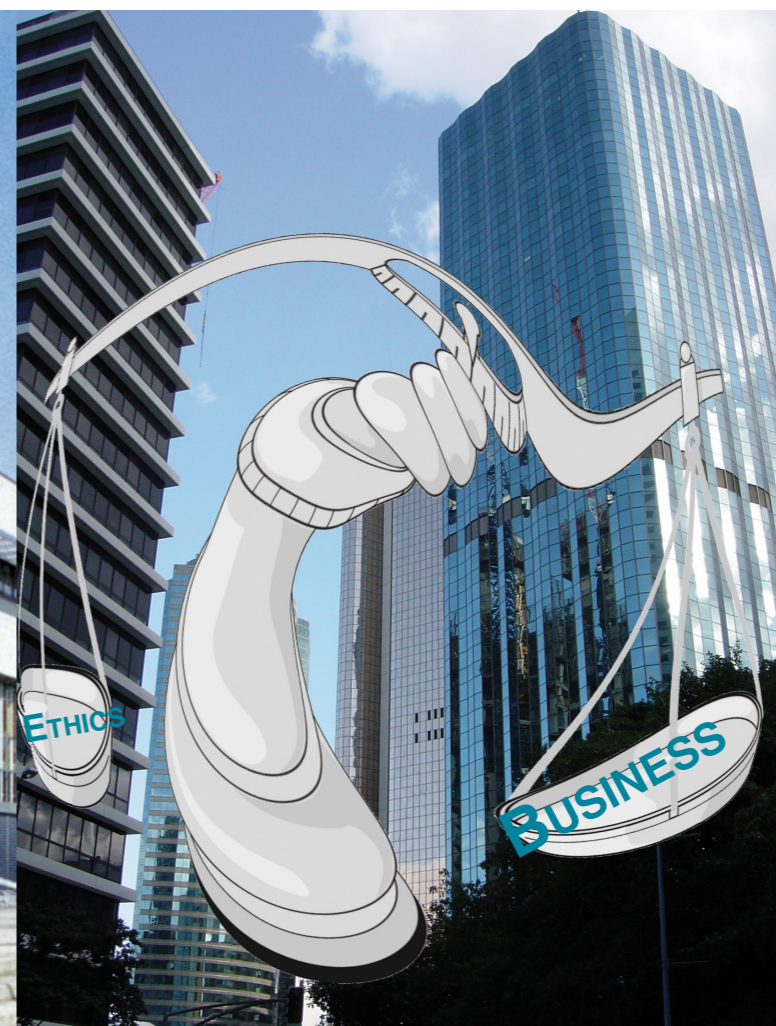


# baltic management review



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Grit Bugasch

## **VALUES MANAGEMENT THE ETHICS AUDIT AND THE ETHICS CERTIFICATION**

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## **BUSINESS ETHICS IN TODAY'S BUSINESS WORLD**

The present edition is dedicated to topics related to ethics in a closer and wider sense in today's business world. These articles are derived from bachelor or diploma thesis of former students written in joint ventures of professors of the Fachhochschule Stralsund – University of Applied Sciences with companies.

Although this issue in a kind of workshop shows applied science of our students under the supervision of our professors, also entrepreneurs, foreign professors and others will be authors of prospective publications.

We hope that you will enjoy to read this second issue of the Baltic Management Review and that you will benefit from these articles.

Dr. rer. pol. habil. Olaf Erhardt  
Prof. for International Finance and Capital Markets

Dr. rer. pol. Patrick Moore  
Prof. for International Finance and Capital Markets

December 2007





# INTEGRITY AS A CORPORATE SUCCESS FACTOR

Grit Bugasch

**Abstract.** The presented article will reflect on substantial questions and relevant discussions within the field of business ethics and corporate culture. There are lots of different attitudes, marked by various experiences and divergent developments. The article will especially deal with the significance and influence of integrity as a corporate success factor – it comprises a critical stock-taking regarding the importance, effects and limits of integrity within a company. Different stages of examination from the theoretical as well as the practical point of view – i.a. the discussion of several theses about integrity and the role of integrity in a company – will give an idea concerning the variety of approaches to the subject of business ethics and integrity.

**JEL Classification: M14, Z13**

## Why ethics and integrity?

Since ages people are dreaming of a progressive development – from replacing physical strength by mechanical energy until exchanging human intellect by computational intelligence. They thought once they will live in wealth and luxury, they will naturally be unlimited happy as well. Meanwhile some of the dreams have come true and some have not – the industrial age did not fulfil its great promises. It became more and more obvious that happiness and pleasure do not necessarily result from the satisfaction of needs and do not directly lead to well-being.

In November 1954, when Albert Schweitzer came to Oslo to get the „Nobel Peace Prize“ he required the whole world to see things as they are: In his opinion the individual has become superman, but could not raise the superhuman rationality that should correspond to superhuman power.<sup>1</sup> Nowadays, dynamic developments offer unsuspected possibilities, e.g. in information technology, biotechnology, genetic research etc. Thanks to the progress in science and technology people are more and more able to mesh with life. However, this does not only result in chances and possibilities, but also in obligations and responsibility.

It seems that the call for morality, ethics, integrity or sense of responsibility only arises when basic problems are solved and other questions, uncertainties or instabilities become obvious instead. Naturally this topic refers to all sectors and members

of the society. And enterprises do not exist in a vacuum either – they are an important part of the society and as such required to act morally and ethically. This does not mean that business ethics or economy ethics are asked because companies or managers behave increasingly unethically. However, managers have a far more reaching responsibility. Not only gained market shares or profits are important for a company's success. Quite the opposite – an increase in value concerns all stakeholders to a certain extent. Business is no unbiased activity, but can get a worthless activity soon. In order to make market economy no empty phrase it needs an ethical base. Therefore it is necessary to discuss ethical values and standards and finally derive appropriate behaviour.<sup>2</sup>

Concerning the reasons for their decisions managers often refer to market economy. But market economy just offers the framework for market participants to act in it. In the sense of ethics, this framework can only be designed by joint and responsible action of all parties involved. That means existing problems and conflicts within the society cannot be got over by ignoring or disregarding them. Everybody has to take responsibility – no matter whether it is a private person, an employer, a politician or someone else. Market economy is based on individual responsibility. Who agrees with the principle of market economy is required to discuss ethical values. Future problems can only be solved by a market economy that is based on values and individual responsibility.<sup>3</sup>

Corresponding to Aristotle's considerations the term „ethics“ comprises a critical reflection on „right“ or „good“ human behaviour or way of living.<sup>4</sup> However, a discussion about what kind of ethics will usually bring more new questions than answers: How does a „good“ human being behave? What does the „ideal“ company look like? Is it desirable to reach these ideals? And where are the limits?

This article shall give an idea of how to bring together very ambitious standards of philosophy on the one hand and actual conditions of real business live on the other hand. The article cannot give general answers to the philosophical questions of live – it will convey some basic ideas as well as practical examples regarding business ethics and integrity in a company. However, it should be considered that business ethics refers to conducts and activities of the company as such, whereas integrity mainly applies to attitudes and behaviour of the company's single employee apart from the level of hierarchy.

<sup>2</sup> cf. Management-Symposium St. Gallen „Solche Parolen...“, in: „Die Zeit“ of 08/06/84, page 31

<sup>3</sup> cf. *ibid.*

<sup>4</sup> cf. Andersen „Einführung in die Ethik“, page 2

<sup>1</sup> cf. Fromm „Haben oder Sein“, page 14

## Ethics within the economy

Practical philosophy is – in contrast to the classical theoretical philosophy – dealing with questions of applied theories within the human community. Beside science ethics, policy ethics, theological ethics etc. it comprises economy ethics as well. Practical philosophy aims on actual moral improvements in daily life. Therefore, it evaluates morality in different aspects and various fields of life. It does not create morality as such but can reflect and improve already existing morality.

In practice there are several modes to evaluate ethics within the economy. They are mainly differing concerning their level to refer to and their scope of action. What they have in common is to contribute to a peaceful coordination of economic activities for the benefit of all people irrespective of the social class they belong to. Such efforts are especially necessary when traditional moral norms loose their commitment.<sup>5</sup> Then it is important that people in all parts of the society are able and willing to take responsibility according to their possibilities. What concerns all people can only be done by all.

Economy ethics is – as the name implies – referring to the economic system as a whole. On this level politicians have to decide on the extent of an organisational framework being most advantageous for the national economy: How much and what kind of regulation is necessary? And what is beneficial? The same principle applies to the other levels. The highest instance needs to decide on respective rules and activities – the board of directors for its company, the management for its operations, the head of department for his division etc. Accordingly, one can speak about business ethics, management ethics, leadership ethics etc.

Depending on the respective author, the terminology of economy ethics is seen as partly different. Steinmann/Löhr consider economy ethics just as ethical reflections concerning the structure of the economic system.<sup>6</sup> A more comprehensive definition is given by Dietzfelbinger: Economy ethics is dealing with the question which moral standards and ideals can be put into use under the conditions of the modern economy and society. Thus, economy ethics comprises the individual and the corporate level because it considers objectives and norms of individual as well as governmental economic activities.<sup>7</sup> One more criterion is added by Meckenstock: The assumption that there is a real scope for decision making that can be influenced by moral norms is indispensable for the development of economy ethics.<sup>8</sup>

5 cf. Steinmann/Löhr „Unternehmensethik“ (UE), page 5

6 cf. *ibid.*, page 6

7 cf. *op. cit.* Dietzfelbinger „Aller Anfang ist leicht“, page 177

8 cf. Meckenstock „Wirtschaftsethik“, page 4

All definitions have in common that economy ethics concerns a critical evaluation of the entire economy. But it is still open how far the competence should reach and which prerequisites need to be fulfilled to develop an ethical economy. Does it just comprise fundamental questions or problems of individual and company related responsibility as well? These aspects are in a way depicting the development process. In former times – when discussions on ethics in the economy were considered as something curious or exotic – the economic lobby did not want politicians to get competence regarding ethical behaviour of enterprises. Meanwhile, they have recognised that the state – even if following the principle of subsidiarity – needs some competence to establish appropriate frameworks for an ethical society.

The contentious point indicates a smooth transition to business ethics. It seems to be much easier to define business ethics, because: „The term is ... just a combination of two very familiar words ... so also can we talk of something called ‚business ethics‘ as being peculiarly concerned with moral issues in business.“<sup>9</sup> The general principle is easy – it comprises all inherent questions of the company and decision-making powers are settled by hierarchy. However, the debate becomes increasingly difficult when talking about methods of business ethics. A far more concrete – and more problem potential containing – definition is given by Steinmann/Löhr: Business ethics contains all norms that are based on dialogical discourse with affected people or material and procedural reasons. These norms are compulsory for the company itself and put into force in order to restrict conflict potential resulting from the profit principle in business management activities.<sup>10</sup> The problem with this definition is concentrated in two aspects: (1) It is exclusively based on dialogical agreement, and (2) it just aims on conflicting effects of the profit principle. The first point refers to general criticism on dialogistic ethics. Not all problems can be solved by dialogue, because people are not always open to rational solutions (if there are such). Furthermore, it should be considered that a company's democratic potential is limited to a certain extent. The second part refers to the motivation for business ethics. If a decision is conflicting with profit it should not just be talked about it but comprise far more moral questions.

Criticism will be more comprehensible when talking about the motivation of companies to behave ethically: (1) Ethical efforts are functional to gain profit (e.g. if consumers pay attention to ecological aspects); (2) two strategies offer the same pro-

9 Chryssides/Kaler „An introduction to business ethics“ (Introduction), page 12

10 cf. Steinmann/Löhr (UE), page 10

fit, but only one of them can be ethically approved; and (3) following the profit principle would lead to unintentional, negative external results. In the first case ethics would actually not be substantiated in the company, but in the market. So the last two cases are potential situations to develop business ethics.<sup>11</sup> In accordance to future requirements a few more motivations could be added. At least one example shall be mentioned here: Companies want to sensitise their employees in order to forestall moral dilemmas (e.g. arising from different cultural backgrounds).

The picture 1 shall give an idea on main influence factors to entrepreneurial activity:<sup>12</sup>

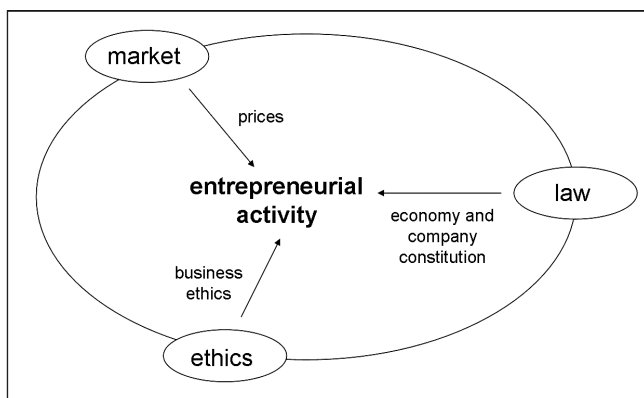


Figure 1 Influence factors to entrepreneurial activity

Another important element of business ethics that every enterprise needs to decide about is the mixture of methods used. Chryssides/Kaler stress on two aspects of business ethics: „One involves the specific situations in which ethical controversy arise; the other concerns the principles of behaviour by which it is appropriate to abide.“<sup>13</sup> Behavioural principles can be fixed by internal agreements, organisational regulations, corporate vision or other guidelines. But if the statutes shall not have hundreds of pages there are a lot of problems that cannot be solved thereby. It is far more difficult to find appropriate methods for specific situations because economic practice comprises lots of cases where people need to decide specifically. These are the situations where responsible action in accordance with morality is required. And then it is going back to the personal level again – the concrete decision lies with the individual based on its own moral characterisation.

11 cf. *ibid.*, page 7f

12 cf. Steinmann/Löhr „Grundlagen der Unternehmensethik“ (Grdlg. UE), page 119

13 Chryssides/Kaler „Essentials of business ethics“ (Essentials), page 3

## The role of integrity

Individual morality can imply a lot of values, virtues, maxims, norms of behaviour etc. Integrity might be a component of this – a term of common use, which is in fact not easy to grasp. There is no doubt that integrity is an ethically charged term. Asked for a definition most people would probably answer: Acting with integrity is the same as acting ethically or morally. But this would be too easy.

At first it is important to consider that: „Integrity is not so much a virtue itself as it is a complex of virtues, the virtues working together to form a coherent character, an identifiable and trustworthy personality.“<sup>14</sup> This implies that integrity is nothing to be easily learnt, nothing that can be acquired by one or several activities. It is simply a quality somebody has or lacks. Furthermore, there is an indication of different attributes shaping integrity as a whole.

Another approach to integrity is given by de George. He does not aim on covering all features of integrity but tries to describe it as a general category: „Acting with integrity means both acting in accordance with one's highest self-accepted norms of behaviour and imposing on oneself the norms demanded by ethics and morality.“<sup>15</sup> This definition again refers to ethics and morality but integrity is in fact more and partly even different. An example shall help to understand what is meant: „Integrity is often understood as honesty. But honesty is too limited for integrity, and there may be times when integrity requires being less than candid, even lying.“<sup>16</sup> Thus it seems that integrity has two contradictory meanings – conformity on the one and independence on the other hand. But this contrast should not be misleading. Integrity includes in fact two aspects – loyalty and membership as well as a sense of moral autonomy.<sup>17</sup>

Petrick/Quinn offer one more possibility to reflect on integrity: „Integrity can be defined as the individual and collective process of repeated alignment of moral awareness, judgment, character, and conduct that demonstrates balanced judgment and promotes sustained moral development.“<sup>18</sup> Thus it is important to consider that (1) integrity is some kind of process, (2) it is connected to morality, and (3) it is subject to development. They also refer to the collective level that implies the scope of integrity – from self-interest to universal principal regard for others.

Although the relation to morality has been mentioned sever-

14 *op. cit.* Solomon „Ethics and excellence“, page 168

15 de George „Competing with integrity“, page 6

16 *op. cit.* Solomon, page 168

17 cf. *ibid.*

18 Petrick/Quinn „Management ethics“, page 61

al times integrity can be clearly distinguished from it. To behave in a way required by moral norms would just constitute the moral minimum. Though integrity is going further: „...integrity often requires action and ‚pro-active‘ behaviour; it is not just ‚not giving in‘... Either way integrity is essentially moral courage, the will and willingness to do what one knows one ought to do.“<sup>19</sup> In other words – not just to follow given rules rather to be willing to go beyond basic moral requirements makes the difference. Additionally, this reveals the preventive character of integrity.

Considering all aspects mentioned it could be concluded that employing integer people on all levels would be the easiest way to be recognised as an ethical company. This might be true but rather illusive. The problem with integrity in corporate life inevitably arises from a number of different and sometimes contradictory demands and principles. Thus, acting with integrity requires conviction and commitment as well as the willingness to negotiate and compromise.<sup>20</sup> In order to facilitate integer behaviour and to support this process the company needs to provide an appropriate environment by establishing respective frameworks.

### Interrelations between individual, company and society

The relation between individual, company and society constitutes one of the crucial items in the analysis of morality and ethics within the economy, because it still leaves a wide field for discussion. „The point is that we will never understand the world of business (or any other human world) unless we begin with human interrelations and how people ‚fit in‘ with organizations and institutions.“<sup>21</sup>

In order to get an idea on the variety of interconnections within the society and the role of company and individual figure 2 might be helpful.<sup>22</sup>

As shown a society basically consists of three circles – politics, economy and culture. They are overlapping each other and the arising common field is the so-called common sense that every part of society is responsible for. But what about the particular relation between company and society? Is not all going back to the individual – is not all just a „collection“ of a certain number of them?

