e.g., anger, etc.), tell them about the process and allow exonerated employees to give feedback about the process.

2.13 Reward Successes, Punish Failures

- Reward employees who live the policies; punish and remove those who do not and those who condone or permit such transgressions. Hold employees accountable for transgressions.
- Celebrate successes. Make them organizational legend.
- “What is measured is done.” Use performance management systems to address employee behavior, good and bad, and to monitor compliance with standards.
- Consider bonus incentives for measurable ethical performance success.

3.0 HR’s Role in Corporate Ethics Initiatives

3.1 Generally

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- Everything HR does – every action, initiative, program and project – has an effect on corporate culture.
 - Every HR function must be involved in a systemic effort to create a values-based culture.
- Carry corporate values into the department mission statement.
 - “Attracting, retaining, developing and supporting extraordinary warrior spirits, who will enhance our corporate culture and deliver positively outrageous customer service.” Mission Statement, People Department, Southwest Airlines.
- Internalize the company’s external branding message.
 - Southwest Airlines brand message features, “giving people freedom.” HR adopted an internal branding message featuring eight employee freedoms (e.g., freedom to pursue good health, freedom to create financial security, freedom to learn and grow, etc.)

3.2 As an Ethics Leader

- Significant Role in:
 - Creating codes of conduct (see 2.8 Ethics Policies and Codes)
 - Developing ethics training and integrating ethics in all training (see 2.9 Ethics Training)
 - Adjusting performance systems to include ethics
 - Designing compensation systems to incent ethics performance
 - Integrate ethics as a criteria in recruiting, promotion and succession decisions
 - Managing ethics upward by making sure leaders have guidance on and awareness of their roles in shaping ethics culture
 - Monitor leadership decisions and provide feedback on how the ethics of these decisions may or may not be perceived by employees, stakeholders and the public

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- Provide coaching to leaders on enhancing communications about their ethical commitment and feedback on the visibility and consistency of ethics messages being sent in their speeches, presentations, interviews and articles
- Bring to senior management's attention specific concerns and challenges occurring at lower levels and engage their discussions of the appropriate course of action
- Bring industry best practices and current thinking to their attention through articles, reports, surveys, etc.

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Suggested Reading and Resources

Suggested Reading

Insights 2000: A report of the ERC Fellows Program (available online @ www.ethics.org) Report covers insights, challenges, implications and recommendations on corporate ethics initiatives

The 2000 National Business Ethics Survey: Key Findings and What They Mean for Organizations (available online @ www.ethics.org). Results from nationwide survey of 1500 employees

Corporate Integrity and Globalization: The Dawning of a New Era of Accountability & Transparency (available online @ www.ethics.org)

Online Resources

Business for Social Responsibility, www.bsr.org

Ethics Resources Center, www.ethics.org