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Mr, Johan Scheffer, MLC Chair  
Law Reform Committee  
Parliament of Victoria  
Spring Street,  
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Dear Mr Scheffer

I am Secretary of the Australian Association for Professional and Applied Ethics (AAPAE). I recently received a telephone call from your Executive Officer Ms Kerryn Riseley and a letter from you regarding your review of the Members of Parliament (Register of Interests) Act, and your interest in obtaining submissions to the inquiry.

I have circulated information on your review to the executive of AAPAE, and made an announcement on the AAPAE's list server, which goes out to some 300 teachers of ethics and practitioners who have a workplace responsibility for ensuring observance of ethical practices.

This letter, however, is an individual, not an AAPAE submission. It is intended to bring to your attention the results of recent research (and some well established administrative practices) on developing effective codes of ethics. This work is outlined in a recent paper that a colleague and I wrote for an accounting journal and which is attached. In essence, it says that codes of ethics (and register of interests, which is essentially a code of ethics) are most effective when developed by the people who are responsible for observing the code. There three reasons for this increased effectiveness:

1. People who are at the front line of organisational ethical challenges are more likely to know what are the ethical issues that will surface and challenge them
2. If they identify them, and decide what the code's response should be, they are more likely to commit to observance of the code. This builds on the well established theory that participation in decision-making ensures that the participant is more committed to implementing that decision.
3. Self development overcomes the belief that the code is dictated by those in positions of authority, designed as PR to show the world that the organisation is ethical

There is little chance that a self designed code would be self serving. There are enough ethical people, or enough people who want to show that they are ethical for the full picture to come out.

The attached paper suggests that this development is done by workshops, supplemented by additional research on problems particular to that agency or company. I have rarely heard of a workshop for an entire parliament, but maybe a voluntary one is possible. Alternatively a questionnaire to all parliamentarians rather than a workshop appears feasible. What are the more likely ethical issues faced by parliamentarians? What should the limits on the interests that should be registered? Parliamentarians would know the answers better than outsiders. If any of your staff want to discuss these ideas further I would be only too pleased to help.

Yours sincerely

Peter Bowden



## Making codes of ethics meaningful and effective

By **Peter Bowden**, Department of Philosophy, University of Sydney and National Secretary, Australian Association of Professional and Applied Ethics, and **Vanya Smythe**, Partner and Trainer, Magellan Ethics Consulting

- *Reasons for ensuring effectiveness of codes of ethics lie in benefits of corporate citizenship and profitability*
- *Vital for codes of ethics to have widespread staff involvement and for staff to be assigned to manage the operation, updating and disciplinary processes*
- *Effective codes of ethics respond to actual ethical issues experienced by organisations*

Codes of ethics are widely regarded as being ineffective. So the question to answer is if we want to make them effective, what do we need to do? And if we cannot make them effective should we even bother to have them? This article attempts to answer those questions. It is about building the efficacy of codes, their problems and their solutions, and is based on an extensive review of the research literature plus much experience on the effectiveness of codes of ethics.

Two principal reasons lie behind the reported lack of effectiveness of codes of ethics.<sup>1</sup> First, companies are seen to use them primarily as public relations vehicles. As such, codes of ethics are designed more to convince customers, suppliers, employees and even shareholders, that the companies are honest, trustworthy organisations. There is, however, little or no managerial backup that ensures that the code is ethically useful and relevant to the needs of the organisation's stakeholders.

Second, codes are seen by staff as top-down management dictates. They are designed more to stop theft or other misuse of resources by

employees than to stop the company itself adopting unethical practices. There are dozens of areas in which companies can ignore the ethical issues that concern their employees and the public — in their advertising, pricing and marketing practices; in their commitment to environmental issues; in employee relations; in executive payments and particularly in their recruitment, promotion or dismissal systems. We have seen many examples of ethical misbehaviour in Australia in recent times, including FAL, HIH, the Australian Wheat Board, James Hardie, and the developer funding of political parties. Or the concerns in the public sector — Wollongong Council, the scandals in hospitals, the unethical behaviour of some politicians, the graft in NSW RailCorp, or the NSW Fire Brigade for instance.