Of course, an enterprise as well as a society are living from its individuals. But the difference between them is constituted in the aspect of choice. A society is primarily a community where most people are born into without having any influ-

ence on that.<sup>23</sup> In contrast to that, a company seems to be a voluntary community. But this would be misleading. „Business is social practice, not the collective activity of isolated individuals. It is possible only because it takes place in a culture with an established set of procedures and expectations. Corporations are communities with structure and an organization in which individuals find their roles and create their identities in the term of the organization.“<sup>24</sup>

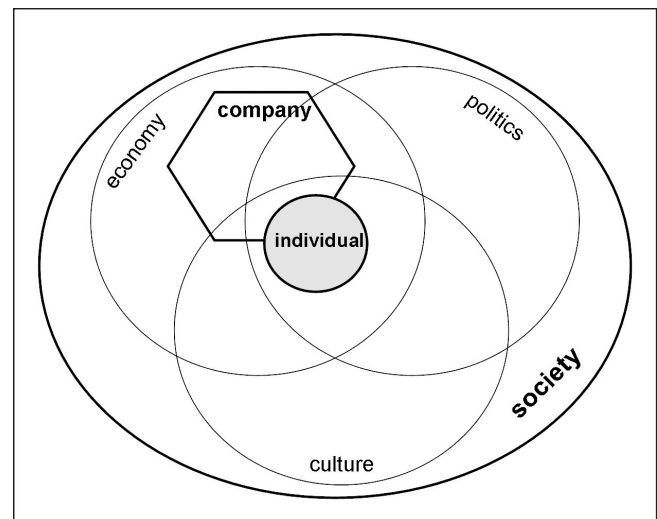


Figure 2 Role of individual and company within the society

Discussions on how business should fit into operations of the entire society with regard to ethics have increased in recent years. Especially the social role of companies was paid more attention to – it was seen as a general and important role. According to their acceptance in the public (based on products or services, quality, PR, political and social engagement etc.) enterprises can set or influence moral standards. Furthermore they can gain resources, benefits and privileges offered by the society – so they should give back their part to the society by fulfilling duties and obligations or by voluntarily assuming an additional portion of responsibility.

An even more comprehensive approach has arisen meanwhile – „corporate citizenship“ is going beyond social responsibility. The purpose behind is the insight that (whatever kinds of) policies are increasingly depending on the goodwill of the economy in times of global business networks and investment strategies.<sup>25</sup> According to corporate citizenship, companies have two different kinds of duties: (1) Fixed duties, and (2) additional duties. The first category comprises duties that may be fixed in advance (e.g. payment of taxes,

19 op. cit. Solomon, page 168

20 cf. ibid., page 172

21 op. cit. Solomon, page 75

22 Own, simplified illustration.

23 In this case not to have any influence means neither having the choice on being born or not nor having the choice in which society to be born into.

24 op. cit. Solomon, page 82

25 cf. Wieland „Globalisierung und rechtliche Verantwortung“, page 55

maintenance of roads). The second part is more difficult to grasp – it includes mutual obligations and the demand for mutual respect. And therefore it is not and cannot be fixed by law, regulations or contracts. It is based on the understanding and the insight that citizenship is first of all a relationship of shared identity and mutual concern.<sup>26</sup> However, the concept of corporate citizenship is not the attempt of clever politicians to personify enterprises, but rather the establishment of a larger moral framework which business is an important part of and must be placed in.

### **Pros and cons – theses about integrity**

The discussion of several theses shall facilitate a more detailed evaluation of a few selected aspects of integrity. It shall give an impression of sense, benefits and effects of integrity as well as its far-reaching importance. The argumentation will focus on six different aspects that have been arbitrarily selected and do not necessarily present the most important issues. The chosen method – thesis-antithesis-synthesis – is considered to be the best suitable one, because the „right“ (or better appropriate) answer always depends on the respective situation.

### **Ethics and integrity are no issues for crisis times.**

The problem behind is the same as the general justification of business ethics and integrity. Why should managers adopt these principles to their companies? Should not others start to do that? Is it suitable to the principle of business in general? And what about integrity in case of imminent bankruptcy?

The assessment of a company's reputation and capabilities within a society is usually not only based on its products or services. Sometimes it is even more important for the general public to see if and how the company copes with pressure from high social requirements. Public interest for such questions has constantly grown in recent years. The motives for that are diverse but probably the economic development constitutes an important reason. The fact that a continually stable economic situation causes rising interest for social and ecological issues can be described as a general phenomenon. If the society feels economically stable people will ask for more social engagement, ecological products, sustainable development etc. Successful companies are expected to take responsibility for the whole society and to contribute their part to social development.

However, in times of recession, economical and structural changes and unemployment public interest for ethical or so-

cial issues mostly decreases. Maintaining or creating jobs and social protection related to redundancies usually move into the main focus and displace everything else. Nevertheless, there are clearly perceivable tendencies in public perception of business morality. But the compatibility of commercially profitable and morally proper behaviour has probably been problematic at all times.<sup>27</sup>

According to Friedman the only genuine task and social responsibility of a company consists in making profits and complying with law.<sup>28</sup> However, bearing in mind the overall goal of business ethics – to contribute to a peaceful coordination of economic activities – the application of the profit principle needs to be in accordance with the respective situation. That does not mean the profit principle should be generally questioned but it is getting an „ethical correctness assumption“. Thus, profit principle and business ethics have a rule-exception-relation.<sup>29</sup> In other words: When entrepreneurial activity is connected with conflicting side effects business ethics needs to operate as a guiding hand. Then it is necessary to offer consensual decisions and alternative strategies because the economic system just constitutes an organisational framework that has to be put into concrete terms by the company for itself.

But sometimes it might happen that a company cannot solve ethical problems on its own level. If surrounding conditions (e.g. strong competitive pressure) would be disadvantageous for the company it could be threatened even by ruin when following ethical norms or integrity as the only company. However, this does not mean to renounce ethics and integrity, it would rather be essential to find a common regulation on a higher level (e.g. branch obligation, legal regulation). The ability to react and behave adequately in such situations is elementary for the company. It needs sufficient scope of action so that ethical decisions do not query the existence of the company in general. Successful business strategies offering chances for adequate profitability are an empirical prerequisite for ethics and integrity within the firm. Thus, the possible extent of ethical or integer behaviour is dependent on autonomous strategies as well as heterogeneous framework conditions.<sup>30</sup>

To conclude that a mixture of economic boom and established, profitable companies automatically results in ethical behaviour whereas the combination of recession and younger,

27 cf. Leisinger „Unternehmensethik“, page 21f

28 cf. Goodpaster/Matthews „Können Unternehmen ein Gewissen haben?“, page 13

29 cf. Lammers/Schmitz „Der moralische Handlungsspielraum von Unternehmen“, page 20f

30 cf. op. cit. Steinmann/Löhr (Grdlg. UE), page 108f

26 cf. op. cit. Solomon, page 83

developing enterprises leads to unethical activities would be far too easy. It is not possible to establish a flourishing and profitable firm at first and to implement ethical or integer behaviour later on. Nor is it sensible to be integer in boom phases and to go back to the legal minimum in recession. And it is the same with profitability: Business life is a clear proof that there is no automatism in business ethics. If it would be like this there would be no need for debates on sense or benefits – it would just work.

However, the limits of business ethics and integrity become obvious when it concerns the existence of the company. The crucial criterion is the break-even-point: „When survival is threatened, the niceties of ethics inevitably take second place. A vixen will try to avoid confrontation with a pursuer until she is cornered and her life is threatened. Then she will turn and fight wildly without constraint to her last breath. This is a common phenomenon with many biological, social and political systems.“<sup>31</sup>

No wonder that an enterprise, namely its board of management, would act similarly. In most companies ethics and integrity are just relevant topics as long as there are no fundamental problems. But if there are such managers are only too willing to throw overboard their ethical principles. In case of imminent bankruptcy they will try to do everything to avoid it – at first they will probably stop all activities that just seem to cost money without short-term success for the preservation of the company. Often activities concerning ethics or integrity are still seen as belonging to this category. But even if the reaction is understandable, it is not sensible and could be precisely the wrong one.

According to Pearson the ethical status of a company and its level of integrity are closely connected to each other.<sup>32</sup> If the existence is threatened integrity usually goes back to the pre-conventional level. That means: „Any action to preserve the business is open to consideration. The only constraint is the law, the likelihood of being caught and the probable punishment.“<sup>33</sup> But if the company is ethically dependent and

31 Pearson „Integrity in organizations“, page 83

32 There are two levels of integrity: (1) Conventional and (2) pre-conventional level. (1) Conventional level corresponds to an interpersonal viewpoint, based on shared feelings, agreements and expectations. Morality consists in socially shared systems of moral rules, roles and norms. (2) Pre-conventional level reflects an egocentric viewpoint, based on prospects of being caught, degrees of punishment etc. The ethical status of companies can be classified in four groups: (a) Ethically negative, (b) ethically neutral, (c) ethically positive, and (d) ethically dependent. To be ethically dependent means, the business has based its competitive strength on a dependence on integrity. Its particular ethical approach is its source of differentiation, e.g. The Body Shop, ethical investment trusts. (cf. op. cit. Pearson, page 139f)

33 *ibid.*, page 86

would decide to renounce its ethical requirements it would destroy its core values and thus the business itself. Consequently, the right decision depends on a conglomerate of aspects to be considered. Just to set short-term versus long-term goals would more or less correspond to the question profit or ethics.

In times of risen public awareness there is neither the necessity nor the possibility to decide just in favour of profit and against ethics or the other way round. At least the society will always require a mixture otherwise the company has to cope with respective consequences. Ethics and integrity themselves cannot prevent bankruptcy. „But a sense of one’s own integrity is what allows us to navigate the treacherous waters of those dilemmas, and though integrity does not guarantee success, there can be no success without it.“<sup>34</sup> Ethics and integrity have become more relevant for business life in general. Thus, it cannot be said that they are no issue for crisis times. They are surely an issue for good times and crisis times equally. But it is neither sensible to discuss them first-time during a crisis nor to skip them – ethics and integrity need to be discussed and converted into practice continually.

### **Only the company benefits from integrity.**

In order to be perceived as an ethical enterprise by the public a firm is heavily dependent on the behaviour of its staff – on conducts and omissions on all levels of hierarchy. However, to ask why people should behave integer if only the company benefits from that would reflect an egocentric viewpoint. At first glance it may seem that benefits will accumulate summarising just for the company. But better reputation, bigger market share, increasing revenues and profits etc. are only one side of the medal – these more direct effects are visible for the public. Yet there are lots of rather indirect consequences as well that become perceptible when taking a look behind the scenes.

Enterprises need to make profit otherwise they have been existing for the longest time. In recent years, however, a trend has established to look for an identity behind the purpose of pure existence in order to connect entrepreneurial activity with a more meaningful intention. The result of this insight is the development of concepts like corporate identity or social responsibility. Both concepts do not just aim on outside activities and perception. When people spend an important part of their lives at work it is important to make those places suitable to social requirements.<sup>35</sup> Aspects like a democratic corporate culture, team spirit, empowerment, identification with

34 *op. cit.* Solomon, page 174

35 *cf. op. cit.* Dierkes/Zimmermann „Ethik und Geschäft“, page 82

the firm and its products, engagement for the society etc. got more significance for employees. And in order to get qualified and motivated staff it is substantial for companies to offer those qualities.

„A company’s reputation is one of its most important assets – an asset that does not appear on its financial balance sheet. The reputation as a reliable, ethical company justifiably commands a premium from those who use the company’s products or services. Employees take pride in working for a well-reputed company, trust their futures to it, and assume that they will be treated fairly by it.“<sup>36</sup> But a good reputation does not only attract employees, it will logically also have consequences on customers, subcontractors, suppliers and other business partners. They will probably „...prefer to deal with a firm they feel they can trust. Reputation is a result of continuous ethical action and of an ethical corporate culture.“<sup>37</sup> Thus, it will be evident that ethics and integrity are compatible with profit and success.

When analysing the chain of effects based on integrity one could go even further and say: The further developed integrity within a company as more people will benefit from it. The following picture shall give an overview on the relation between business objectives, transactions and level of integrity: <sup>38</sup>

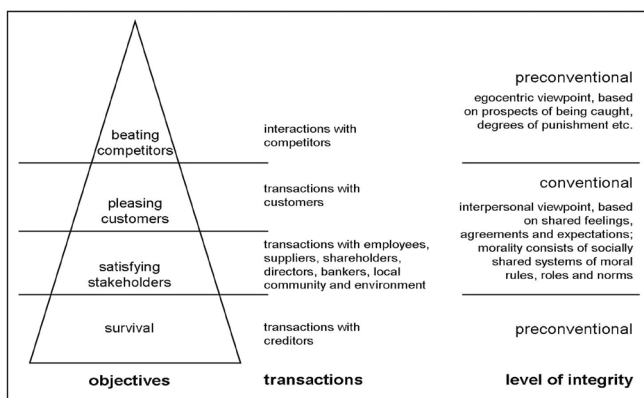


Figure 3 Business objectives, transaction and level of integrity

That means if a company is fighting to survive or if it wants to beat competitors at all costs integrity does not really play an important role. In both situations the pressure to behave unethically is quite high and thus integrity is at a preconventional level. At the intermediate levels of objectives hierarchy – satisfying stakeholders and pleasing customers – the pressure to unethical behaviour is lower. In these cases integrity is at a conventional level, trustworthiness is expected and ma-

36 op. cit. de George, page 7  
 37 ibid.  
 38 cf. Pearson, page 82/124

nagers have a chance to do some „good work“ beside their core tasks. However, this is not possible any longer if main objectives are not achieved.

These examples clarify the necessity of a strategic decision on the highest level – integrity is only possible in a company whose board of management is backing and living it by itself. If employees need to be afraid of being fired they will probably decide for the presumably safer way instead of taking a courageous and integer decision. However, if the board of management establishes integrity as one of its core values, decides to support relevant projects and to provide appropriate financial backing to promote integrity within the company it has the best prerequisites to achieve this aim. Of course, it is a long-term goal and cannot be easily measured in financial terms but the deeper the company is penetrated by the principle of integrity the more positive effects will arise.

At first integer behaviour will bring direct effects for the company itself. Previous experiences have shown that integrity will lead to decreasing costs for interactions or frictions with the public. When the firm does not have problems with the public – no critical reporting in the media, no demonstration, no boycott or something similar – management capacity is not tied to defensive activities. It is rather free to decide on necessary operative and strategic questions. If integrity is established it works like comprehensive crisis prophylaxis or an early warning system.<sup>39</sup> People are sensitised for potential problems, open communication is possible and they know whom to talk to in critical cases. The new quality can be perceived within the whole company – openness, better communication, sensitivity in difficult decisions, higher motivation, better team spirit, stronger identification, pleasure from work, less notifications of illness, less personnel fluctuation, higher efficiency etc. will show positive relations between applied business ethics and motivation of staff. No question that both parties – employees and enterprise – will gain equally.

In addition, the firm can get positive and cost-free promotion. Possibly following publications in reports or case studies are of high promotional value. They will have positive effects in inside and outside relations especially in crisis times; e.g. if people feel they can rely on „their company“ they are also willing to work more in problematic times if necessary.<sup>40</sup> The principle works like a self-contained circle – if a company invests in integrity this will pay back in different aspects and at several levels. Integrity attracts all stakeholders – shareholders, suppliers, subcontractors and other business partners, local community etc. will benefit in a direct or indirect way.

39 cf. op. cit. Leisinger, page 177  
 40 cf. ibid., page 180

Integrity is even beneficial for the customer: If he is seen as a well-informed and serious person he can rely on the company and will remain as a buyer. Last but not least the preventive character of integrity can help to beat potential legal regulations. This could work as a cost-saving factor and improve the firm's position in a competitive market.

All in all ethics and integrity can be seen as investments in the future. Commercial success is not possible without social acceptance any more. Good reputation is a valuable asset but cannot be reached free of charge. Thus, sustainable entrepreneurial success is just imaginable as a combination of profit and ethical behaviour. Of course the company will benefit from integrity – otherwise it would make no sense to invest in it – but different other parties as well as the society as a whole will get advantages too.

### **The corporate vision does not help to reach integrity**

When talking on role and importance of a corporate vision the reproach can often be heard that: Corporate visions are just theoretical constructs or nice facades but they are not converted into practice. This might be true in some cases but most firms have understood that lip-services stated in a colourful brochure are even worse than not having a corporate vision at all. More and more enterprises use their corporate vision to communicate their basic values and aims.

According to de George „...integrity depends not on what a company says but on what it does.“<sup>41</sup> However, everybody will understand that enterprises need to coordinate the actions of its staff to give them a certain direction. To get a common identity on this way they need to state their goals and values, motivate their staff to strive for it, etc. One possibility to establish such an identity are corporate visions. They are abstracting from daily business life – they should be used as general guidelines for the whole company, but do not explain things in detail. They usually emerge from a thorough analysis and shall act as an orientation showing new perspectives. Mostly corporate visions contain statements on the relations between a company and its surrounding – internal and external partners, employees, the society, customers, suppliers, competitors etc. are addressed.

