# *ETHIC CODES FOR MODERN CORPORATIONS*

*2005*

# CODES OF ETHICS FOR MODERN CORPORATIONS

> *"When nuclear plants blow up, planes crash and firms fail, we tend to blame human error. The world is a safer place if we can locate the source of a disaster in an individual's mistake, poor judgment, or even wicked human nature. While our recent business scandals have produced the usual rogues' gallery of despicable individuals, our deepest fear is that our economic institutions are flawed in some fundamental way. If so, all seems lost."*
>
> James P. Walsh, Professor of Organizational Behavior and Corporate Strategy (Crisis in Corporate America, 2005)

## Introduction

The latest five or six years can be called a dot.com era, when traditional values tend to rapid change and diverge from their habitual perception. At the same time, recent events have clear-cut the vulnerability of post-modern value-system when plenty of what we have already accustomed just rushes in collapse without any visible reason for estranged observers. At first glance it can look almost incredible and impossible, but what we consider standards of stability flummoxes, depriving as sometimes from our abiding faith in future.

Nowadays we are witnessing rapid demands for corporations that are now in the vanguard of social progress. Recently we have all become the "hostages" of business whether we like it or not. We are employed by corporations and companies and our welfare depends on private business as we receive salaries from business, invest in business, and consume the goods created by business. We are literally surrounded by corporate business in our everyday life.

As far as modern corporations seem to be the pillars of modern society, people are eligible to insist for certain accountability of business (Callahan, 1988). In this essay I will argument the needs for strict codes of ethics for modern corporations.

**The need for codes of ethics in modern business**

Growing value of modern business increasingly requires development of clear standards of ethic codes and responsibility principles that would be declared and shared by corporations. These ethic codes which serve “constitutions” for businesses are probably the most important demands of society to corporations. The ultimate function of ethic is to produce greatest good for greatest number of people (Callahan, 1988)

The same way as society demands ethics and morality in political sphere (constitutions and checks and balances systems are obviously the best examples of governments’ accountability for society) it determines design of corresponding ethic codes in business environment. Ethic codes are first of all associated with the issues of corporate compliance, corporate governance, corporate sustainability and corporate social responsibility (Hurst, 2004).

Corporate ethics is a complex issue and is usually defined as overall relationship of corporation with all of its stakeholders, including customers, employees, communities, owners/investors, government, suppliers and competitors (Hurst, 2004). In a wider extent, business ethic involves moral obligation of CEOs and chief officers, their concern of organizational and social problems that extend the boarders of a single company. To my mind, ethic codes are nothing else than CEOs’ obligations to provide transparent and frank business policy with concern of not only direct shareholders but of a society as a whole. As a matter of fact, ethic codes are first of all moral responsibilities of companies (Cowe, 2001).

Callahan (1988) subdivides three general perspectives of ethics, i.e.: metaethics (or the ethics as an ultimate good in philosophical meaning), theoretical normative ethics (what is generally good or bad) and applied ethic (specific ethic norms and principles applicable to different spheres).

For a long time business ethics had been considered a contestable issue (Callahan, 1988). Though it is widely recognized nowadays, we are still witnessing now the most daring financial frauds. This thesis seems to challenge the practical need for codes of ethics. Indeed what is the reason for ethics if it is not followed by CEOs and senior officers? This issue needs more detailed analysis.

Until the last quarter of XX century business hardly implied excessive humanity. Ethics and morality were the possible reasons for defeat in a war for clients and market. However, as the role of private business increased globally, the issue of ethic codes became one of the central in relationships between business and society.

Growing importance of business ethics is strongly associated with globalization and forming of transnational corporations. On the one hand globalization created incredible perspectives for corporations. On the other hand, however, it provided an ever-greatest challenge for business. Without clear code of ethics all modern system of business may turn to be a house of cards provoking global and national economies collapse. The 1929 financial crisis serves a good illustration to this idea (Cowe, 2001).

Since the 1970s, multiple corporations have been gradually recognizing business ethics in a number of ways. This included development of compliance programs for personnel, design of board-level ethics committees, introduction of codes of conduct and value statements, publishing annual reports, recruiting corporate social responsibility (CSR) managers and provision of special trainings for personnel. Regardless these visible efforts the problem of ethics in business is still disputable. Observing Callahan (1988, p.10) corporate ethics in 1970s-1980s received wisdom, values, and pieties of conventional morality established by tradition and directed by customary rule of the business.

In fact, ethics and morality appear to be complex questions that include philosophical, moral, ethical, social and economic aspects. However, as conventional wisdom says that excessive morality may spoil one’s business, many companies still prefer not to declare their codes of ethics. The most common examples are probably Enron, Daewoo Motors, WorldCom, ImClone Parmalat, Bre-X and many others. Applying the ideas of Callahan (1988) to the issue many contemporary corporations still tend to be “directed by traditional or customary rules or practices without stopping to examine or criticize those rules or practices or customs” (Callahan, 1988, p. 10).