Enron Corporation's code of ethics is perhaps the best known example of a public relations exercise. The 64-page document was placed on the internet by a public interest website. In the words of Enron's Chairman, Kenneth Lay, subsequently convicted on six counts of conspiracy, securities and wire fraud in the corporate trial and all charges against him in the personal banking trial:

*As officers of Enron Corp, its subsidiaries, and its affiliated companies, we are responsible for conducting the business affairs of the companies in accordance with all applicable laws and in a moral and honest manner ... We want to be proud of Enron and to know that it enjoys a reputation for fairness and honesty and that it is respected...*

*Compliance with the law and ethical standards are conditions of employment and violations will result in disciplinary action, which may include termination ... in addition to responding to the legislation, we are adopting this Policy Statement to avoid even the appearance of improper conduct on the part of anyone employed by or associated with the Company ... We have all worked hard over the years to establish our reputation for integrity and ethical conduct. We cannot afford to have it damaged.<sup>2</sup>*

The document prohibits directors, officers or employees from trading in Enron stock, an issue on which several of Enron's directors came unstuck.

The strongest arguments supporting the importance of the design and adoption of an effective code of ethics can be found in the research that indicates that most of us want to work for an ethical employer, a finding based on extensive surveys of employee attitudes. It is also a finding that is readily acceptable. People believe that an ethical company will treat them fairly, and will itself interrelate with the outside world in ways that employees will support.<sup>3</sup>

Other research findings we need to mention are that ethical companies are more profitable. This finding has come from studies by researchers in the US.<sup>4</sup> One reason for this finding may be that employees who believe that they work for an ethical company will give it greater loyalty and commitment. A more pragmatic explanation is that ethical companies have lower compliance and contracting costs and are therefore more profitable.

For reasons of greater staff commitment and profitability, therefore, an effective code of ethics can be of considerable benefit to any organisation. From the perspective of the company, however, these are selfish reasons. Deeper reasons are all too obvious. The increasing importance of the role of business in our society, the impact that corporations have on the global community now and the increasing impact they will have on future generations dictate that we make every effort to ensure that they behave ethically and to the benefit of us all.

The moral and financial reasons for developing an effective code of ethics are reinforced by the increased emphasis being placed on sound corporate governance by regulatory authorities, and the role that codes of ethics have in these developments.

In all major industrialised countries, legislation and guidelines have been introduced to strengthen corporate governance practices. The steps adopted in Australia comprise:

- (a) the introduction in 2003 of the ASX Corporate Governance Council Principles and Recommendations, and their strengthening in 2007
- (b) the introduction in 2003 by the then Chairman of the ACCC of policies to reduce penalties in light of corporate compliance with the *Trade Practices Act 1974*, together with the current Chairman's policy in August 2003 to absolve companies that adopted a voluntary code of conduct from being subject to competition laws
- (c) revisions as part of CLERP 9 in 2004 to the *Corporations Act 2001*
- (d) the introduction of the AS 8000 series of Australian corporate governance standards,

which include the standard on codes of conduct, AS 8002–2003.

The ASX Corporate Governance Council Guidelines require the development of a code of conduct, with Listing Rules that require the company's annual report to state the extent to which the company complies with the guidelines.

The possibility that the Australian guidelines may be extended further is seen in the US Sarbanes-Oxley Act (SOX), which is more prescriptive than Australian legislative requirements. Introduced following the WorldCom and Enron debacles, SOX legislates board responsibility, the establishment of ethical standards and a code of ethics, and the creation of an internal whistleblower system for reporting wrongdoing in the organisation. Although the full impact of these changes is uncertain, they are nevertheless steps that are much stronger than current Australian practice.

The principal argument of this article, however, is that although the regulatory burden is increasing, the reasons behind ensuring an effective code of ethics lie more in the benefits that arise through good corporate citizenship and increased profitability. The following paragraphs first define a useful code of ethics and then set out a six-point program to ensure its effectiveness.