Corporate visions offer the chance to state aims that are forced by the company, but on the other hand it is difficult to transfer any purposes that are not included in the corporate vision. Those seem not to correspond to the firm's aims and values and therefore one will encounter resistance when trying to implement them.<sup>42</sup> Consequently an enterprise should take

41 op. cit. de George, page 188

42 cf. op. cit. Lammers/Schmitz, page 99

some time to establish its corporate vision as a kind of compromise of all people concerned. The possibility to do this is based on the fact that it usually not arises from legal pressure but from own initiative. However, corporate visions need to follow some principles regarding formation and implementation in order to be credible and powerful.

Establishing a corporate vision is a complicated job: On the one hand it should offer solutions for concrete problems; on the other hand it should not be a fat statute book. According to Leisinger corporate visions need to fulfil the following criteria: (1) They should go beyond current law, (2) they should go beyond usual customs and traditions of the branch, (3) they should contain clear principles, (4) they should refer to those activities of the company implying the greatest social controversies, (5) they should be honest (not just promising), and (6) they should be continually adapted to the latest changes.<sup>43</sup>

The quality of a corporate vision can be easily improved when paying attention to the principles of dialogue and consensus. Neither the formation nor the implementation of a corporate vision should be exclusively a top-down activity. Only if all people concerned were involved somehow and find themselves in it they will see it as „their own corporate vision“ and transfer it into praxis. However, one decision on top is essential – that its mind and letter will be demonstrated and not only lectured by the management.<sup>44</sup> An optimal implementation process should comprise the following measures: (1) It should be connected with a communication programme, (2) binding force should be underlined by a written confirmation of all employees, (3) concerned managers should be accountable, (4) some higher instance should be established to be appealed if necessary (e.g. ethics committee, ombudsman, hotline).<sup>45</sup>

However, the backside of the medal should also be considered. The most eminent problems of corporate visions can be divided into three groups. At first: The corporate vision is just an expression of will. The company states its intention to orientate its activities to specified values, aims etc. That does not say anything on the fulfilment of these claims and it does not contain any comment on sanctions. Thus, stated ideas or goals can only be realised if concrete and binding organisational regulations are derived from them. Second problem: Corporate visions are only binding to the respective firm. That means integrity can have competitive disadvantages for the respective company and the general problem still remains (e.g. corruption). The only solution would be to con-

43 cf. op. cit. Leisinger, page 116

44 cf. ibid.

45 cf. ibid.



vince competitors of the correctness of integrity but this usually leads to a dilemma situation because companies do not know if they can trust each other.<sup>46</sup> This situation can only be overcome by open communication or unambiguous behaviour. Third problem: When having a good working corporate vision companies often have an illusion of safety. But such guidelines cannot guarantee ethical or integer behaviour for all times. As the name says they can just guide between „right“ and „wrong“ but what is still needed is the individual ability to decide with sense of responsibility.<sup>47</sup> The corporate vision and its effects can just be as strong as the people adopting it. That means corporate visions need an adequate organisational structure and an adequate corporate culture to be converted into practice.

As already mentioned the implementation of the corporate vision should be connected with additional sensible activities in order to facilitate integrity. In the USA, most common organisational forms to facilitate moral behaviour are: (a) Code of ethics/conduct, (b) ethics committee of the board of directors, (c) corporate ethics and business conduct office.<sup>48</sup> These three aspects refer to the mentioned criticisms – commitment, support from the board of management, continuous communication and control. A combined use of all three forms could therefore give more power to the issue of ethics and integrity and would constitute an important component for its successful realisation.

Finally, it can be said that the corporate vision can be seen as a company's fundament, orientation, guideline or self-obligation. But it is just the basis for necessary supplementing measures and activities. Reputation cannot be reached by pure declarations of intent. Therefore, a corporate vision needs to fulfil mentioned criteria and to follow certain principles. If it furthermore represents „living“ values and culture it can help a lot to reach integrity.

### **Integrity applies to the whole staff equally.**

At first glance it will be probably agreed that integrity applies to the whole staff equally. Why should different levels of hierarchy be measured with different standards? Would this not reduce the claim for integrity to absurdity? De George seems to emphasize this approach: „Firms that act with integrity must

46 The so-called prisoner's dilemma is a classical part of the game theory. It is based on the assumption that situations with this structure are omnipresent in social live. Its core problem is the fact that two parties do not know if they can trust each other. Therefore every party decides just from the egocentric viewpoint although a common decision would be much more beneficial. (for more detailed explanations: see Leisinger, page 118f)

47 cf. *ibid.*, page 117ff

48 op. cit. Lammers/Schmitz, page 118

possess corporate courage, both on the level of the firm and on the level of the individual within the firm, if their ethical concerns are to be taken seriously.<sup>49</sup> That means integrity is required by the top-management as well as the mass of staff equally – otherwise it will not work. On the one hand the manager has to take moral decisions in detailed questions, like dealing with customers or beating competitors, as well as regarding general strategic issues, like attitude towards child labour or bribery. On the other hand every single employee is asked for moral courage, for instance when a corporate superior wants him to falsify documents or to backdate orders. Of course, these are ordinary examples but integer behaviour starts with the basics. Only when integrity grows from the roots it will be successful.

However, it is also de George who states „... that business ... can be no more ethical than the persons who run the firms. ... Top managers are the crucial players. Unless they exemplify integrity, demand it of their employees, and support it throughout the firm, the company cannot – and so will not – act with integrity.“<sup>50</sup> The consequence is that management has the responsibility to make ethics explicit – they have to focus on assessing, specifying, reporting and further developing integer standards within the relations of the firm. A typical phenomenon in public perception is to equate the top-management with the entire company. And if the top-management fails it causes frustration. An American psychologist has described this as the „trilemma of the leader“ who has to be „one of us, most of us and best of us“. That means a potential leader should be like all of us, but embody our best virtues, and these in an ideal way. Naturally, these requirements will create an area of conflict in which the manager is asked to act adequately.<sup>51</sup> As a consequence managers are not only challenged by more comprehensive problem potential and stronger responsibility but also measured and punished to higher standards.

So if managers are most characteristic for public perception of the whole firm they will finally shape the behaviour of all employees in good and bad times. In comparison to the mass of staff they have bigger scope of action, more decision-making powers and more room for decision making, but they also need to consider that their decisions have far-reaching consequences. Additionally, they have an important model role – employees on all hierarchy levels will consciously or unconsciously observe their managers' behaviour. People's conducts and omissions are formed by its surrounding. If mana-

49 op. cit. de George, page 110

50 *ibid.*, unpagged (Preface)

51 cf. Neuberger „Zum Doppelleben gezwungen“, in: „Die Zeit“ of 04/08/95, page 18

gers are just dedicated to their own interests it does not surprise that other employees will be more interested in personal advantages than fairness too. Who still believes that Adam Smith' „intangible hand“ will fix everything probably considers ethics and integrity as something superfluous. If management only feels obliged to the principle of profit maximisation it will hardly improve the moral level of the company.

Although it is a widespread opinion that moral behaviour of the top-management causes stronger effects than written guidelines it is necessary to have them too. They give moral standards and integrity a more official character, more power and binding force. To state integrity as being promoted by the board of management is an important prerequisite – if there is no „signal“ from the top integrity will hardly be realised. However, such statements should be carefully dealt with. It would be a company's worst case if words and activities were not congruent. Then ethics and integrity would become irrelevant (at best) or just be a topic of cynical comments (at worst).

In concrete situations the board needs to rely on its managers. Especially in decentralised firms managers usually need to decide on their own. This would be easy when having just two alternatives – but business life is more complicated. In most cases there are more alternatives and managers do neither have the chance nor the time to consider all necessary aspects.<sup>52</sup> A certain backing can be given by a reliable team, which in turn is shaped by the behaviour of its superior. This proves the far-reaching significance of moral behaviour of the top-management. Shaping the corporate community starts with personal influence of responsible leaders, followed by fixed moral principles and adequate methods.<sup>53</sup>

Although top-management has a clearly higher responsibility it does not mean that other staff cannot be made accountable at all. However: „If employees are to fulfil their roles in achieving the organization's integrity they need to receive specific training.“<sup>54</sup> Again it belongs to the tasks of top-management but it also shows the importance of things like empowerment and participative leadership. If a manager is either not willing or not able to trust others and involve them in several tasks he will hardly cope with high requirements of responsibility and integrity. Public perception of integrity lives from the top but it needs to penetrate all hierarchical levels by example. If employees do not get a chance for independent decisions they cannot internalise moral behaviour. Integrity needs „...an appropriate top management role model, the public punishment

of transgressors and the public reward of achievers.“<sup>55</sup>

Finally, it turned out that integrity matters all hierarchical levels – but to different extents: The same moral norms as for any person apply to managers. But a manager has additional responsibility as he works with other people's money. Furthermore, he has to fulfil a model function for his staff and also a social and economic responsibility – the bigger the company the bigger its responsibility.<sup>56</sup>

6.5 Internal and external integrity are the same.

It is the age-old problem of praying water and drinking wine what is behind the scenes. A more pragmatic person could possibly say: „It does not matter to anybody else than the company itself if they do what they talk about or not. At least as long as nobody is harmed.“ A consistent idealist would probably contradict vehemently: „Of course it matters whether one can rely on what he was promised or not.“ Being integer does not only mean to talk about the issue but rather to behave adequately as well. That does not depend on whether somebody has noticed it right at the moment or not.

Several examples seem to deny the assertion that integrity needs to be consistent in word and deed. Often enough fiddler, liars and swindler manage to come up to the top of business. It looks like there is no conclusive economic need to be always honest – to break one's word will not necessarily be punished. There are still a lot of people who try to see themselves all right away from law and morality. And they live marvellously with that.<sup>57</sup> It seems to be the same in business, but who tries to lead one's partners up the garden path permanently will sometime have no business any more. Of course, the quality of products and services is important but one cannot survive without trustworthiness and integrity in the long term. Only then people will stick with the company in good and bad times.

It is impossible to divide integrity – internal and external aspects need to go together. It cannot be started to build up integrity to external partners in order to get good reputation and constitute inside integrity later on. And it is the same the other way round: Integrity can only be established by a holistic approach – based on a process of internal and external confidence building, credibility and reliability. „Holism encourages and ultimately requires reference to ‚the big picture‘, to the overall context in which a business decision and in fact business itself is engaged, to the ‚whole‘ rather than just a part...“<sup>58</sup> It would not go with each other to appear integer to one side and behave differently to the other side. „Ho-

55 *ibid.*

56 *cf.* Berger „Härte und Moral gefragt“, in: „Die Zeit“ of 04/08/95, page 18

57 *cf.* Bhide/Stevenson „Warum rechtschaffen sein“, page 43

58 *op. cit.* Solomon, page 181

52 *cf.* Andrews „Moral fängt ganz oben an“, page 27

53 *cf. ibid.*, page 29

54 *op. cit.* Pearson, page 145

lism, accordingly, means seeing beyond all of those contextually useful but ultimately self-defeating or otherwise inadequate dichotomies...<sup>59</sup>

Internal and external integrity create a mutual relation – once inconsistency will be noticed one part it will react upon the other. But the same is valid for the positive variant. So if integrity penetrates internal relations of the company it will be recognised externally as well. And if a company bases its external relations on the principle of integrity that will underline inside effects again. The result of consistency in external and internal integrity is increasing moral trustworthiness. „A corporation’s trustworthiness is determined by how much the stakeholders believe that the corporation was, is or will be faithful to their positive expectations.“<sup>60</sup> And this, in turn, creates a good reputation for the enterprise.

However, external integrity can only convince if it works inside as well. It is not useful for the company to appear morally proper if this is not really practised. Such situations are unfortunately not unique in business. But what is behind does not necessarily need to be malicious intention – even if it can happen. Apparent inconsistency of external and internal aspects can also be caused by communicational problems. Wrong or insufficient information to the company’s management will influence its reputation as well. The most problematic areas are the consistence of external and internal appearance as well as a functioning reliable communication system. Hence the establishment of integrity is a process – if moral behaviour increases reputation does so too. It should always be considered that integrity has outside (e.g. image, investor attractiveness) and inside consequences (e.g. satisfaction, motivation of staff) equally. What is crucial for the external perception is appearance and behaviour of the top-management, but they can just function if internal loyalty exists.

Thus, internal and external aspects of integrity are not the same – but both are necessary to make ethics and integrity a successfully working principle. Most often the argumentation starts from outside perception; however the internal part is the imperative one. As both – internal and external aspects – are mutually dependent on each other integrity should not be conceived as outer limit, but rather as inner basis of entrepreneurial success.

### **Integrity cannot be measured or encouraged by incentives**

The question of measurability is well-known to everybody doing preventive work. The crucial point is that nobody can pre-

59 *ibid.*

60 Kaptein „Ethics Management“, page 32

dict what would happen if this or that kind of job would not be done. Only if things happen benefits or losses can be exactly calculated in financial terms and the „real value“ of preventive work becomes obvious. However, reality does not follow any theoretical model and that is why a lot of people still excuse themselves with the explanation: „Preventive work is just not measurable.“ But this would be too easy.

Business ethics and integrity create values and these are – even if not always calculable in total figures – comprehensible and thus measurable. Created values are diverse and can come up on different levels inside and outside the company. The actual value of benefits depends on the subjective view of the person or group affected and can vary from one to the other. However, a basic requirement for measurability of effects arising from ethics or integrity is their institutionalisation. Only what has a sense of obligation and is somehow fixed within the firm can also be verified and thus measured.

The question is: Does it actually make sense to measure integrity? Or is not the institutionalisation of such issues the first step to ruin them? – Of course, it does not ruin ethics or integrity when institutionalising them. If somebody wants to avoid the topic he will find a way to do this anyway. But if ethics and integrity are considered to be relevant and important issues this can even be pushed. What is actually behind is the decision whether to follow the „third-party-approach“ or the „self-governance-approach“. The „third-party-approach“ is based on stakeholder theory – meaning the company will find out and consider the interests of its stakeholders what will influence moral behaviour as well. In contrast, the „self-governance-approach“ assumes that only the existence and realisation of an internally institutionalised process is verifiable.<sup>61</sup> When following the second approach – and otherwise there would be no institutionalisation – this leads up to the third question connected with measurability: How to institutionalise ethics and integrity?

This is a complex that is still open for the most part in Germany. However, if relying on American experiences instruments for organising this process could be codes of conduct, ethics officers, ethics departments, trainings or hotlines. All these instruments will be integrated into an ethics management system, which is a combination of company specific instruments whose aim is to define moral status and norms of an organisation and to make them living in practice.<sup>62</sup> Once common moral norms or rules were codified they need to be communicated internally and externally. This is what makes them verifiable and measurable. If norms are not officially known the

61 *cf. op. cit.* Bausch/Kleinfeld/Steinmann, page 161

62 *cf. ibid.*, page 161f

company can – and probably will – always draw back in critical situations.

The question whether integrity can be encouraged by incentives or not is actually not under discussion. According to Weise morality and ethics basically owe their existence to a conflicting structure of incentives: People want to take advantageous action for themselves, however, recognise that they will harm others or minimise their own future advantage thereby. Depending on people's preference structure, ability to act, environment and other's behaviour moral behaviour can then be worthwhile or not.<sup>63</sup> Derived from that one needs just to stress more on relevant aspects and the motivation structure of the respective person will automatically change. This is nothing else than encouraging the person's behaviour by certain incentives in this or that way – no matter whether it is done consciously or unconsciously.

So if incentives are set anyway why should this method not intentionally be used to establish ethics and integrity as common principles within a company? It should be the purpose of incentive systems to strengthen positive aspects and to force them. However, this requires a critical analysis of motivation for moral or immoral behaviour at first. Only who knows which motives result in what kind of conduct can identify potentially intensifying factors. Once the motivation structure was analysed adequate incentives can be developed to influence people's behaviour.

What still remains are two problems: Who should set these incentives? And what could they look like in order to be successful? Concerning the initiation of incentives there are again two approaches: (1) government-regulation, and (2) self-regulation. Government-regulation is based on legal frameworks given by the state. However, lots of enterprises complain on too much regulation already now. Most important arguments in favour of „less state“ are that business ethics cannot be sufficiently codified by legal regulations if it should not get out of hand and that entrepreneurial activity will probably decrease if regulation would increase. Hence, moral behaviour on a voluntary basis would be the most effective and most economic way.<sup>64</sup> The consequence would be to prefer self-regulation, which insists on individual or collective self-obligation. Substantiated by legal and social reasons this approach follows the principle of subsidiarity.<sup>65</sup> To transfer control func-

tions from the state to the enterprise seems to be sensible but it needs to go along with a complex system of incentives and punishments. To organise such a system is the most difficult task. It cannot be based on economic aspects only, because if so it would not really cause moral behaviour or integrity. The company would just decide for the most cost-effective way then.

Finally can be stated that integrity is measurable in fact because it creates value to the company and the society as a whole. However, in order to make effects and benefits clearly verifiable it is necessary to institutionalise integrity to a certain extent. To fix integrity makes it a reliable tool for employees and management as well as all other partners and shows that it is highly esteemed in this company. What matters the question of enforcement by incentives should be proved that this is actually already done. The crucial question is how to make use of the motivation structure analysed before in order to strengthen those aspects that should be forced. The most important challenge consists in the creation of an effective system of incentives and punishments – a mixture of legal frameworks, economic intentions, public acknowledgements etc. Once the system will work successfully nobody will ask anymore if it makes sense to institutionalise ethics and integrity.