With concern of this governments and people put dramatic efforts to force corporations follow certain codes of ethics. These efforts are usually endorsed by the following arguments.

First of all, as mentioned above, modern society is increasingly dependent upon business. Therewith, taxpayers have the right to know the policy and standards of the important market players. People have the right to receive the all-round information about the company, its potential threats, forthcoming crises, etc. In the other words, people have the right to know if their welfare and investments are managed properly (Grayson, 2005).

The second argument implies relationships between corporations and stakeholders, i.e. employees and their families, customers, suppliers, investors, etc. In terms of globalization each company may have millions or even dozens of millions of stakeholders. Let’s take the instances of McDonalds which services around ten millions people daily or Microsoft which software is installed obviously on each of thousands’ millions of PC elsewhere. Hence, quite often the whole civilization appears dependent on a single company. It is a harmful tendency which must be managed by means of codes of ethics (DeJardins and McCall, 2000).

The third problem is companies’ accountability for society as a whole. In a wider context, all people appear to be stakeholders of corporations to a lesser or greater degree. Hence, they require clear interrelationships between business and society. Thus, the companies are responsible for struggle with long standing problems of society among which diseases, illiteracy, poverty and underdevelopment can be mentioned.

Eventually, in terms when politics, doctors, engineers and other professionals do have their codes of ethics it is essential for corporations to develop their own standards of ethical conduct (Callahan, 1988). The doctors will hardly have a good practice without blameless reputation; engineers and architects will not have projects without ensuring reliability of their mechanisms and business; yet, politics will never be elected without a clear program also implying ethical principles (Lewis, 2003).

Summarizing these theses, the general idea of modern business ethics lies in growing role of corporations and their intervening into various areas of social life. This growing role of business leads to increasing moral, social and economic obligations of corporations. This insists of corporations’ accountability for stakeholders and society in general.

**Poor codes of ethics as the reasons behind financial scandals**

It is globally recognized that one of the major problems contributing to the collapse of such giants as Enron, WorldCom, ImClone, Parmalat, Barings and many others were poor morality and ethics. Also the causality between organizational effectiveness and ethics may seem vague at first glance both concepts are inextricably linked. Underdeveloped ethical principles often result in workers non-compliance, high level of employees’ turnover, poor corporate reputations, ineffective management, poor communication within corporation and with clients and suppliers, yet, inability to create respected and demanded products. Besides, absence of control (the system of checks and balances) allows the companies to make uncontrolled business behind stakeholders’ back.

A good example of ethics’ role in corporate environment is the case of Chrysler. Being at the point of collapse Chrysler clearly declared its ethic code that inspired hope in stakeholders and society. In 1987 the CEO of Chrysler Corp. Lee Iacocca managed to master the trouble puzzling out the situation that seemed dead-end. The benefit was double: on the one hand Chrysler coped with the problem successful and on the other hand received an image of a trustworthy company which cares of its stakeholders.

There are of course many opposite examples. Recent corporate scandals (e.g.: Enron, WorldCom, Tyco in the US, Bre-X in Canada, and Parmalat, Vivendi, Ahold in Europe) have emphasized the vitality of codes of ethics (Thomas, 2005). The case of Enron is one of the most notorious financial collapses associated with poor business ethics.

Enron that collapsed after a disclosure of massive frauds on December 2001 was one of the leading companies on the US energy market. Within fifteen years Enron grew up from local company to the US seventh largest corporation 21.000 personnel in more than 40 countries (Thomas, 2005).

Enron’s case is specific as it used a surrogate (I would called it staged) ethic code. For three years before its collapse Enron was named among the 100 Best Companies to Work for in America. In the year prior to its disclosure Enron received six environmental awards for its politics towards climate change, human rights, and anti-corruption. However, the Enron corporate code of ethics which appeared to be the most sold issue on eBay soon after company close was named the never opened book (Lewis, 2003).

The overall theatrics, however, was a part of Enron’s corporate strategy. Enron’s CEO Jeffrey Skilling used a theatric of leadership to convince stakeholders that the company is far from financial collapse. Being aware of forthcoming crisis Enron’s chairman kept playing a sort of a public relations game which measured with knockabout – illusion of corporate theatre. This knockabout was clearly demonstrated in 1997 when Jeff Skilling signed a deliberate loss making deal with twenty percent discount (as compared with Peco Company) just to enter Pennsylvania's market (Hurst, 2004). This showmanship of Enron's leader was accompanied with nine radio interviews, plane flights and banners within a single day.