### The preferred type of code of ethics

A code can be a statement of values or it can be a statement of the ethical issues that staff are likely to encounter and the expected behaviour of staff when faced with these issues. Or, it can be a combination of both (which is the model that we advocate). Statements of values are statements like 'Be ethical', 'Act with integrity' or 'Be honest with customers, staff, owners, suppliers'. These statements can sometimes be taken to excess. The statement of values for the Australian Public Service, for instance, sets out 15 principles which could be easily condensed into two or three.

Perhaps the clearest example of a code of ethics gone wild, however, is that of the Institute of Engineers of Australia. Despite providing no specific guidelines on many of the ethical issues in the industry, the code sets out a multitude of exhortations on shared values, tenets, cardinal and specific principles, obligations to the community, obligations to clients and employers, obligations to colleagues and requirements in acting as an expert witness. Many of these abstract notions or generalised principles are superfluous and to a large extent repetitive. The code also does not provide guidelines, or at best offers only a very general guideline on some of the more difficult or contentious issues that an engineer may encounter.

The code that identifies ethical issues, sometimes termed a code of conduct, is more useful than the

values statement. It sets out to identify the issues that an employee might encounter and defines what the organisation or profession considers acceptable conduct. A statement of values is a desirable companion to a code of conduct, being designed to cover those new or unanticipated ethical difficulties that an employee may encounter. The trick is to get an all-encompassing statement of ethical values into as few sentences as possible.

### **Involvement of staff**

The involvement of staff in the development of the code overcomes the problem of staff regarding a code as a senior management dictate. The pivotal significance of the development process in contributing to the long-term effectiveness and crucial sense of code-ownership by staff is repeatedly acknowledged in code studies. A typical response by two researchers is 'A good code corresponds to the concrete moral dilemmas which employees of the firm experience in their duties'.<sup>5</sup> We believe that employees, given adequate support facilities to develop their own code — at times in discussion with senior management on desirable policy, and with the eventual endorsement by the CEO — will produce an effective code for the organisation, one that is actually followed.

We see the process of code development as an extension of the activities required to produce an ethics training program for the organisation, or for the industry. Developing such a program must be driven from the ground up. We emphasise the importance of interactive code development and maintenance, not as a management tool but as an aspect of company culture in which all staff recognise a sense of personal and collective ownership that contributes to pride in belonging to an ethical organisation.

The research evidence further supports our assertion that, just as people cannot be taught to be ethical, so codes cannot — and consequently ought not be intended to — manipulate behaviour. The myth that a code of ethics can be a tool to control ethical behaviour is frequently encountered. The results of extensive studies on code effectiveness, however, shows only 'mixed results'; that the impact of a code on organisational and individual behaviour 'provided only weak correlation'. One text noted 'that organizations can steer the conduct of employees to only a limited degree'.<sup>6</sup>

The answer then is staff involvement. There is sufficient evidence in psychology literature to assert that a group of individuals working collectively will produce guidelines that are morally sound and administratively effective.

### **The active contribution of senior management**

Despite the arguments for a bottom-up code, the active commitment by senior management is crucial to the creation of an ethical company. This commitment can be evidenced by the CEO's endorsement of the code and assignment of independent staff to manage the ethics program (of which the code is an integral part). There will be decisions on corporate ethical behaviour that have financial implications — issues of safety training, environmental protection, gift giving and receiving, treatment of suppliers and buyers, even shareholder policy — that will require executive approval. There will be times (hopefully not too often) when the developers of the code will need to reconcile differences that arise between the company's executives. CEO support in this endeavour is highly desirable.

Executive endorsement has to extend to the employee-generated code. An introductory statement by the CEO or Executive Committee that the code was developed by employees but has the full support of senior management, and that the organisation will ensure compliance, is a powerful statement.