### **The ideal case – what business ethics and integrity in a company could look like**

The decisive question is now what business ethics and integrity in a company should look like. The answer „The ‚best practice example‘ could look like a perfect mixture of activities taken by progressive companies.“ would be as right as simple. But no matter whether it is a multinational enterprise or a rather small and regionally acting company the best suitable solution depends on different aspects. Everybody needs to consider respective surrounding conditions, own attitudes, aims and visions, legal regulations, cultural peculiarities, social requirements etc.

What is generally important is the fact that the basics are needed to be laid down in writing. To find the most effective way for this is the task of the board of management of the respective company. The decision will of course be influenced by the structure and organisation of the firm – by the number of hierarchy levels, its integration into the parent company, relations to other subsidiaries etc. Several forms of such a basic do-

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asons are based on the insight that social engagement serves the long-term protection of the company's own markets. Thus long-term oriented economic interests are motivating this kind of engagement. (cf. op. cit. Lammers/Schmitz, page 116ff)

63 cf. Weise "Individualethik oder Institutionenethik", page 11

64 cf. op. cit. Leisinger, page 181

65 An example for legal reasons can be given from the USA where financial responsibility of enterprises for conducts of their employees has been tightened by "Federal Sentencing Guidelines" since 1991. These guidelines threaten companies with fines if they cannot prove relevant organisational measures to guarantee legitimate behaviour of their employees. Social re-

document are conceivable, like corporate vision, code of ethics or code of conduct, general business principles etc. It does not matter what it is called, but it matters that the chosen method and realisation fit each other. And one should be aware that the code of conduct is not just the American counterpart to the German „Unternehmensleitbild“. The corporate vision, as a description of values valid for a firm, is rather a part of the code of conduct. Other parts of the code of conduct put statements on the system of values in more concrete terms. That means values and beliefs are completed by further explanations giving particular instructions on how to behave.<sup>66</sup> What regards the compulsory nature of these regulations the decision is again up to the board. In the USA it is meanwhile quite common to make codes of conduct being a part of the employment contract. This might be partly based on legal regulations but also gives the opportunity to punish malicious activity with dismissal. However, it needs to be decided by the company if this would be sensible or not.

The second very important issue to be considered is: Even if a multinational enterprise should have globally consistent documents and procedures for all its subsidiaries, there is an essential need for local adaptation that cannot be reduced to pure translation. If people have not been involved in drawing up fundamental documents it will most probably be difficult to realise them. Nowadays mergers and acquisitions of enterprises happen quite often, but this should not lead to a takeover or handing over of a corporate vision. It is important for all employees to find themselves inside the corporate vision as well as to know about reasons, backgrounds and contents. Even if companies finally manage to communicate their corporate visions and positive developments caused by it, they need additional efforts to get these results.

Meanwhile numerous companies recognised that business ethics and integrity cannot be reduced to simple statements. They need to be connected with further regulations and appropriate measures to make them more comprehensible. Especially for lower hierarchy levels it seems to be important to get an idea of potential dilemma situations and to show that everybody can be concerned by such problems in this or that way. Otherwise it could happen that they do not feel affected by the discussion because of their lower scope of action and decision making.

A further aspect that should not be undervalued is the need for a so-called higher instance with regard to ethical questions. It can be established by means of a hotline or an otherwise independent person or function, but an institution offering the chance to appeal to is absolutely indispensable. It

66 cf. op. cit. Lammers/Schmitz, page 118f

is necessary to get anonymous hints as well as to settle disputes (e.g. between an employee and his superior). Finally, not a single activity or measure will make a company successful in establishing ethical behaviour but rather a balanced mixture of various documents, policies, strategies, measures and activities.

## Review

Previous experiences show that integrity is often mentioned as a prerequisite for moral behaviour in enterprises. Sometimes this is related to fair conduct between employees inside the company, sometimes it is mentioned in connection to trustworthy dealings with customers, suppliers etc. However, in most cases integrity is just stated together with other moral qualities, like honesty, reliability, trustworthiness etc. That means, it is neither questioned nor analysed as a real moral quality. But even if it does yet not really fulfil the significance of a separate category, integrity actually is a corporate success factor. However it must be admitted that importance and effects of integrity are neither consciously perceived nor used for the development of ethical behaviour in business life.

What, among other things, obviously reflects the standing of integrity as a moral category is a confusing use of the term in relevant literature – sometimes it refers to individuals and sometimes it is applied to institutions or organisations. This does not make it easier to handle the subject. Sense, meaning and consequences of integrity can only be pushed when using its preventive character by means of proactive dealings. In other words: Intentionally using the qualities of integrity as a corporate success factor needs to query the requirements of integer behaviour for every single employee, to query necessary surrounding conditions to be created by the company as well as to query organisational frameworks to be established by state or society.

When doing so integrity could become part of a system of moral values and virtues that are not only required by the society but also practised inside the economy. Beyond this integrity would contribute to further development of ethical behaviour on all levels inside the economy. Then it would not be necessary any more to discuss on suitability of ethics and profit. „Ethical action is compatible with profit and success. ... Ethics without a good product and without good management will not make a company succeed. But without ethics a good product and smart management cannot guarantee a company's success.“<sup>67</sup> More detailed consequences regarding the importance of public commitment of the board of management, the role of corporate vision and consensual dialo-

67 op. cit. de George, page 8

gue, the necessity of applied corporate culture as well as the long-term character of business ethics strategies have been sufficiently described.

What remains is the difficult relation between individual and institutional ethics, which is probably causing at least parts of confusion around business ethics and integrity. Therefore, a final comment on that shall be given: According to Weise it is still argued that ethical behaviour as such can only be individually ethical. Such ethical (or moral) action is compared with behaviour in case of existing markets and social norms. The central concept for comparisons between individual and institutional ethics is that of transfer costs. Only in case of perfect markets or complete immobility there is no need for individual ethics. In all other cases of relative mobility far-reaching institutional ethics cannot replace individual ethics. Institutional ethics can support individual ethics on the one hand, but can also undermine it on the other.<sup>68</sup> Thus, the power of concepts on institutional ethics should not be undervalued even if they are codified and realised by individuals.

The crucial question is: What should be done to help integrity (and also business ethics) getting the significance that it actually should have. A basic necessity is the insight that acting with integrity makes sense and the recognition of the importance of corporate culture as an intangible, but valuable asset. A company that wants to act with integrity needs a sense of self-identity – certain values and ideals to look beyond the pure financial aim – in order to include its whole staff. When deciding for this way the enterprise should be aware that the process will not be free of problems. Therefore, they should ask and answer questions like: „Who attempts to resolve dilemmas involving ethical displacement? Where are the ethical gray areas in the company? Who internally challenges corporate procedures or structures from an ethical point of view? How might such questioning or attempts at resolution be institutionalized? Does the company need a devil's (or an angel's) advocate to do just that?“<sup>69</sup>

The essential role of top managers, the need for moral imagination and courage as well as the fact that acting with integrity can be sometimes costly have been already mentioned. Nevertheless, personal integrity is obviously not enough. What is needed is a complex of policies, activities and measures promoting ethical and integer behaviour – an ethics management system. The process of creating such a system is running in four stages: (1) codification, (2) communication, (3) implementation, and (4) organisation. Ethics management is based on establishment and codification of those values that

shall determine its identity and structure its decisions. Codified values need to be communicated within the company (intra team), between companies (inter team) and to the society (extra team). The implementation of values can be realised and audited via compliance and/or value programmes. In the end, an ethics management system needs to be organised.<sup>70</sup> What finally decides on consequences of practical ethics is its instrumentation. Without fixing moral requirements there will neither be moral discourse in companies, nor wanted economic effects.

The nature of a system of ethics management implies the requirement for a holistic approach. „Holism ... is concern for the whole rather than some of its parts, an emphasis on the big picture rather than the analysis of narrowly circumscribed details such as profit.“<sup>71</sup> It does not make sense just to reflect on certain details and to leave out some others that are completing the picture.

Future prospects and importance of concepts on business ethics and integrity will heavily depend on how the subject will be handled on all levels affected. Obviously there is something on the way – European enterprises can learn a lot from what has happened in the USA and American companies can learn from European practice as well. However, in view of developments and effects of globalising markets it is sensible to extend activities to the international level too. Where national regulations come up to their limits the responsibility of enterprises will increase – a well-balanced mixture of duty and voluntariness would be the adequate response to that. Finally, there is still the responsibility for the whole: No society can exist without consent on certain behavioural norms. A society that cannot agree on minimal ethical norms and that does not accept moral barriers will inevitably collapse in the future.<sup>72</sup>

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70 cf. op. cit. Bausch/Kleinfeld/Steinmann „Unternehmensethik in der Wirtschaftspraxis“, page 163 ff

71 op. cit. Solomon, page 180

72 Dönhoff „Wo bleibt das Ethos?“, in: „Die Zeit“ of 05/07/96, page 7

68 cf. op. cit. Weise, page 10

69 op. cit. de George, page 98

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## VALUES MANAGEMENT

### THE ETHICS AUDIT AND THE ETHICS CERTIFICATION

Julia Ridegh

**Abstract.** The article “Values Management: The ethics audit and the ethics certification” describes the different levels of business ethics and the values management system. Furthermore tools and practices to measure business ethics are introduced: the diagnostic tool ethics audit, EU guidelines and other international standards as well as the ethics certification and its providers. In the final section the general success factors related to the ethics audit and the ethics certification are defined.

**JEL Classification** G34, Z13

#### The need of business ethics

The topic of business ethics is not a new one but gets augmented attention by stakeholders such as consumer groups who are interested in the circumstances under which goods and services are produced and placed on the market. Corporations are watched by their stakeholders and have to take responsibility for their actions in order to keep the licence to operate from them. The business environment and conditions under which corporations do business have changed e.g. due to the world's globalisation and scarcity of resources. These upcoming challenges have changed the role of the state and formerly clear boundaries between politics and economy have been blurred. In this context the state increasingly demands accountability of corporations towards society and the way they do business and act as local citizens. The term stakeholder also includes the employees of corporations. This directs attention to the internal dimension of business ethics on which this article focuses.

This article describes the different levels of business ethics, the values management system, the diagnostic tool ethics audit, EU guidelines and the ethics certification and its providers are introduced. In the final section the general success factors related to the ethics audit and the ethics certification are defined.

#### Levels of business ethics

Enderle<sup>1</sup> defines three dimensions of business ethics: the macro, meso and micro level. The macro level focuses on the political conditions shaped and set by the state, such as laws or incentives to motivate businesses to act in certain ways. An example would be the restriction of greenhouse gas production for which, if exceeded, penalties have to be paid.

The meso level concentrates on the accountability within corporations. The arrangement of the institutional framework incites the ethical behaviour of the corporations individuals. This could be achieved by installing guidelines and policies to prevent unethical behaviour and enable ethical behaviour of employees. The meso level alleges one of the two norms of behaviour, the “espoused norms”.

The second norms identified are the “norms-in-use”, defined as the micro level of business ethics by Enderle. The “norms-in-use” steer the individual ethical behaviour of employees. The corporate culture is influenced by the meso level and “espoused norms” but mainly consists of the norms-in-use on the micro level.

Especially executives hold a vital role as they act as role models and are also multiplier of the corporate values and significantly shape the “norms-in-use”. Moreover it is important to see business ethics as a way to do the core business ethically and make ethics part of the corporate identity. According to Grüninger and John<sup>2</sup> the linkage of ethics to core business processes would be the way in which business ethics is most efficient.

#### Values management system

In order to bring business ethics into their culture corporations often implement values management systems. They focus on the structural organisation of corporations. Processes are defined but content can be tailored to corporate needs and specifications. Especially the defined processes allow these systems to be certifiable. The most established values management system is developed by the Zentrum für Wertemanagement gGmbH (ZfW) and foresees the following steps to implement the ValuesManagementSystemZfW: The codifying of business values, the communicating of the implementation, the systematizing of instruments, and the organising of the corporation. The implementation of the ValuesManagementSystemZfW should at least include the departments risk management, quality management, human resources, environ-

1 Göbel, E. (2006). Unternehmensethik. Stuttgart: Utb, p. 79

2 Grüninger, S. & John, D. (2004). Corporate Governance und Vertrauensmanagement. In J. Wieland (Hrsg.), Handbuch Wertemanagement (p. 177). Hamburg: Murmann

mental management the department responsible for corporate citizenship. The close cooperation of these departments is of vital importance to ensure the effectiveness of the ethics programme<sup>3</sup>.

After successful implementation of the ethics programme the corporation has to prove evidence that the system has been implemented. This is a periodical process that can be done internally or externally with conduction of an ethics audit.

Nonetheless no business ethics programme guarantees that unethical behaviour won't occur in a corporation that has implemented a programme although it minimizes the risk to a large extend.

### The ethics audit

The ethics audit has the function to monitor and ensure the following conditions: Does the corporation meet the interests of its stakeholders? Do structures in the corporation enable employees to act ethically? To which extend a corporation meets these goals can be measured in an ethics audit.

According to Kaptein<sup>4</sup> the ethics audits serve five functions:

1. Descriptive: the ethics audit shows the current situation.
2. Normative: the desired situation is formulated on the basis of a description of the current situation.
3. Discrepancy identifying: the ethics audit shows the discrepancy between the current and the desired situation.
4. Sanctioning: the ethics audit provides information for backtracking unethical behaviour to individuals or departments.
5. Evaluative: Conduction of the ethics audit over a period of time, changes in the performance can be determined.

The methods used conducting an ethics audit are various. Questionnaires, interviews, document reviews and the analysis of other data are the methods Kaptein describes in his "six instruments of an ethics audit" which are described in detail below. The ethics audit provides a snap shot which enables the detection of weak points in the corporate culture. Moreover measures for further development of the ethics management can be derived from the snap shot. The measures of ethics management should be continuously developed in order to prevent risks<sup>5</sup>. Conducting an ethics audit and comparing the desired situation with the current situation underlines the credibility of the corporation aiming to fulfill the self-imposed guidelines, the co-operation with stakeholders regar-

3 Wieland, J. (2004). Wozu Wertemanagement. In J. Wieland (Hrsg.), Handbuch Wertemanagement (p. 13-52). Hamburg: Murmann.

4 Kaptein, M. (1998). Ethics Management – Auditing and Developing the Ethical Content of Organizations. Dordrecht: Kluwer Academic Publishers.

5 Kreikebaum, H. (1996). Grundlagen der Unternehmensethik. Stuttgart: Schäffer-Poeschel.

ding transparency, openness in communication, and leadership quality. Indicators chosen to determine the performance vary. Examples would be theft, employee fluctuation, status of employee's illness or the corporate image<sup>6</sup>.

If periodically conducted the ethics audit can be used as a process tool as it is in the Plan-Do-Check-Act-Cycle.<sup>7</sup> The advantage of this cycle is the discovery of positive or negative trends within the corporate culture at an early stage due to determination, measuring, and analysis of the current situation<sup>8</sup>. Objectives are defined, possible solutions discussed, and put into practice with the resources needed. The results will then be measured again<sup>9</sup>.

The ethics audit can be carried out corporation-wide but also on branch, department or even process level. Sometimes this is reasonable as the departments differ in the way they operate<sup>10</sup>. The conduction of an ethics audit may also differ. It could be carried out internally or externally depending on the preferences of the corporations. The advantages of an external audit are first of all the availability of the corporations own resources. Moreover knowledge and expertise is purchased which also means that auditors are impartial. That in turn amplifies credibility of results, secures confidentiality to processes, and enhances the quality of suggestions for improvement due to impartiality<sup>11</sup>. The advantages of the internally conducted ethics audit are the easier identification of individuals to be interviewed and the possibly higher acceptance among management and employees<sup>12</sup>.

### The ethics audit instruments

As stated above Kaptein<sup>13</sup> identifies six instruments to conduct an ethics audit. All of these instruments can be combined or deployed separately. The more instruments are applied the more precise the analysis of the corporate culture will be. In the following section the instruments are introduced.

6 Palazzo, B. (2001). Unternehmensethik als strategischer Erfolgsfaktor - Ein pragmatischer Ansatz. management, 1,2/2001, 48-55.

7 Cp. Wikipedia. PDCA, <http://de.wikipedia.org/wiki/PDCA>.

8 Kaptein, M. (1998). Ethics Management – Auditing and Developing the Ethical Content of Organizations. Dordrecht: Kluwer Academic Publishers, p 162.

9 TÜV Nord Cert GmbH. (n.d.). [Erfolg] durch ein wert(e)volles Miteinander. Available at: [http://www.ethikverband.de/cms/upload/pdf/Prosp.Ethik\\_2109\\_Einzel.pdf](http://www.ethikverband.de/cms/upload/pdf/Prosp.Ethik_2109_Einzel.pdf) (02.04.2007), p. 14

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11 Allen, M. B. (1995). The Ethics Audit a tool whose time has come. Nonprofit World, 13/6, 51-55.

12 Mason, D. E. (1993). Put the Power of Ethics to Work in Your Organization. Nonprofit World, 11/1, 30-33.

13 Kaptein, M. (1998). Ethics Management – Auditing and Developing the Ethical Content of Organizations. Dordrecht: Kluwer Academic Publishers.