Besides, Enron lied about its net profits and used to conceal the debts so that they did not show up in corporate accounts. Additionally Enron's CEO employed the practice of shady dealings that were not appearing in company's reports (The Chronology of Enron Corp., 2005).

The credo of company's administration was clearly reflected in its motto "The Coolest Company on Earth" (Streitfeld and Romney, 2002). It is illustrative that when Enron's case was about to be regulated its CEO and senior executive managers appeared to be rats leaving a sinking ship. Unfortunately this kind of ethic is still common in modern business.

WorldCom, another notorious example of poor codes of ethics, perpetrated accounting fraud leading to one of the largest bankruptcy in world's economic history that took place in July 2002. WorldCom, one of the leading telecommunication companies in the US and overseas operating in 65 countries, employing around 85.000 people and having a network stretching over 150.000 kilometers, was accused of fraud following its announcement it inflated cash flows by US $ 4 billion (Hurst, 2004).

As well as Enron, WorldCom was a victim of poor business ethics that embodied in poor accounting. On June 25, 2002 WorldCom CEO Bernard Ebbers announced the fact of improper accounting of US $ 3.8 billion within the periods of 2001 and first quarter of 2002. It was not a mistake, however. WorldCom deliberately concealed its profits and ignored some senior managers' warnings about possible threats. As reported, WorldCom "disguised its true operating performance" and "misled investors about its reported earnings" (Accounting scandals, 2005).

Again, the issue of corporate ethics was implicated in WorldCom case. Disclosed companies debts soon led to 80% decrease of WorldCom's share price. Eventually, in July 2002 after the audit conducted by Arthur Andersen (which in fact indicated no accounting problems) the company collapsed as well as hundreds thousands of shareholders, including employees and their families. Within six months that is by the end of 2003 WorldCom's assets were estimated to inflate by around US $ 12 billion. It is noteworthy, that quite soon the company with almost a hundred years experience also stepped in corporate crimes.

Peculiarity and obviously an aggravation of the WorldCom case is that its CEO Bernard John Ebbers was an active member of Easthaven Baptist Church teaching in Sunday school. Also he admitted he was unaware of the case, for most people his personality remains a good illustration of hypocrisy in respect to ethical principles. It is indeed s strange case of split personality when a moralist who stands behind pulpit becomes a deceiver coming back to his office (MCI, 2005).

**Codes of ethics in a wider context: the need of morality and checks and balances**

To assess the ethical issues of all above cases we also need to provide a wider context for our analysis. With this I mean the need to examine ethical codes of Wall Street – the US major financial center and Bay Street – Canadian financial Mecca. The point is that neither in the US nor in Canada can a single deal occur without the implication of Wall Street or Bay Street financiers. When a company goes a wrong way it is a responsibility of financiers and accountants to disclosure the evil (Bachelder, 2005). So, in all of the above mentioned cases financial tycoons were obviously conspiring with CEO and senior executive managers.

It is illustrative that many responders tend to believe that Wall Street higher-ups were responsible for all of the above mentioned scandals (A Sore Spot…, 2005). Thus, the original issue of business ethics extends nowadays the limits of a single company; it is rather an ethic of a business in principle, an issue of responsibility, and moral obligations of greats for common people, yet, an issue of conscience. To my mind it is the same weak moral that is allegorized in a well-known proverb: one beats the bush while another catches the birds.

I believe that Wall Street and Bay Street need to have greater checks and balances than national governments. A single governmental administration can not be as effective in monitoring of corporate ethics as accountants and financial experts. Therewith, the issue of business ethics needs to be first of all shared by NASDAQ, Toronto and Montreal Stock Exchange involved in this process.

However, we also can not forget about the ethics of companies. Nowadays we are the witnesses of increasing tendency to declare one principle of ethics and follow brand different one. CEO and senior executive managers either hire their relatives and friends or warn them about forthcoming crises (ImClone and Parmalat case). Financial experts and accountants often have financial interests in a certain companies or serve as consultants (Enron case). Brokers often have various interests and do not want to lose their money and upset their clients (Vivendi case). Politicians often have their own concern in business and maintain selected corporations, often instructing accountants and experts what to investigate and what not to investigate (Halliburton case) (Ferrell and Ferrell, 2005).

To my mind this tendency is nothing else than spoiled system of checks and balances, rotten objectivity and morality, centralization of control in the same offices which need to be controlled themselves. A good illustration to this idea is Latin morality “Who will guard (watch) the guardians”. This issue is a dilemma in fact. Actually, there are two possible solutions. On the one hand it is development of effective system of checks and balances. On the other hand it is the issue of morality and ethics, responsibilities and obligations, yet, honesty and dignity of managers and owners. To my mind, the combination of both factors may be the best way out from the problem.

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