### **The identification of the organisation's ethical issues**

The ethical issues experienced or likely to be experienced by the organisation or professional association, and its policy on handling them, needs to be set out in the code. These issues can be identified in a number of ways: through the use of an external consultant, through interviewing a range of middle to senior management, or through a workshop. Workshops can be designed solely to develop a code, or as part of a wider ethics training program. The ethical issues could range from the relatively mundane, such as the company's policy on gift giving or receiving, to the more complex. A company working in developing nations, for instance, will often work in an environment where bribes and extortion are normal practice. At times the continued operation of the business will require it to accede to an unethical demand which is common across all companies in that country. It will need to decide how its own staff should respond.

Time and effort also need to be devoted to developing a statement of the corporation's social responsibility. This concept, in effect, examines the impact of the corporation's decisions on its various stakeholders — owners, staff, suppliers, customers, the public at large, and finally, future generations — and adopts those that maximise benefits or minimise the harm to each stakeholder category.

There are mixed views on the practice. Some liken it to window dressing, somewhat akin to versions of codes of ethics. Others argue that the implementation of corporate social responsibility (CSR) will have a beneficial effect on the bottom line. The reasoning behind this argument is that employees, customers, suppliers and others regard a statement on CSR similar to a published code of ethics — that the measurable adoption of CSR by an organisation will bring the benefits provided by an increased employee commitment to that organisation. We also believe that the arguments we propose for the widespread involvement of staff in the development of a code of ethics, if adopted, will result in the inclusion of the principal components of CSR, with a resulting influence on actual practice.

### **An independent whistleblowing system**

An essential component of an effective code is a method by which any employee can call the organisation's attention to breaches of the code. Australians have long regarded with suspicion those who tittle-tattle on their colleagues, describing them as 'dobbers'. The accusation is one reason why whistleblowers are treated so savagely. The charge however, is far from accurate, nor is it fair. Whistleblowers are treated badly primarily when they expose wrongdoing that impinges on the reputations of senior management or on the image of the organisation itself. The organisation needs to implement some method of preventing the retaliation, and supporting the person who exposes wrongdoing.

Professional and trade associations could act as whistleblower support centres for their industries. Through their ability to license or otherwise endorse the professional capabilities of a company or of an individual member, they are in a particularly strong position to ensure a deep degree of ethical behaviour in an industry.

There are private organisations, such as accounting companies or security firms, that supply external whistleblowing support systems. These systems usually supply a confidential hotline by which employees can report unethical or illegal behaviour. In most cases, the hotline does not investigate, unless authorised to do so by the company. Alternatively, the company could develop its own system and ensure that it is independent.<sup>7</sup>

### **The establishment of a system of sanctions for breaches of the code**

We can be quite certain that if there were no traffic police on the roads, willing to catch and fine those who ignored the traffic regulations, there would be many more infringements than there are currently. There would also be many more accidents. For similar

reasons organisations need a system of sanctions for code violations. It seems almost axiomatic that a reasonable sanction would be dismissal — that a company would not want anybody to work for them if they broke its code of ethics.

However, it is possible to adopt sanctions which range from a slap on the wrist to complete expulsion. Expulsion sanctions can extend to a member of a professional or trade association. They can be harsh on professional bodies and trade organisations for they are in fact, reluctant to adopt sanctions that involve loss of membership. Nevertheless, industry associations and professional societies are the strongest arbiters of behaviour in that industry. It behoves them to apply sanctions commensurate with this responsibility.

### **Assignment of staff to manage the code and ethics-related activities.**

Systems designed to build ethical behaviour in an organisation require people to develop and run them. The tasks are many. The company has to identify the more serious ethical issues it faces, develop a code, decide for private companies what the guidelines for a statement of CSR should be, implement an internal whistleblowing system — or contract an outside one — organise training courses, not only a workshop to develop the code and the organisation's key ethical issues but to train new staff in the finished code and the internal disclosure systems.

The organisation can contract outsiders to do some of this work. In fact the identification of the key ethical issues is possibly best handled by an outsider, for insiders might be more willing to talk freely to an external person rather than somebody internal whom they know.

The content of the system however, must be developed internally. Handing to an outsider the problems of developing a code and all associated aspects of managing it would be just as ineffective as the CEO unilaterally drawing up a code. Consultants can help provide the development method, even the training, but the development of the ethical behaviour of an organisation must come from inside and reflect the values and moral objectives of the people in it.

