

## The role of corporate codes of ethics in building trustworthiness

Monday 19 June 2017

This note reports on a meeting held at the Institute of Business Ethics on June 19 2017 to discuss the contribution of ethical codes of behaviour to the development of trustworthiness in corporations. It grouped senior practitioners from leading companies across a range of sectors (including banking, energy, defence, utilities, outsourced services, and industrial materials) alongside senior academics involved in the British Academy's Future of the Corporation project. The discussion was held under the Chatham House rule so participants are not identified, but the IBE hopes this account of the proceedings will be helpful both to the project itself and, eventually, to a broader audience.

### BACKGROUND

The discussion was held as part of the British Academy's Future of the Corporation project which is a response to the widely perceived need to restore trust in companies. The project will examine the social and human challenges faced by society over the next two to three decades. It will call on a range of academic input to make practical recommendations. Academic disciplines involved will include law, anthropology and philosophy in an effort to look widely at the impact of ownership structures, governance, performance and companies' ability to address social problems. It will also link up with the Royal Society to look at how science and technology will change the corporation.

The project team wants to understand how companies are trying to adopt and implement ethical codes as part of the change process. Are the codes embedded properly and taken seriously? How do companies measure success? And what happens when the company's circumstances change, for example through ownership changes?

**A central question for the academic participants was whether codes contributed to value creation. The consensus among participants was that they did in the sense that they were an important part of long term risk management.**

### SUMMARY CONCLUSIONS

In many cases codes are drawn up and introduced as a result of a crisis. They need to be readily understandable and written in plain language, but key to their effectiveness is that they are based on a common understanding of the values of the business. This meant they were not necessarily a set of rules but more a guide to behaviour and there was some leeway for judgement in specific circumstances. Codes are helpful when they guide responses to situations that were not foreshadowed in a firm rule-book.

An accompanying speak-up line was seen as important to implementation and embedding but it was also important that response to the code was part of performance appraisals and that the board and senior

leadership needed to maintain an active interest to ensure continuing awareness at all levels.

Both qualitative and quantitative measures are relevant to assessment of the effectiveness of codes. These needed to include some forward looking indicators, and there was potentially some role for outside assurance.

Among the challenges to effective use of codes were the long timeframe around culture change, loss of momentum through leadership change and concerns that investors were not patient enough to wait for the benefits. The operation of effective codes was, however, seen as a key element in the establishment of trustworthiness.

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## VALUES AS A DEFINING FACTOR

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Most participants agreed that codes needed to be rooted in the corporate values. For them to be effective, the company needed to be clear about what its values were and also to ensure that there was a common understanding throughout the organisation about what the values meant. Too many companies have values which sound good but lack content. The values had to have real meaning, not just be empty words and they have to resonate with the entire workforce.

There has to be management buy-in. Indeed, the top management needs to promote the values both by example and by the way they are communicated with staff. The workforce quickly senses, and may push back when the values are empty and meaningless or when management ignores them rather than face up to difficult decisions, for example about slavery in the supply chain. Values needed context so that people could see their practical application. Codes would not be effective if the leadership did not support them and was not seen to follow them.

**It requires a lot of iteration to reach the point where the values could be expressed in a way that related to the workforce as a whole. The group felt that the involvement of lawyers in drawing up and promoting values and in writing codes was not necessarily helpful.**

Some drew a distinction between a values-based and a rules-based code. The latter was more heavily focused on compliance and with a strong emphasis on disciplinary action for infringement. Ultimately this type of code was less productive.

Many said the exercise in their companies had been prompted as part of a response to a crisis, though some had also been driven by a feeling that they were part of a sector under pressure. Crises had forced companies to rethink their values and introduce or revise their codes of behaviour. There was, however, some concern expressed about the selection by Western companies of a set of values which did not fit well in emerging markets. Some participants said that codes helped define the line where the right thing for a business to do was to walk away. They were thus a potential source of support for people facing difficult decisions.

One participant asked about start-ups which might have quirky values reflecting the character of the founder. What happened to these values as the business grew? Corporate participants noted that core values might not change much over a long period, though they might

be expressed differently. As companies grew and employed more people, relationships within the organisation became less personal and this created a need for a set of values that could be promulgated and shared among a larger workforce. There was a challenge in ensuring, however, that big did not necessarily mean bland.

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## ADDRESSING EMPLOYEE CONCERNS

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One quality of value-based codes is that they have to be rooted in the concerns of the workforce. The board and senior leadership are responsible for defining and articulating the values and then embedding them in the organisation. However, both the code and the underlying values have to reflect the real day-to-day concerns of the workforce so that they appear relevant to the entire organisation. This requires a continuing process of iteration and dialogue with employees.

Participants said that speak-up lines were an important ancillary tool as they provide a means for employees to speak up when they have concerns. Speak-up lines have to be independent of management and they need to protect the identity of those who speak up. This can sometimes be difficult. Also, the response needs to be interpreted in the right way. Speak up lines should not aim simply at identifying a single point of failure. They should be able to expose situations where the whole culture is drifting in a negative direction. Recognising the point at which this starts to happen is one of the most difficult challenges for boards.

The aggregate data from speak-up lines can help and they are therefore an important tool of risk management and oversight. But here again, care needs to be taken with interpretation. In continental jurisdictions, employees are less likely to use a speak-up line than in the UK as the culture and legal background is different.

Nonetheless, having a clear code and ensuring employees are familiar with it is a good starting point for an effective speak-up line because it sets out parameters for behaviour which will tell potential whistle-blowers whether their concern is likely to be shared at the top.

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## MEASUREMENT AND EMBEDDING

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Many participants said their boards tracked the response to the code as part of their risk oversight process. One said the board sees data on the code regularly, broken down on a country-by-country basis.

**Some boards track the data on training and awareness of code issues. Others noted that boards will look at the record of breaches of the code and associated disciplinary cases. Also a common question for employee surveys is: does my line manager adhere to the code?**

This sort of exercise was part of a broader set of data used by boards as indicators of culture. One participant noted that the generation of abnormal profits in one part of the organisation was a possible sign of a poor culture as the staff might be cheating to obtain such unlikely success. Another warned that some executives will outsource questionable activities in order to “avoid getting their

hands dirty.” Participants said it was important for the leadership to recognise their responsibility for what went on throughout the supply chain. It was suggested that boards should focus on leading rather than lagging indicators. These might include critical equipment failure and near hits on health and safety. Some companies use a regular “pulse” survey of employees but fear the results disappear into a void. Participants said incentives were important. Bonuses and salary increases should not be paid just on what people had achieved but on how those results had been achieved.

All these were subjects for the board and provided a context for assessing the operation of the code. There were slightly mixed views about the role of internal and external audit. Some participants said audit could provide useful reassurance. Other cautioned that auditors could measure compliance but they could not judge it against societal expectations, which may also change over time. Boards had to be on top of societal expectations and ensure that codes reflected them.

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## CHALLENGES TO SUCCESS

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A number of challenges were mentioned:

- Companies could come under pressure from competitors who were cutting corners. Short term pressures made it harder to deliver high standards of behaviour.
  - Change of leadership at the top or a takeover can prove a setback and undermine work already undertaken.
  - Changing culture is difficult and requires time. There was some uncertainty over whether CEOs had a long enough run.
  - There was a risk of creep insofar as codes might be used to enforce policies which were not directly related to ethics and behaviour. The incentive to do this was increased when there was mandatory training around codes.
  - Codes could become too long. One participant referred to an “at a glance” version which employees could use to keep themselves familiar.
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