1. Qualities Monitor

The Qualities Monitor analysis to which extend the corporation actually lives its values. The methods used to collect the data are a questionnaire combined with interviews. According to Kaptein the questionnaire should contain about 100 items in order to reflect the perceived situation of the corporation appropriately. Although these answers reflect a subjective view they can be used to identify weak points within the corporate culture.

2. Conduct Detector

The conduct detector discloses how ethical the employee's behaviour is. Using also questionnaires and interviews the discrepancy between the desired and the current situation could be assessed by asking employees up to which extend unethical behaviour is accepted. These results are also subjective and should be underlined with facts such as the status of employees illness.

3. Stakeholder Reflector

The success of corporations depend to a large extend on their ability to meet its stakeholders requirements. The stakeholder reflector measures to which extend corporations succeed to meet the interests of their stakeholders. To apply this instrument the identification of stakeholder is necessary as well as to classify them and their interests as of relevance to the corporation<sup>14</sup>. Stakeholder meetings could be used to collect the relevant information throughout interviews and or questionnaires. This data can furthermore be used for development of the corporations products.

4. Measures Scan

With this instrument corporations may check their guidelines, rules, training activities which enable and support ethical behaviour of employees. The measures scan shall give an overview about all measures and which risks they secure against. It provides information about responsibilities of measures and monitoring as well as how effective the implemented measures are. It also shows where tools are conflicting and dilemma situations may arise.

5. Dilemmas Decoder

The dilemmas decoder is used to reveal dilemma situations employees may face. A supportive framework to discover these situations are ethics workshops. Employees analyse examples in which conflicting values and possible assistance of the corporation are discussed.

6. Individual Characteristics Assessment

The individuals shall live the corporate values in daily business and thereby shape the corporate culture. The individual characteristic assessment scans (potential or new) employees in terms of their suitability to the values of the corporation and their ability to identify with these values. Kaptein<sup>15</sup> identifies three criteria as important to assess the matching of personal and individual values. Firstly the intention of the individual: Does he or she want to act ethically? Secondly the cognition of the individual: Is the employee aware that he or she should act in a certain way? And thirdly the individuals capability: Is the employee skilled to cope with dilemma situations?

These instruments can be combined in the ethics thermometer which is a questionnaire that comprises aspects of certain instruments. It discloses the current situation of the corporate values lived and status of measures implementation. The following figure shows the ethics audit instruments within the different levels of business ethics.

The process of conducting an ethics audit is according to pro-

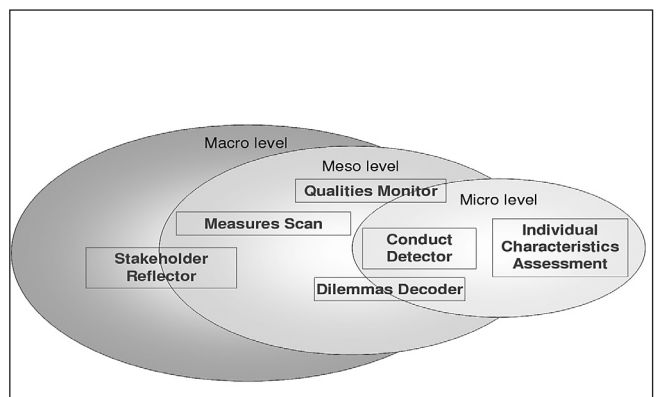


Figure 1 Ethics audit instruments related to the levels of business ethics

viders similar in most aspects. In a preliminary talk between provider and corporation, areas of the corporation to be audited and the criterion to be measured against are agreed on. It is also decided which methods will be used and a pre-audit is conducted. This should provide the auditor with the basic information about the corporation and its values management. In this step of the process it is necessary to start communicating the advantages of the audit to enhance the acceptance and support of employees and management. The next step is the process of the audit itself. Documents are reviewed and interviews conducted. All information is documented in a report which is handed over at the end of the audit phase. Identified

14 Kaptein, M. (1998). Ethics Management – Auditing and Developing the Ethical Content of Organizations. Dordrecht: Kluwer Academic Publishers, p. 124

15 Kaptein, M. (1998). Ethics Management – Auditing and Developing the Ethical Content of Organizations. Dordrecht: Kluwer Academic Publishers, p. 130

problems are to be discussed and followed up. Subsequently action is to be taken and measures developed.

The ethics audit should be conducted regularly as it identifies changes in the corporate culture and helps to reveal weak points which might be or turn into serious risks for the corporation.

### **EU and other international standards**

The European Union has issued a green paper which outlines a framework for corporate social responsibility. It consists of 10 criteria concerning social and ecological corporate governance including operational and strategic issues as well as stakeholder involvement. Split into an internal and external section, the internal section includes the human resources management, health and safety, adaptation to change and environmental compatibility as well as cultivation of natural resources. The external section is concerned with the social responsibility towards the local community with business partners, suppliers and consumers as well as Human Rights and global environmental protection. The green paper focuses on an integrated approach to corporate social responsibility and therefore includes the reporting, the quality of work, social and environmental seals of approval and socially responsible investment. The working group of this green paper has become „The European Alliance for CSR“. The green paper is a guideline that focuses on corporate social responsibility in the broader sense. Conspicuous is the fact that the topic corruption is not among the ten criteria. In addition to the European Unions green paper further standards on this topic exist as the Global Compact, issued by the United Nations and the Guidelines for Multinational Corporations released by the OECD.

The Global Compact was founded by Kofi Annan in 1999 and consists of ten principles based on the Human Rights declaration, international labour convention, the Rio declaration of environment protection and the United Nation anti-corruption convention.<sup>16</sup>

The Guidelines for Multinational Corporations address multinational corporations which are based in any of the signing countries. At first put into place 1979 it has been revised and has about 40 member states. It focuses on the four declarations mentioned above and additionally promotes transparency in business conduct and finance; moreover requires the compliance with tax regulations and promotes the knowledge transfer to developing countries.<sup>17</sup>

16 Cp. United Nations Global Compact, <http://www.unglobalcompact.org>.

17 Cp. OECD. Die OECD-Leitsätze für multinationale Unternehmen. Neufassung 2000, <http://www.oecd.org/dataoecd/56/40/1922480.pdf>.

The ISO 26000 is currently under development and will be issued by 2008. The standard will not be certifiable yet but will serve as a guideline concerning the broader view of business ethics – corporate social responsibility.<sup>18</sup>

All of these guidelines were developed to secure social standards within corporations which do business in developing countries or are business partners with companies of these countries. These standards are of peripheral relevance to the service sector as there are no business relationships to developing countries. Moreover are the requirements within the developed world mostly regulated by law. The challenge of the ISO 26000 standard is to make a standard applicable for the service sector.

### **The ethics certification**

Combining the traditional certification with the individual ethics of corporations makes the ethics certification a challenge. In order to get these two contradicting parts combined the ethics certification uses instruments of the ethics audit to certify corporations. Certification is defined as the compliance with certain features of a product or as the compliance with a certain system in which processes are defined.<sup>19</sup> The ethics certification is a system certification as it certifies the existence of a values management system. To obtain a certification means the compliance with a standard which in turn guarantees a certain level of quality in processes or products and means for many corporations orientation in the globalised world. Especially corporations in the manufacturing industry operating in developing countries ask suppliers to certify that their processes are in accordance with e.g. the SA8000 standard.<sup>20</sup> As mentioned above the traditional certification is a quite static certification which makes it difficult to measure the specific ethic of corporations. A static certification in this paper is defined as a certification for which an independent standard exists against which corporations can be certified. These certifications have the advantage that they make corporations comparable to a high degree. The static ethics certifications currently on the market are the SA8000 and AA1000. The AA1000 focuses on the stakeholder engagement in all processes and ethics reporting.

The ethics certification bridges the gap between the traditional certification and the ethics audit which is tailored to the specific characteristics of corporations. The non-static cer-

18 Cp. ISO. Future ISO 26000 standard on social responsibility reaches positive turning point., <http://www.iso.org/iso/en/commcentre/pressreleases/2007/Ref1049.html>.

19 Cp. Wikipedia, <http://de.wikipedia.org/wiki/Zertifizierung>.

20 Cp. Social Accountability International (SAI). SA8000, <http://www.sa-intl.org>.

tification is the ethics audit which could also be certified but does not allow comparability with other corporations as it is tailored to the specific ethics of corporations. There are three providers of ethics certifications that bridge the gap between these two types of certifications.

### **Ethics certification providers**

The ethics certification providers that are analysed within this thesis are the following three: DEKRA Certification GmbH, TÜV Nord Cert GmbH, and the Zentrum für Wirtschaftsethik gGmbH (ZfW). DEKRA is an international certification company that co-operates with the EthikColleg Mehren which is specialized in business ethics. TÜV Nord Cert as a traditional international certification company co-operates also with an ethics institution, which is the Ethikverband der Deutschen Wirtschaft e.V. The Zentrum für Wirtschaftsethik is specialized in the field of business ethics and has conducted ethics audits and ethics certifications for several years already.

With regards to the topics covered in the certifications it can be said that they are overlapping to a large extent. All of the providers cover the aspects of corporate ethics, corporate governance, and corporate citizenship. While DEKRAs analysis at some points appears too detailed TÜV Nord Cert GmbH and ZfW demand more corporation specific criteria and require the individual corporate vision and corporate culture to be congruent to their values. Moreover the latter two focus on the status of implementation of corporate values.

The methods applied to certify corporations vary little among providers. DEKRA abides to a questionnaire of which the questions are related to a points rationing scheme. TÜV Nord and ZfW however use just partly a questionnaire and conduct interviews. All three providers deploy aspects of the values monitor and the measures scan. The latter is a vital instrument of the ZfWs ethics certification.

The professional competence of the suppliers can either be seen from the certification or from the ethics point of view. It is noticeable that two of the three are professional traditional certification providers. Both of them work in co-operation with business ethic institutions. The third one is the ZfW which is linked to Deutsches Netzwerk Wirtschaftsethik. This institution is leading in the development of business ethics within the German speaking countries and implements its knowledge in various corporations. From an ethics point of view this could make the ZfW the most competent certifier of these three.

Both DEKRA and TÜV are new to the ethics certification market and have little operating experience while the ZfW founded in 1998 conducts ethics audits and certifications for several years.

All providers of ethics certifications assure its certification internationality. The ZfW has directed its entire ValuesManagementSystem towards European Corporate Cultures. TÜV certifies worldwide while DEKRA is limited to Europe.

In terms of independence it should be mentioned that all of the ethics certification providers have developed the ethics certifications themselves and exclusively certify. The core business of ZfW is business ethics consulting and the certification of the implementation of its values management system whereas TÜV Nord and DEKRA are core certification providers.

Comparing the providers of ethics certifications shows that the ethic certification is a new product which although it is to a certain extend still in development certainly is at the brink of its career.

### **Critical Success Factors**

Based on the identified requirements for ethics audits and ethics certifications some critical success factors can be identified which are categorised in the following points:

- Ethics organisation
- Ethics in the continuous improvement process
- Parameters to obtain an ethics certification

#### **Ethics organisation**

The ethics organisation focuses on two aspects: first the position of ethics within the corporation and second the existence of an ethics management system. Business ethics is an interdisciplinary topic that involves several departments within the corporation. This given complexity creates high demands on the involved departments regarding communication and co-operation and results in a number of challenges:

The high complexity of the topic and the involvement of different management divisions may lead to shortcomings in communication of involved parties. In order to prevent miscommunication, to ensure the involvement of all relevant parties and prevent redundancies of concepts, corporations should concentrate the lead of expertise, duties, and responsibilities related to the field business ethics within one management division group wide.

The ethics management system (exemplary the ValuesManagementSystem of the ZfW) consists of ten steps to implement values into structures sustainably<sup>21</sup>.

- Corporations should codify their values in vision, mission and values statement.
- The corporate values should reflect the corporate strate-

<sup>21</sup> Wieland, J. (2004). Wozu Wertemanagement. In J. Wieland (Hrsg.), Handbuch Wertemanagement. Hamburg: Murmann, p. 40 ff

gy and individual characteristics of the corporation and its business environment.

- The internal and external corporate communication is vital for the implementation of vision, mission and values statement.
- Ethics management should be exemplified by top management and executives and the responsibility has to be at top management level. Especially in the run-up to an ethics audit the discussion with top-management should be sought to ensure the top-management communication.
- The resources of the ethics management have to be defined.
- The ethics management has to be communicated internally and externally to increase credibility and allow measurement against self imposed guidelines.
- The corporate values are to be integrated in corporate structures such as employment contracts or/ and performance evaluation.
- The values management system is a system subject to continuous improvement and therefore focuses its self evaluation by conduction of an ethics audit.
- The documentation of the ValuesManagementSystem is especially with regard to an evaluation mandatory.
- An evaluation of the ValuesManagementSystem by the top management is required on a regular basis, to ensure the quality of the ethics management system and its adaptation to changes.

Moreover it has to be said that the introduction of an ethics management system is the precondition for any ethics certification.

### **Ethics in the continuous improvement process**

An ethics management is a continuous process that has to react to changes in the environment. Therefore it is essential to measure the ethics management periodically respective efficiency<sup>22</sup>. This way weak points within the corporate culture can be discovered at an early stage which provides the possibility to redirect the ethics management instruments. The results provide the basis for improvement steps.

The instruments of an ethics audit are described in detail above. Critical factors for success are the in depth analysis of the corporate culture which would mean the combination of various instruments of within an ethics audit. The vital preconditions for conducting an ethics audit are the following:

#### 1. Qualities Monitor

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22 Rottluff, J. & Schneider, H.-J. (2004). Qualitätsmanagement und gelebte Wertekultur. In J. Wieland (Hrsg.), Handbuch Wertemanagement (p. 440). Hamburg: Murmann

In order to use the qualities monitor as a tool to measure ethics, employees should be willing to participate in a survey. As a precondition to gain meaningful results the topic should be accepted among employees and supported by management. In order to obtain a detailed result, numerous questions and personal interviews would have to be conducted.

#### 2. Conduct Detector

The conduct detector uses the same methods to gather information as the qualities monitor. Therefore the same preconditions must be fulfilled. Also the conduct detector analysis information that most often exists already within corporations. It should therefore be ensured that there is access to data already collected within the corporation.

#### 3. Stakeholder Reflector

The prerequisite to apply the stakeholder reflector is the knowledge about the corporations stakeholder. According to De Colle<sup>23</sup> they should be grouped depending on the extend of their influence and power, and their degree of interest concerning the corporation. Stakeholders should then be prioritised and their interests should accordingly be met. Feedback processes installed should be verified regarding their suitability for ethics audits.

#### 4. Measures Scan

In order to apply the measures scan it is necessary to have processes, guidelines, measures and the like documented. Furthermore it is essential to be fully aware of all measures available within the corporation, which risks they cover and where is further need for action. The precondition to apply the measures scan is a detailed depiction of all measures applied and responsibilities for implementation need to be settled.

#### 5. Dilemmas Decoder

For the application of the dilemmas decoder the employees should be fully aware of the corporate values. Communication channels should be established which can be used by employees who want to report ethical dilemma situations. The dilemmas decoder sessions should be led by an ethics officer or consultant.

#### 6. Individual Characteristics Assessment

To assess the characteristics of individuals periodical consultations between employees and their supervisors or interviews are required.

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23 De Colle, S. (2004). Die Systematik des Stakeholder-Managements. In J. Wieland (Hrsg.), Handbuch Wertemanagement (p. 526-550). Hamburg: Murmann

## Parameters to obtain an ethics certification

The prerequisite to obtain an ethics certification is the existence and function of an ethics management system and the documentation of it is of vital importance. Even not mandatory to obtain an ethics certification, the conduction of an ethics audit smoothes the way for an ethics certification.

## Conclusion

The ethics management is not a product which is finalized at some point. It is rather a process which continuously needs to be adapted in order to be improved.

The basis for ethics management is a functioning ethics management system. This includes the second step, securing the continuous improvement of the process by e.g. conducting ethics audits. It can be concluded that the more of the ethics audit tools are applied, the more precise the results will be. The more precise the results are, the better the possibility to develop the most suitable tool to counteract weak points within the corporate culture. An advantage of the ethics audit is its individuality compared to the ethics certification. It can be tailored to the specific needs of e.g. "ethically sensitive" departments or more general function as a benchmark comparing the performance among departments or subsidiaries<sup>24</sup>.

Step one and two pave already the way for the third step which should be the ethics certification of the corporation. The key differences between ethics audits and the certification are the different levels of business ethics audited and the intended purpose of both. The ethics audit analysis primarily the individual behaviour and intends an analysis of the corporate culture regarding the living of corporate values which should afterwards result in measures to enhance the ethical behaviour of employees. The ethics certification focuses on the meso level of business ethics, the existence and analysis of the ethics management system, documents and compliance with guidelines. The overall aim is to obtain the certification.

It is to be added that the popularity of ethics certification will most probably increase due to the rising interest of ethical investment opportunities and necessary rating that goes along with it. This thesis analysed three providers of certifications.

Summing up it is to be said that corporations often have implemented structures and tools to ingrain the corporate values into the daily business and the minds of employees. Con-

<sup>24</sup> Kaptein, M. (1998). *Ethics Management – Auditing and Developing the Ethical Content of Organizations*. Dordrecht: Kluwer Academic Publishers, p. 154

ducting an ethics audit will provide the information needed concerning the status of corporate values implementation as well as detect weak points within the corporate culture. Therewith it will provide the basis for the development of additional methods and tools to be implemented in order to further secure corporations against ethical risks.