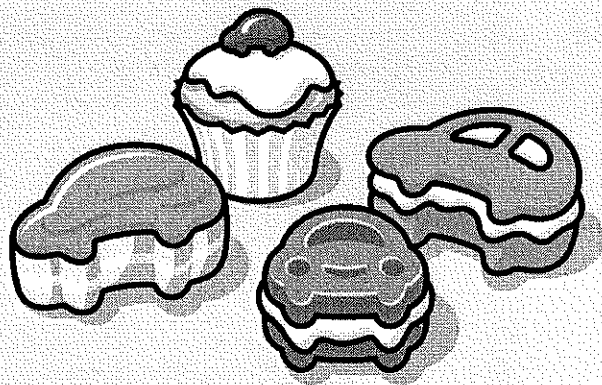
Staff need to be assigned to each of these tasks. For a small company it may be only one person part time. For a large corporation it could be a small branch, spread over each of the divisions and headed by a committee of the board.

The payoff will be there, not only in increased staff commitment and greater profitability, but also in the knowledge that the organisation will be strengthening its contribution, as a business, or as an industry association, to the social development of the country.

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### Notes

- 1 The majority of supporting references for this article can be found in the research article *Theories on Teaching Ethics* at <http://www.whistleblowingethics.info> [7 October 2008]. Significant references are also provided below
- 2 Quoted from [http://www.soxfirst.com/50226711/enrons\\_code\\_of\\_ethics.php](http://www.soxfirst.com/50226711/enrons_code_of_ethics.php) [7 October 2008]. An internet search of codes of ethics for Enron will bring up numerous websites expressing cynical amusement at Enron's code. Most draw on the full code published by <http://www.thesmokinggun.com/graphics/packageart/enron/enron.pdf> [7 October 2008]
- 3 For example, see S Valentine and T Barnett (2003) 'Ethics Code Awareness, Perceived Ethical Values, and Organizational Commitment', *Journal of Personal Sales Management*, Vol. XXIII, no 4, pp 359–367, which contends that employees prefer working for ethical companies. Furthermore, their research finds a positive correlation between an employer's ethical values and staff commitment to the organisation. See also JP Mulki et al (2006) 'Effects of Ethical Climate and Supervisory Trust on Salesperson's Job Attitudes and Intentions to Quit', *Journal of Personal Selling and Sales Management*, Vol 26, No 1, pp 19–26, which indicates that ethical climate is a significant predictor of trust in supervisor, of job satisfaction, and organisational commitment
- 4 Early research on this issue produced two widely accepted publications, RM Kanter (1996) *The Change Masters: Corporate Entrepreneurs at Work*, London, International Thomson Business Press, and JP Kotter and JL Heskett (1992) *Corporate Culture and Performance*, New York, Free Press. The most rigorous research, however is that of M Orlitzky, FL Schmidt and SL Rynes (2003) 'Corporate social and financial performance: A meta-analysis' *Organization Studies*, Vol 24 No 3, pp 403–441. They find that 'corporate virtue in the form of social responsibility and, to a lesser extent, environmental responsibility is likely to pay off'. See also *People and Profits? The Search for a Link between a Company's Social and Financial Performance*, by JD Margolis and JP Walsh (2002), Center for Advanced Studies in Management, Mahwah, NJ: Erlbaum
- 5 See especially M Kaptein and J Wempe (1998) 'Twelve Gordian Knots When Developing an Organizational Code of Ethics', *Journal of Business Ethics*, Vol 17, No 8, pp 853–869. We agree that a good code reflects the moral dilemmas that employees experience, and provides assistance in their resolution
- 6 S Helin and J Sandstrom (2007) 'An Inquiry into the Study of Corporate Codes of Ethics' *Journal of Business Ethics*, Vol 75, No 3, pp 253–271
- 7 See also J Pascoe, 'Corporate whistleblowing — some regulatory and ethical issues', starting on p 593 of this issue of *Keeping good companies* ●



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