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# CORPORATE COMPLIANCE - BENEFIT OR BURDEN?

Ina Oldendorf

**Abstract.** Corporate compliance drew a growing amount of attention in recent years and has become a keyword in times of tightening legislation. The term comprises all efforts undertaken in order to ensure that applicable laws and standards are adhered to. Due to the costs and efforts connected to become and remain compliant many corporations regard the implementation of compliance management as a huge burden. However, compliance is not a stand-alone issue but related to other areas of management. Therefore it can be turned into an opportunity for improvement of related fields and through its ethical components have a positive impact on corporate culture.

**JEL Classification G34, M14, Z13**

## What is Compliance?

'Compliance' is a general term derived from the Anglo-Saxon legal terminology<sup>1</sup>. The expression simply means 'acting in accordance' and therefore leaves space for very broad interpretations.<sup>2</sup>

In the business context the term might be accompanied by the prefix "corporate" in order to express the application of compliance activities within an enterprise.<sup>3</sup> It describes the sum of reasonable efforts, which ensure a behavior of employees and directors of an organization that is necessary to obey all applicable laws. Additionally conformity with values and beliefs, moral and ethics of the society should be guaranteed.<sup>4</sup> Compliance can be considered as a managerial task with the aim to create conformity with interbranch (e.g. Sarbanes-Oxley Act), sector-specific (e.g. Basel II) as well as national laws and regulations.<sup>5</sup> Due to the connection to managerial responsibilities compliance is often referred to as compliance management. According to Pricewaterhouse Coopers (PWC) compliance management involves a whole set of pro-

1 Cf. Hauschka, C. E.; "Corporate Compliance – Handbuch der Haftungsvermeidung im Unternehmen", 2007, p. 2

2 Cf. Vrije Universiteit Amsterdam on: <http://www.feweb.vu.nl/link.asp?itemnumber=7727>, viewed 23.02.2007

3 *ibid.*

4 Cf. Wikipedia on: [http://de.wikipedia.org/wiki/Compliance\\_\(BWL\)](http://de.wikipedia.org/wiki/Compliance_(BWL)), viewed 02.02.2007

5 Cf. Computer Associates International, Inc.; "Compliance = ROI" on: [http://www.ca.com/de/products/Compliance=ROI\\_Brochure06-01-06.pdf](http://www.ca.com/de/products/Compliance=ROI_Brochure06-01-06.pdf), 02.02.2007

cesses and systems, which ensure conformity with relevant regulations.<sup>6</sup> Successfully conducted compliance management will reach this goal without decreasing the efficiency of the related processes.<sup>7</sup>

Since violations of applicable legislation can be considered as an economic risk for a company corporate compliance is aimed at minimization of these risks.<sup>8</sup> Furthermore compliance activities will lead to improved transparency, which in turn might reveal potential weaknesses in operational processes. Addressing those bottlenecks may result in an increase of efficiency and effectiveness of processes.<sup>9</sup> Additionally, negative publicity as known from the cases of Enron, WorldCom and others could be avoided. Therefore it can be said that successful compliance management will protect the interests and reputation of a company and its stakeholders.<sup>10</sup>

## Development of Corporate Compliance

When considering the meaning of the term compliance in its broadest sense –obeying laws and regulations- logically one will come to the conclusion that there must have been at least basic compliance activities from the moment on, in which laws affecting business entities came into force.<sup>11</sup>

Nowadays compliance exists in a more complex version. At the end of the 20th and the beginning of the 21st century laws especially for stock listed companies have become stricter, which in turn lead to increased compliance duties. But obviously companies had an interest in compliance management even before this development. The traditional method has been the establishment of internal audit departments especially in the financial sector.<sup>12</sup>

In the USA compliance initiatives emerged in Cold War times in order to enable the local industry to cope with rapidly changing and heavily sanctioned export restrictions for countries

6 Cf. Wolf, K.; "Corporate Compliance - Ein neues Schlagwort? Ansatzpunkte zur Umsetzung der Compliance in der Finanzberichterstattung", in *DStR Deutsches Steuerrecht*, 44/ 2006, p. 1995

7 Cf. Puschke, M.; "Die Compliance- Fibel – Prozessorientierte Integration von Sanktionslistenprüfungen", 2005, p. 5

8 Cf. Hauschka, C. E.; "Corporate Compliance – Handbuch der Haftungsvermeidung im Unternehmen", 2007, p. 3

9 Cf. Menzies, Ch.; "Compliance: Integration mit System" on <http://www.compliancemagazin.de/fachbeitraege/entscheidungshilfen/pwc151206.html>, viewed 27.02.2007

10 Cf. Harvard Business Manager; Geißler, C. "Was ist... Compliance Management?" on: <http://www.harvardbusinessmanager.de/img/cat/HBMO/compliancemanagement-Was.pdf>, 05.02.2007

11 Information derived from talk with Marijke Schmitz, Paulussen- Advocaten & Procureurs, 22.02.2007

12 Cf. Mengel, A. & Hagemeister, V.; "Compliance und Arbeitsrecht" in "Betriebs- Berater", Heft 45, 06.11.2006, p. 2466

of the former Eastern Bloc.<sup>13</sup>

Simultaneously compliance management has been practiced by financial service providers especially for money laundering, corruption and insider trading. In a context affecting more than just these institutions corporate compliance took shape in the USA during the late 1980's, even though a strong connection to the financial sector was still given.<sup>14</sup> Companies established a self- commitment to install systems, which were able to guarantee compliance of employees with respective legal obligations. This development was encouraged by a revision of the 'U.S. Federal Sentencing Guidelines'. This guidelines offered the possibility of reduced punishment in non- compliance cases under the condition that the enterprise could satisfyingly prove that a compliance system was in place, related regulations had been disclosed to the employees and their compliance had been overseen.<sup>15</sup>

Due to an increasing amount of business relationships with US- companies the trend of intensifying compliance efforts logically reached Europe and quickly spread also in sectors other than the financial one. At first it had an impact on internationally operating corporations especially in strongly regulated markets such as the energy or chemical sector. These enterprises felt the necessity to establish systems, which could handle the complexity of rapidly changing regulations (e.g. cartel or environmental laws) in order to identify risks before a lawsuit could be initiated.<sup>16</sup>

But in today's world of business simply complying with legal requirements is not sufficient anymore for a corporation that aims to be publicly respected. The legal side of compliance should therefore be supplemented by ethic elements.<sup>17</sup> A large number of enterprises has already discovered the necessity to ensure corporate integrity and introduced so- called 'Codes of Conduct' to direct the behavior of their co-workers for example in conflict of interest situations. Additionally, corporations active in environmentally critical sectors might commit themselves to long- term measures for environmental protection. Although these self- commitments cannot be enforced by legal action a company might suffer from repu-

tational harm -and therefore financial losses- in case of a violation of their own guidelines. Furthermore an effective compliance system might be a precondition for obtaining loans from institutions such as the World Bank.<sup>18</sup>

## Performing Compliance Management

Compliance has been addressed as an up-to-date keyword by different business publications. Related articles state e.g. that compliance is no longer a novelty to bigger companies.<sup>19</sup> Some experts present compliance even as a future success factor in the business context.<sup>20</sup> But how can compliance management efficiently be put into practice?

## The Internal Control Structure

To efficiently carry out compliance management it will prove useful to know the internal control structure of a company.<sup>21</sup> The internal control structure summarizes all principles, actions and procedures released by a company's management, which are aimed at the operational implementation of management decisions in the following areas:<sup>22</sup>

- Securing effectiveness and efficiency of business operations;
- Accurateness and reliability of internal and external accounting and reporting; and
- Compliance with applicable legislation.

The internal control structure consists of an internal guidance system, which comprises procedures for steering business operations; and an internal monitoring system. The latter can be subdivided into a process- integrated monitoring system (operational security measures, controls) and a monitoring system, which is not linked to a process (internal audit, etc.). Additionally a company's risk management system is part of the internal control structure.<sup>23</sup>

One of the main purposes of the internal control system is

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18 Cf. Harvard Business Manager; Geißler, C. "Was ist... Compliance Management?" on: <http://www.harvardbusinessmanager.de/img/cat/HBMO/compliancemanagement-Was.pdf>, 05.02.2007

19 Cf. Mengel, A. & Hagemeyer, V.; "Compliance und Arbeitsrecht" in "Betriebs- Berater", Heft 45, 06.11.2006, p. 2466

20 Cf. Wolf, K.; "Corporate Compliance - Ein neues Schlagwort? Ansatzpunkte zur Umsetzung der Compliance in der Finanzberichterstattung", in DStR Deutsches Steuerrecht, 44/ 2006, p. 1995

21 Information derived from talk with Marijke Schmitz, Paulussen- Advocaten & Procureurs, 24.04.2007

22 Cf. Marten, K., Quick, R., Ruhnke, K.; "Wirtschaftsprüfung- Grundlagen des betriebswirtschaftlichen Prüfungswesens nach nationalen und internationalen Normen", 2007, p. 269

23 Cf. Marten, K., Quick, R., Ruhnke, K.; "Wirtschaftsprüfung- Grundlagen des betriebswirtschaftlichen Prüfungswesens nach nationalen und internationalen Normen", 2007, p. 269

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13 Cf. Hauschka, C. E.; "Corporate Compliance – Handbuch der Haftungsvermeidung im Unternehmen", 2007, p. 19

14 Cf. Harvard Business Manager; Geißler, C. "Was ist... Compliance Management?" on: <http://www.harvardbusinessmanager.de/img/cat/HBMO/compliancemanagement-Was.pdf>, 05.02.2007

15 *ibid.*

16 Cf. Harvard Business Manager; Geißler, C. "Was ist... Compliance Management?" on: <http://www.harvardbusinessmanager.de/img/cat/HBMO/compliancemanagement-Was.pdf>, 05.02.2007

17 Cf. Wolf, K.; "Corporate Compliance - Ein neues Schlagwort? Ansatzpunkte zur Umsetzung der Compliance in der Finanzberichterstattung", in DStR Deutsches Steuerrecht, 44/ 2006, p. 1995

the prevention of errors in accounting and reporting systems. Additionally, it is meant to reveal mistakes, which already occurred, and to correct them.<sup>24</sup>

An effective internal control structure is based on the following principles:<sup>25</sup>

- **Segregation of duties.** Planning, execution and monitoring of the same process should not be concentrated in the hands of one single person. At least two employees should be involved in the process with clearly stated responsibilities. When executing the tasks of his/ her sub-process the employee should simultaneously check the performance of the previous process part. This principle is meant to prevent that the possibility of committing fraud or misusing company assets is granted to a single person. But the smaller the company the more difficult it will be to segregate duties.
- **Grouping of competencies.** This principle is the counterpart to segregation of duties, since a certain group of employees should only be allowed to execute a certain competency together (e.g. four-eyes principle). Consequently employees will have to monitor each other.
- **Organization of work flows.** It should be fixed in writing: who is doing what, when and how, as well how separate tasks relate to each other.
- **Principle of control.** Within an efficient internal control structure no major task should be performed without related controls.

Tools used in an internal control structure could be, amongst others, work instructions, charts of accounts as well as declaration forms. If available the internal audit department will review the internal control structure periodically.<sup>26</sup>

In relation to the internal control structure a control risk exists. It expresses the probability that material errors are not revealed by the internal control structure. The control risk can never be equal to zero since even the most effective internal controls do not guarantee that all errors are prevented or detected. Errors may occur due to mistakable instructions, a lack of accurateness, etc., even if respective controls are in place. Furthermore checks, which are based on segregation of duties, may be outsmarted by fraudulent cooperation of employees. Moreover, there is the possibility of manage-

24 Cf. Marten, K., Quick, R., Ruhnke, K.; "Wirtschaftsprüfung- Grundlagen des betriebswirtschaftlichen Prüfungswesens nach nationalen und internationalen Normen", 2007, p. 270

25 Cf. Marten, K., Quick, R., Ruhnke, K.; "Wirtschaftsprüfung- Grundlagen des betriebswirtschaftlichen Prüfungswesens nach nationalen und internationalen Normen", 2007, p. 270f

26 Cf. Marten, K., Quick, R., Ruhnke, K.; "Wirtschaftsprüfung- Grundlagen des betriebswirtschaftlichen Prüfungswesens nach nationalen und internationalen Normen", 2007, p. 271

ment override, which outlines that management willfully avoids control procedures.<sup>27</sup>

Unfortunately, the concept of internal controls has certain limitations. It can neither promise a corporations success nor its survival. This is due to the existence of the control risk as mentioned earlier. Internal controls can therefore be only considered as tool to support the achievement of business goals, not a guarantee.<sup>28</sup>

### Compliance Phases

There are different models describing the set-up of a compliance process and even though many of them are tailored for specific focus areas or business sectors certain parallels can be drawn between most of them. The following flowchart -published by Bwise, a producer of compliance software applications- distinguishes six different compliance phases<sup>29</sup>.

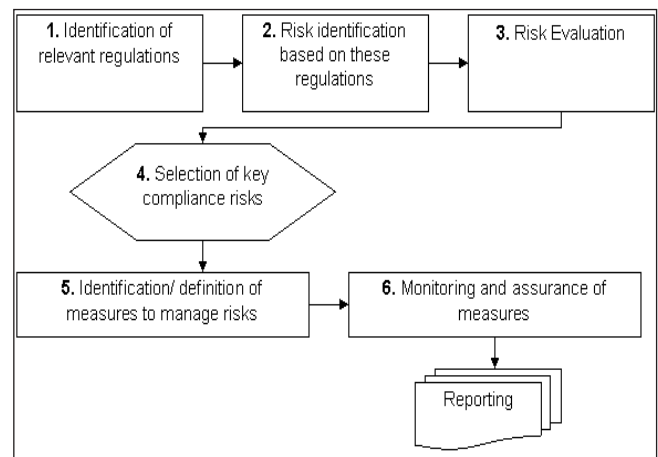


Figure 1 Compliance Phases

In phase one (1) all regulations, which apply to a certain company are identified. This might be achieved in co-operation with an internal legal department or an external lawyer since a layperson will hardly have a full overview over all laws in place.<sup>30</sup>

In the following phase (2) it has to be determined, which regulations expose the company to a risk. In this phase the relation between compliance and risk management becomes

27 Cf. Marten, K., Quick, R., Ruhnke, K.; "Wirtschaftsprüfung- Grundlagen des betriebswirtschaftlichen Prüfungswesens nach nationalen und internationalen Normen", 2007, p. 215f

28 Cf. COSO on: [http://www.coso.org/publications/executive\\_summary\\_integrated\\_framework.htm](http://www.coso.org/publications/executive_summary_integrated_framework.htm), viewed 06.05.2007

29 Bwise: "Compliance – Lessons Learned" in Conference Binder of "Dag van de Compliance Officer", Amsterdam, 14.02.2007, translated by I. Oidendorf

30 Information derived from talk with Marijke Schmitz, Paulussen- Advocaten & Procureurs, 30.01.2007

obvious, since both approaches involve risk identification and risk evaluation.<sup>31</sup>

An evaluation and classification of risks is performed in step three (3). Assessing risks can be based on information derived from a large variety of sources such as benchmarking. Additionally the responsible auditing firm can deliver valuable information on areas with high risk exposure.<sup>32</sup>

Based on the risk evaluation a selection of the risks with the strongest impact on a company takes place (4). A compliance risk can be defined as the risk of sanctions, loss of resources or reputational harm resulting from non-conformity with applicable standards.<sup>33</sup> The priority setting should be based on a thorough analysis including questions such as:<sup>34</sup>

- How likely is the occurrence of a certain risk?
- What would be the effect on operations, financial resources, reputation etc. in case of occurrence?

Based on the answer to those questions the following matrix can assist in prioritizing the identified risks.

		Probability of occurrence	
		Low	High
Impact on company	Low	Priority 4	Priority 3
	High	Priority 2	Priority 1

Figure 2 Risk Priority Matrix, Table created by I. Oldendorf

The risks categorized in section 'Priority 1' (high impact/ high probability of occurrence) should definitely become key compliance risks supplemented by a selection of risks from 'Priority 2' (high impact/ low probability of occurrence) and 'Priority 3' (low impact/ high probability of occurrence). Addressing risks from 'Priority 4' (low impact/ low probability of occurrence) might in practice become more costly than the actual occurrence. Therefore these risks are least likely to become key compliance risks.

31 Cf. Wolke, T.; "Risikomanagement", 2007, p.4

32 Information derived from talk with Marijke Schmitz, Paulussen- Advocaten & Procureurs, 30.01.2007

33 Cf. Dasselaar, C. J.; Opening Speech in Conference Binder of "Dag van de Compliance Officer", Amsterdam, 14.02.2007

34 Cf. Hauschka, C. E.; "Corporate Compliance – Handbuch der Haftungsvermeidung im Unternehmen", 2007, p. 92

After having selected the key compliance risks, measures have to be installed to manage them (5). In many companies respective measures or controls are already in place in the frame of the internal control structure. The task that has to be added here is documentation on the proper performance of these controls. Showing that a check is in place ("audit of design"<sup>35</sup>) is not enough anymore in the world of compliance, the company needs to be able to prove that it has been carried out properly ("audit of effectiveness"<sup>36</sup>). This includes regular monitoring (6) of the documentation and the appropriate assessment of the results of checks performed.<sup>37</sup>

From a logical point of view the phases described by B Wise should have been displayed in a circular layout to account for the fact that compliance is an ongoing process. The current layout might induce the assumption that compliance management is a one-time issue, which is definitely not the case. Laws change over time and additional regulations are passed, which might lead to a different picture in a company's risk portfolio. Therefore the whole process needs to be repeated periodically.

### The Compliance Officer

Besides the commitment of a company's top management and a mentality change among the employees the implementation of proper compliance management requires someone dealing with compliance-related issues on a day-to-day-basis. Many enterprises have therefore established the position of a Chief Compliance Officer (CCO), who is in some cases supported by a whole compliance department.<sup>38</sup> The Dutch Compliance Institute describes the compliance officer as a position appointed by the board of management, to which he/ she directly reports. Furthermore it is specified that the position of the compliance officer should be an independent one.<sup>39</sup>

Usually the compliance officer will act as contact point for communication and questions concerning applicable regulations. To overcome geographical distances this might be realized in form of a telephone hotline.<sup>40</sup> Furthermore the com-

35 Visser, N.; "Kennismangement van de Compliance Afdeling" in Conference Binder of "Dag van de Compliance Officer", Amsterdam, 14.02.2007

36 Visser, N.; "Kennismangement van de Compliance Afdeling" in Conference Binder of "Dag van de Compliance Officer", Amsterdam, 14.02.2007

37 Information derived from talk with Marijke Schmitz, Paulussen- Advocaten & Procureurs, 30.03.2007

38 Cf. Wolf, K.; "Corporate Compliance - Ein neues Schlagwort? Ansatzpunkte zur Umsetzung der Compliance in der Finanzberichterstattung", in DStR Deutsches Steuerrecht, 44/ 2006, p. 1996

39 Cf. Nederlands Compliance Instituut on: <http://www.compliance-instituut.nl/faq.html>, 02.02.2007

40 Cf. Wolf, K.; "Corporate Compliance - Ein neues Schlagwort? Ansatzpunkte zur Umsetzung der Compliance in der Finanzberichterstattung", in DStR

pliance officer is concerned with identifying training needs and initiating as well as supervising the execution of respective training sessions. The compliance officer should regularly report to the CEO and CFO.<sup>41</sup> In most cases the compliance officer will also perform random checks on proper documentation of controls and might even store the documents in a central place for more convenience when being audited. On the other hand the compliance officer is not responsible to perform these controls him-/ herself. This stays within the responsibility of the line- management or respective process owners.<sup>42</sup> Compliance activities related to controls have to be integrated into the operational business in order to reduce additional efforts to a minimum.<sup>43</sup>

To clarify the qualifications expected from the compliance officer I developed the following table, which is based on eight job ads for compliance officers ('monster.de', 'Stepstone', 'Jobscout24.de' and 'e- financial careers', December 12, 2006). Seven vacancies were placed by financial institutions. Six out of these eight companies stated that they are operating internationally. Due to the small number of ads reviewed this statistic cannot be considered as representative. Anyway it provides a first indication about tasks, which the compliance officer is supposed to perform; and the qualification a candidate is expected to possess.

One might be surprised that the job ads for compliance officers were mainly placed by enterprises active in the financial sector. But this should not lead to the assumption that only this sector is searching for compliance staff. My finding was that the vacancies are not necessarily advertised under the headline 'compliance officer'. Companies are looking amongst others for compliance managers, compliance analysts or compliance specialists. In some cases compliance positions are directly related to specific regulations as vacancies for SOX managers and managers for IFRS compliance indicate.

### The Whistle Blowing Process

As mentioned earlier compliance should not be limited to legal aspects but also account for ethical behavior or corporate integrity. Therefore the compliance officer might be involved in the development of a code of conduct or a similar

document in case this has not been put into practice so far. This kind of document usually contains information on whom to address to report on breaches of rules. Representing this contact point does not necessarily belong to the scope of duty of the compliance officer but he/ she might be involved in the whistle blowing process at a certain point.

A whistleblower literally is someone who blows the whistle and

Job profile includes...	Mentioned by ... companies
Monitoring activities	5
Tasks related to money laundering	5
Adaptation and implementation of applicable legislation	4
Training	4
Reporting	4
Risk analysis	3
Complaint management/ whistle blowing	3
Audit- related tasks	2
Introducing Compliance Management	1
Calculations on financial impact of non- compliance	1
Qualification of Candidate	Requested by ... companies
English	8
Knowledge of law for relevant sector	5
Either legal or economic background	5
Communication skills	4
Auditing background	3
Additional foreign language	3
Purely legal background	1

Figure 3 Profile of compliance positions, Table created by I. Oldendorf

in this way makes the public aware of something.<sup>44</sup> The whistleblower appears in many different languages even though under different names. The Dutch talk about someone striking a bell (klokkenluider); the Russians call him/ her a lighthouse keeper.<sup>45</sup> In the German language however, no accurate equivalent has emerged. Instead the English term is widely used. If a German expression is utilized it usually has a negative drift (German equivalents of 'squealer' or 'someone who fouls his/ her own nest' can be found).

Usually whistleblowers disclose information on illegal actions, which they learn about in their working environment.<sup>46</sup>

Whistle blowing has therefore become a synonym for moral courage, since the denounced person or institution is usually not satisfied if publicly accused of fraud, insider trading, environmental pollution etc.<sup>47</sup> Even though whistle blowing is

Deutsches Steuerrecht, 44/ 2006, p. 1996  
 41 Cf. Wolf, K.; "Corporate Compliance - Ein neues Schlagwort? Ansatzpunkte zur Umsetzung der Compliance in der Finanzberichterstattung", in DStR Deutsches Steuerrecht, 44/ 2006, p. 1996  
 42 Information derived from talk with Marijke Schmitz, Paulussen- Advocaten & Procureurs, 15.03.2007  
 43 Cf. Wolf, K.; "Corporate Compliance - Ein neues Schlagwort? Ansatzpunkte zur Umsetzung der Compliance in der Finanzberichterstattung", in DStR Deutsches Steuerrecht, 44/ 2006, p. 1997

44 Cf. Harvard Business Manager; Geißler, C. "Was ist... ein Whistleblower?" on: [http://www.harvardbusinessmanager.de/img/cat/HBMO/was\\_ist\\_0106.pdf](http://www.harvardbusinessmanager.de/img/cat/HBMO/was_ist_0106.pdf), 10.04.2007  
 45 Cf. Planet Wissen on: <http://www.planet-wissen.de/pw/Artikel,,,,,E7587198F70A4DADE0340003BA5E0905,,,,,html>, viewed 26.02.2007  
 46 Cf. Government Accountability Project on: [http://www.whistleblower.org/template/page.cfm?page\\_id=118](http://www.whistleblower.org/template/page.cfm?page_id=118), viewed 23.05.2007  
 47 Cf. Harvard Business Manager; Geißler, C. "Was ist... ein Whistleblower?" on: [http://www.harvardbusinessmanager.de/img/cat/HBMO/was\\_ist\\_0106.pdf](http://www.harvardbusinessmanager.de/img/cat/HBMO/was_ist_0106.pdf), 10.04.2007

appreciated by the society the informant might face retaliations at his/ her workplace. He/ she will probably be accused of betraying the company or become the victim of mobbing or even get dismissed.<sup>48</sup>

An attitude change concerning whistleblowers took place in connection with the accounting scandals at Enron and World-Com, which became public with the help of employees. Since these cases showed the necessity of whistle blowing, laws protecting whistleblowers were initiated. The US- American Sarbanes- Oxley Act of 2002 therefore contains a section, which says that whistleblowers have a right to be protected from sanctions when disclosing information.<sup>49</sup> The effectiveness of these protection measures should however be put into question due to the fact that the first whistleblower (David Welch, former CFO of Cardinal Bancshares) who claimed protection under Sarbanes- Oxley did not succeed in finding another job in his profession.<sup>50</sup>

A whistle blowing process can prove useful even beyond compliance since disclosed information might identify potential risk areas. An early disclosure and thorough investigation could help to protect a company against severe legal and financial consequences. On the other hand this could also be achieved if a company invests in integrity and communication trainings. This enables employees to make ethical decisions and - if a violation should happen anyway - to discuss incidents directly.<sup>51</sup> These trainings should be supported by an emphasis on corporate values and strong commitment of the top management.<sup>52</sup>

### Costs of Compliance

In spite of the earlier mentioned benefits of compliance management, such as risk minimization as well as increased efficiency and effectiveness, a large number of corporations tend to consider compliance merely as a cost factor. Price-waterhouse Coopers distinguishes three types of compliance - related costs.

### Costs of Maintenance

This includes all direct costs for the realization of compliance duties (consultancy expenses, salary of compliance officer, purchase of compliance software, etc.).

- **Costs of Non- Compliance.** This group summarizes all direct and indirect costs related to not complying with relevant standards (fines, expenses for lawyers, financial consequences resulting from reputational harm, etc.).
- **Costs of Governance.** This involves costs related to proper management of a company and related monitoring (auditing expenses, etc.).

The costs of non- compliance should of course be top priority. These expenses should be addressed with the aim of total elimination. After having achieved that the two remaining cost groups should be reviewed in order to increase efficiency of spending.<sup>53</sup> To reach this efficiency it is especially important to objectively assess a company's needs. It does e.g. not make sense to buy a premium software package if the basic version would have supplied all applications needed.<sup>54</sup> Additionally standardization and automation of processes as well as control activities can lead to a substantial cost reduction.<sup>55</sup>

There are several factors, which can be considered crucial for the height of the expenses incurred in aforementioned cost groups. This includes a company's previous efforts to maintain an effective internal control structure and increase awareness for ethical conduct. Furthermore enterprises with complex business structure and/or operations in multiple countries will certainly face a higher workload to harmonize internal control processes.<sup>56</sup>

### Thematic Embedding of Compliance

Compliance can be considered a tool with a variety of focus areas. Since this is - to a certain extent- a matter of perception the embedding of compliance might vary from company to company according to their areas of attention and applicable rules and regulations. The list of focus areas might therefore be longer or shorter depending on a corporation's requirements.

48 Cf. Tarantino, A.; "Manager's Guide to Compliance", 2006, p. 32f

49 Cf. Harvard Business Manager; Geißler, C. "Was ist... ein Whistleblower?" on: [http://www.harvardbusinessmanager.de/img/cat/HBMO/was\\_ist\\_0106.pdf](http://www.harvardbusinessmanager.de/img/cat/HBMO/was_ist_0106.pdf), 10.04.2007

50 Cf. IT Compliance Institute on: <http://www.itcinstitute.com/display.aspx?id=3580>, viewed 22.05.2007

51 Information derived from talk with Marijke Schmitz, Paulussen- Advocaten & Procureurs, 30.03.2007

52 Cf. Wolf, K.; "Corporate Compliance - Ein neues Schlagwort? Ansatzpunkte zur Umsetzung der Compliance in der Finanzberichterstattung", in DStR Deutsches Steuerrecht, 44/ 2006, p. 1996

53 Cf. Wolf, K.; "Corporate Compliance - Ein neues Schlagwort? Ansatzpunkte zur Umsetzung der Compliance in der Finanzberichterstattung", in DStR Deutsches Steuerrecht, 44/ 2006, p. 1996

54 Information derived from talk with Marijke Schmitz, Paulussen- Advocaten & Procureurs, 30.01.2007

55 Cf. Menzies, Ch.; "Compliance: Integration mit System" on <http://www.compliancemagazin.de/fachbeitraege/entscheidungshilfen/pwc151206.html>, viewed 27.02.2007

56 Cf. Gilbert Welytok, J.; "Sarbanes- Oxley for Dummies", 2006, p.160

## Compliance in relation to Corporate Governance

The term 'governance' relates to the process of ruling.<sup>57</sup> If supplemented by the adjunct 'corporate' it refers to steering a corporation. It can be described as a regulation framework used to manage and monitor an enterprise.<sup>58</sup> Since the majority of laws and regulations issued on corporate governance apply to stock listed companies its necessity can be explained quite easily: basically a corporation with numerous shareholders is in need of an organ similar to the government of a democratic state, usually represented by the CEO and the board of directors.<sup>59</sup> Corporate governance could be considered in this context as the constitution of the company.<sup>60</sup>

Commonly accepted characteristics of good corporate governance include<sup>61</sup>:

- Respect and support interests of shareholders as well as other stakeholders by establishing a methodology to meet the company's obligations with integrity and in compliance with relevant laws and regulations.
- Hiring a highly competent CEO and assuring that this person receives the necessary authority to run the corporation.
- Installation of processes to protect the accurateness of financial reporting and assurance of timely disclosure of important incidents in order to give all investors access to accurate information.

A board of management that proves unable to combine these characteristics of corporate governance in a thorough business concept and ensure proper execution will most likely cause a collapse of the company.<sup>62</sup> For this reason also non-listed companies discovered the competitive advantage of good governance as a basis for a sound business strategy, which in turn is the cornerstone for business success.<sup>63</sup>

The characteristics of good corporate governance directly point to the necessity for compliance management. Due to the fact that numerous countries establish their own regulations in this context – amongst others the German Corporate Governance Code and the Code Tabaksblat in the Nether-

lands – there is a growing demand for compliance management especially for corporations active in more than one country. Even though corporate governance and compliance are related terms a difference can be observed in their perspectives. Corporate governance takes on the perception of the regulator assuming the necessity of stricter regulations in order to reestablish the investors' trust after several corporate scandals. Compliance in turn takes on the position of the regulated party presuming an over-regulation, which calls for respective management techniques in order to be able to act in accordance with all regulations in place.<sup>64</sup> As a conclusion drawn from this it can be stated that regulations released to support corporate governance will have a proportional impact on compliance management.

Derived from a number of scandals, which were directly connected to corporate governance, regulations have been restricted and new standards have been put into practice in this area. Especially after the release of the Sarbanes- Oxley Act of 2002 also corporate compliance has drawn a high amount of attention in many companies.

The Sarbanes- Oxley Act (SOX) is applicable to all corporations listed at US- American stock exchanges and their affiliates abroad.<sup>65</sup> The Act has been developed in order to re-establish investor's confidence in the accurateness of financial data of companies.<sup>66</sup> The accounting scandal (involving large stock sales of executives and disrespect of blackout periods, off balance sheet transactions, influencing credit ratings, etc.), which set the ball rolling, was revealed at the energy provider Enron that in those days experienced the largest bankruptcy case in history.<sup>67</sup> As a brief summary it can be said that SOX proclaims a new division of managerial responsibilities and tightens the liability of audit firms as well as the requirements for correctness of financial data.<sup>68</sup>

By far the most famous section is 404 since no other provision of SOX has caused more confusion and worries. It requires the establishment and maintenance of workable internal controls.<sup>69</sup> Financial statements should therefore be substantiated by "an internal control report, which shall –

1. state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and

57 Cf. Colley Jr., J. L., Doyle, J., Logan, G., Stettinius, W.; "What is Corporate Governance?", 2005, p. 2

58 Cf. Hauschka, C. E.; "Corporate Compliance – Handbuch der Haftungsvermeidung im Unternehmen", 2007, p. 2

59 Cf. Colley Jr., J. L., Doyle, J., Logan, G., Stettinius, W.; "What is Corporate Governance?", 2005, p. 2f

60 Cf. Hauschka, C. E.; "Corporate Compliance – Handbuch der Haftungsvermeidung im Unternehmen", 2007, p. 2

61 Cf. Colley Jr., J. L., Doyle, J., Logan, G., Stettinius, W.; "What is Corporate Governance?", 2005, p. 3f

62 *ibid.*

63 Cf. Hauschka, C. E.; "Corporate Compliance – Handbuch der Haftungsvermeidung im Unternehmen", 2007, p. 87

64 Cf. Hauschka, C. E.; "Corporate Compliance – Handbuch der Haftungsvermeidung im Unternehmen", 2007, p. 2f

65 Cf. KPMG on: [http://www.kpmg.de/topics/sox/index\\_8452.html](http://www.kpmg.de/topics/sox/index_8452.html), 23.02.2007

66 Cf. Gilbert Welytok, J.; "Sarbanes- Oxley for Dummies", 2006, p. 9

67 Cf. Gilbert Welytok, J.; "Sarbanes- Oxley for Dummies", 2006, p.26f

68 Cf. KPMG on: [http://www.kpmg.de/topics/sox/index\\_8452.html](http://www.kpmg.de/topics/sox/index_8452.html), viewed 23.02.2007

69 Cf. Tarantino, A.; "Manager's Guide to Compliance", 2006, p. 21

2. contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.<sup>70</sup>

Internal controls in this context comprise all rules and procedures necessary to ensure that books and records are maintained accurately, in reasonable detail and in line with US- GAAP.<sup>71</sup>

Definitely it does not come as a surprise that all the above mentioned compliance efforts might result in a huge financial burden. Consultancy and audit expenditures are expected to grow dramatically at least in the first year of SOX compliance.<sup>72</sup> Despite the high costs there is a way consider the positive effects of the Act for a company. The involved risk assessment might even identify potential non- SOX related weaknesses. Furthermore a thorough Sarbanes- Oxley compliance will increase investors' trust in disclosure of corporate information.<sup>73</sup>

### Compliance in relation to Risk Management

Compliance is not only limited to corporate governance but also affects other areas of management. In the following the relationship between corporate compliance and risk management will be outlined.

A thorough definition of risk management can only be provided after having outlined the expression "risk". It has been derived from the early Italian term 'risicare', which means to hazard/ to venture. An explanation utilized in the business context states that risk comprises the potential damage or loss of an asset without considering respective returns. The separation between risk and returns is important since otherwise earnings might be taken into account double.<sup>74</sup>

Risk management respectively can be defined as strategic dealing with risks with the aim to secure the company's existence and ensure future- oriented planning.<sup>75</sup> This includes the consideration of synergy effects, which means the examination of combined impacts of more than one risk.<sup>76</sup>

One aspect of risk management is concerned with risks of legal or physical nature, such as lawsuits, accidents, fires, natural catastrophes etc. But nowadays risk management goes

70 Cf. Sarbanes- Oxley Act of 2002, section 404 (a) on: <http://www.kpmg.de/library/pdf/amtlicheFassung.pdf>, 23.03.2007

71 Cf. Tarantino, A.; "Manager's Guide to Compliance", 2006, p. 298

72 Cf. Gilbert Welytok, J.; "Sarbanes- Oxley for Dummies", 2006, p.159

73 Cf. Gilbert Welytok, J.; "Sarbanes- Oxley for Dummies", 2006, p.162

74 Cf. Wolke, T.; "Risikomanagement", 2007, p.1

75 Cf Hauschka, C. E.; "Corporate Compliance – Handbuch der Haftungsvermeidung im Unternehmen", 2007, p. 84

76 Cf. Wolke, T.; "Risikomanagement", 2007, p.2

a step further: most corporations also concentrate on risks related to the business operations itself.<sup>77</sup> The application of risk management nowadays is driven by three major causes:

- **Legal Frameworks.** The legal embedding of risk management might vary significantly from country to country. In the German context the KonTraG of 1998, a law focusing on control and transparency within a corporation, should be mentioned. This regulation is primarily affecting non-banking companies and requires the disclosure of risks a corporation is concerned with. In the banking sector Basel II forms the main regulation shaping risk management. For insurance corporations Solvency II is the relevant standard to comply with.<sup>78</sup>

- **Economic causes.** Especially the deregulation of capital markets - such as abolishing fixed exchange rates - and the introduction of new instruments - e.g. in the sector of derivatives - offers opportunities but in return asks for reliable risk management.<sup>79</sup>

- **Technological developments.** The availability of the internet and other electronic media allows a much faster information exchange than decades ago. This results in increased product risks due to shortened product life cycles.<sup>80</sup>

In the scope of risk management a process will be established to manage potential risks. This process comprises the identification of risks applicable to a certain enterprise, measuring and analyzing these risks, implementing instruments to deal with them and finally monitoring the effectiveness of the process.<sup>81</sup>

The simplified chart of a risk management process (Figure 4<sup>82</sup>) underscores the similarities between the compliance phases



Figure 4 Risk Management Process

and the risk management process.

The stage of risk identification corresponds to the compliance phase 2 (risk identification based on relevant regulations) even though the risk management process will not only address applicable legislation and standards but also liquidity risks, etc. In the second stage of the process the impacts of a certain

77 Cf. Colley Jr., J. L., Doyle, J., Logan, G., Stettinius, W.; "What is Corporate Governance?", 2005, p. 73f

78 Cf. Wolke, T.; "Risikomanagement", 2007, p.2

79 *ibid.*

80 Cf. Wolke, T.; "Risikomanagement", 2007, p.2f

81 Cf. Wolke, T.; "Risikomanagement", 2007, p.4

82 Cf. Wolke, T.; "Risikomanagement", 2007, p.4, translated by I. Oldendorf



risk and the need for action are analyzed, which is very similar to compliance phase 3 (risk evaluation). The stage of risk handling could be compared to compliance phase 5 (identification/ definition of measures to manage risks) even though the variety of instruments in the risk management process is usually much broader than in the compliance phases, which primarily refer to internal controls. The risk controlling stage, finally shows certain parallels to compliance phase 6 (monitoring and assurance of measures) since both are -amongst others- concerned with reporting duties.<sup>83</sup>

The risk management process should be initiated by a corporation's board of management. Additionally, risk management has to be considered for the corporate strategy in order to protect shareholders' interest in the long run. Taking these facts into account a relation between risk management and corporate governance cannot be denied.<sup>84</sup>

Compliance requires risk management<sup>85</sup> but is in turn part of it.<sup>86</sup> What seems to be contradictory is actually quite logical: in order to conduct successful compliance management key compliance risks have to be selected and dealt with. As outlined above the necessary steps to do so are part of the risk management process. This process on the other hand covers but is not limited to compliance risks, which are usually of a legal nature.

### **Compliance in relation to Business Ethics**

As stated earlier compliance does not only refer to legislation and other forms of written regulations but also so to beliefs and values. Therefore the relationship between compliance and business ethics will be outlined in the following.

Prevalently morality and ethics are lumped together in the context of business ethics. But by definition morality describes a set of rules and norms, which guides a person's behaviour and causes a sense of guilt as well as reproaches if a violation occurs. Ethics in turn form a scientific approach focusing on morality. This discipline explores amongst others synergies between individual norms, their derivation and purpose. Additionally, recommendations are given in case of conflicting norms.<sup>87</sup>

The so- called 'heart valve scandal' showed how important

moral guidelines can be in the working environment. Producers of medical goods had granted cash and benefits in kind to doctors and hospital employees if they in turn bought their products. Since a conflict of interest situation arose here several principles have been developed in this special case in order to prevent product purchases, which are not based on quality issues and therefore might endanger the health of the patients. These principles include e.g. strict separation between receiving benefits and purchase decisions as well as documentation and disclosure of all benefits received.<sup>88</sup> Similar regulations concerning the receipt of benefits and other conflict of interest situations have been issued within companies in other sectors of business. Gift registers might therefore become a tool of the internal control structure in order to prove that received gifts did not have an impact on decision making.

Whistle blowing can also be considered as an issue of business ethics since in most cases informants do not feel able to arrange cases of severe non- compliance with their moral beliefs. One might therefore come to the conclusion that a corporate compliance would be strongly supported if employees were trained in ethical decision making.

Especially larger corporations seem to understand the necessity of ethical behaviour as an increased interest in topics such as corporate values, ethics corporate integrity and sustainability shows.<sup>89</sup> This trend is also reflected by the range of consultancy services offered in the field of business ethics and corporate values.

### **Conclusion**

Corporate compliance is has drawn a lot of attention in recent years connected to a number of business scandals and fraud cases, which have led to a restriction of laws and regulations. However, the execution of compliance activities especially in the financial sector already decades ago proves that compliance is not catchphrase recently invented.

An effective internal control system forms the basis for successful compliance management. If a company has such a system in place a number of moderate adjustments –such as enhanced documentation (audit of effectiveness) - might be sufficient to comply in view of the relevant standards.

Corporate compliance can be approached from a variety of directions (e.g. corporate governance or risk management).

83 Cf. Wolke, T.; "Risikomanagement", 2007, p.4f

84 Cf. Colley Jr., J. L., Doyle, J., Logan, G., Stettinius, W.; "What is Corporate Governance?", 2005, p. 73f

85 Cf. Hauschka, C. E.; "Corporate Compliance – Handbuch der Haftungsvermeidung im Unternehmen", 2007, p. 3

86 Cf. Hauschka, C. E.; "Corporate Compliance – Handbuch der Haftungsvermeidung im Unternehmen", 2007, p. 11

87 Cf. Homann, K., Lütge, C.; "Einführung in die Wirtschaftsethik", 2005, p. 12

88 Cf. Hauschka, C. E.; "Corporate Compliance – Handbuch der Haftungsvermeidung im Unternehmen", 2007, p. 683ff

89 Information derived from meeting with Prof. Patrick Moore, FH Stralsund and Jo op het Veld, DaimlerChrysler Customer Assistance Center N.V.; Stralsund 02.07.2007

Relations to other fields of managerial practice may be based on the fact that related legislation is tightening and/or on existing parallels in processes employed. Corporate compliance is no standalone issue but interrelated with other areas. Depending on the area concerned it might have more or less impact on corporate strategy.

Additionally, corporate compliance gains momentum from its relation to business ethics. On the one hand this is due to the fact that corporations focus more and more on corporate social responsibility. On the other hand ethical behaviour may guide employees through conflict of interest situations and could prevent fraudulent circumvention of internal controls. For this reason investing in trainings, which increase the awareness for ethical decision making may significantly reduce costs of non-compliance.

In times of tightening laws compliance must not be considered a project with start and end date but a permanent requirement. Therefore a company should devote reasonable attention and resources to ensure efficient and effective compliance management and in this way contribute to long-term corporate success and sustainability.

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# EVALUATING ETHICS AND SUSTAINABILITY IN BANKING & FINANCIAL SERVICES WITH THE CORPORATE RESPONSIBILITY RATING OF OEKOM RESEARCH

Susanne Schwind

Abstract. "In the banking business, the one who has the money has the power."<sup>1</sup> Banks and other financial institutions are in fact powerful as banks can exercise their power by financing projects they approve but on the other hand by also being able to not approve projects they consider unreasonable. Having this power requires exercising it responsibly. "What should I do?" is the main question to be answered in ethics. In the following, the questions what banks should do will be dealt with, how they should act and which activities they should support or avoid in order to satisfy their customers and other stakeholders.

First, ethical problems will be presented that can occur in the conduct of the banking business, how they can be handled, in how far they are prohibited by law and which persons are affected. Issues of lending and sustainability in banking will also be dealt with.

Another ethical issue in finance is socially responsible investment (SRI) or ethical investment, which is used to an increasing extent to satisfy ethically aware investors' wants. The way socially responsible investment can be distinguished from 'ordinary investment' will be next, answering questions such as: who decides which investment is socially responsible. Of course, there are criteria that tell apart SRI from other investment, but who defines these criteria and makes sure they are really kept by the enterprises?

Ethical-ecological rating agencies, like oekom research AG, evaluate companies according to their ethical soundness and their overall sustainable performance. oekom research recommends those companies to its customers, that are considered to carry out business responsibly. Among its customers are, eg, the operators of ethics and ecology funds. Besides oekom research, there are a number of other agencies, carrying out similar business. I will focus on oekom's approach to rating the environmental, ethical and social performance of enterprises, specifically in banking and financial services. Thus, the work of oekom research will be presented in general and then, a comprehensive introduction into its corporate responsibility rating (CRR) will be given, which assesses the

1 ORTIZ, 1995, p. 69

performance of enterprises regarding environmental, social and cultural sustainability.

All in all, this article is first of all meant to give an insight into a wide range of ethical aspects in the banking and financial services business. Furthermore, it intends show in which way ethics influences the conduct of business in this sector and how ethical performance of these institutions can be measured and made more feasible with the help of oekom research's CRR.

## JEL Classification G34, Z13

### Ethics and sustainability in banking

The ethical attempt to answering the question 'What shall I do?' referring to the ability of people to make free decisions<sup>2</sup> can enrich the concept of finance which is claimed to be "(...) limited to answering about what will happen if certain decisions are made"<sup>3</sup>. Boatright (1999, p. 6) claims that by knowing this concept, investors can choose the most effective means to a given end, eg, by choosing an investment strategy. Choosing an end, eg, supporting beneficiary projects by investing socially responsible, referring to ethics is mostly dealt with separately. Thus, "finance theory (...) is concerned with means; ethics with ends"<sup>4</sup>. But what is ethics in banking about and can ethics be reasonably integrated in this sector at all?

Lerena (1995) states that "there is a sort of oral tradition in banking which suggests that banking fulfils its social responsibility by supporting and promoting certain artistic and cultural activities."<sup>5</sup> This reflects mainly what community spending is about, but social responsibilities of banking and ethics are more than just "financing exhibitions, purchasing works of art, (...) providing economic support for scientific research".<sup>6</sup>

### The role of banks

Banks are financial intermediaries and "(...) bring two types of people together; one the one hand, those who present the accumulated result of work done; and on the other hand, those who are planning activities which require credit, [and] financing (...)." <sup>7</sup> It can also be said, that banks are intermediaries between people with shortages on the one hand and people with surpluses of capital on the other hand. <sup>8</sup>

Carrying out this intermediation function, products of banks

2 cf. SUCHANEK, 2001

3 BOATRIGHT, 1999, p. 6

4 *ibid.*, p. 7

5 LERENA, 1995, p. 77

6 *ibid.*

7 ORTIZ, 1995, p. 69

8 cf. JEUCKEN/ BOUMA, 2001, p. 26

include: savings, lending, investment, mediation advice, payments, guarantees, and ownership and trust of real estate. From these, the sources of income are interest earning and provisions earning. Banks get their revenues mainly from fees which they charge their clients for their products and services.<sup>9</sup> Banking activities are distinguished into investment banking, commercial banking, corporate banking, private banking, trade finance, electronic banking, securities financing, loans, savings etc. Usually, universal banks offer all of these services.<sup>10</sup>

However, banks do not only act as financial intermediaries in the sense of bringing together people with opposite needs. Moreover, they also gather information to evaluate risks and credit worthiness, act as investors on their own account in the stock exchange and advise institutional and private investors how to invest their money on the capital market.<sup>11</sup>

Between banks and their clients, usually one or several contracts are concluded and, thus, ethical issues are mainly concerned with the bank's contractual obligations to clients, which can be individuals or organisations.

### **Stakeholders of banks**

Stakeholders are differentiated into internal (eg, employees, board of directors, shareholders) and external stakeholders (eg, costumers, media, society, NGOs, suppliers). However, as stakeholders "involve any group or individual who can affect or is affected by the achievement of the organisation's objectives"<sup>12</sup>, there should be more groups or persons taken into consideration, among others also those who suffer from side-effects of a bank's lending practices. That can be the case when banks, eg, finance controversial projects that lead to the resettlement of native people in the rain forest. Those negatively affected people without a direct connection to the enterprise should also be considered indirect stakeholders of the bank.

### **The importance of ethics in finance and responsibilities in managing a financial institution**

First of all, the special character of the banking business, i.e. accepting, investing and administrating others' funds requires legislation to protect consumers. In the interest of the customers, one of the important arguments for ethics in banking is that if economic agents (eg, consultants) follow a set of ethical regulations, their behaviour becomes more predic-

table. Thus, customers are able to rely on these persons', eg, their consultants' advices more easily.<sup>13</sup> Business ethics in general deals with meeting stakeholders' needs. Furthermore, by managing other people's money and having the power to decide which loan to grant and which not, a bank has influence and power, and thus responsibility and moral consciousness must not be neglected to avoid banks taking advantage of this power. Moreover, the importance of ethics and sustainability in finance is proven by the fact that there are banks whose main focus is on providing customers with products which fulfil ethical, ecological or social standards. Customers wishing to have these considerations included in the respective bank's credit decisions, often choose alternative banks like 'EthikBank' in Germany or 'The Cooperative Bank' in England.<sup>14</sup>

From managing financial institutions the same ethical problems as from managing any other business can be derived, such as equality among employees, privacy and corporate governance. However, from the nature of financial services, specific ethical concerns arise for the management of these institutions, of which the most important will be discussed in the following.

### **Prevention of money laundering**

Money laundering as an ethical and legal problem is addressed by laws, eg, in Germany with the 'Geldwäschegesetz' (Money Laundering Act). Money laundering means that money which was gained through illegal business is brought back to economic circulation. This may hamper the reconstruction of illegal activities (eg, including smuggling and corruption).

In the context of money-laundering, but also when financing of terror is suspected, the question remains in how far the banks should and could lift secrets, perhaps even without informing the customer. Thus, it needs to be asked "When are suspicions about a customer sufficiently well-founded to justify reporting him to the authorities?"<sup>15</sup> In this framework, the identification of the customer and the clarification of the economic background of the business are of crucial importance, especially if there are signs that hint at the transaction being part of an immoral or illegal business.

### **Conflicts of interest**

Conflicts of interest play an especially important role when agents advise customers. To Boatright (1999, p.4), a conflict

9 cf. BOATRIGT, 1999, p. 13

10 cf. BOUMA / JEUCKEN, 2001

11 cf. KOSLOWSKI, 1995, p. 181

12 WILSON p.4 in SEEBACHER, 2005, et al., p. 151

13 cf. BASÁNEZ / CORTÉS, 1995, p. 32,33

14 BOUMA / JEUCKEN, 2001

15 ORTIZ, 1995, p. 65

of interest is “to fail to deliver what has been bought”. It occurs in investment banking for example when brokers receive a higher commission for selling the bank’s mutual funds than for selling funds of other companies and are not sure about selling funds in their or on the customer’s interest. Two main conflicts of interest that may affect a proper business conduct in financial services can be distinguished:

The first one refers to research analysts working for brokerage and investment banking firms. They might be torn between the integrity of their research and the interest of the company. It can occur that a powerful client’s stock develops negatively, so that instead of encouraging the client to buy more shares (‘buy recommendation’), the client would be better advised with a ‘hold’ or ‘sell’ recommendation. The reason is that considering the ‘shoot the messenger’ syndrome, it might have a negative impact for the analyst to report negative news and advise the customer to sell. A consequence could be that “he or she may be coerced by the investment bankers and could be cut off from the company contact”.<sup>16</sup>

The second conflict refers to personal trading. This is not considered illegal, but using one’s position for personal gains should be avoided. Most often, conflicts of interest occur to those people who have access to research material and relevant information (eg, portfolio managers, analysts and traders), so-called access people. Those people can use this information to trade the securities before the purchase for the fund is made. This can raise the price of stock and consequently, the fund would pay more for a security than without the access people’s purchase.

### **Insider trading**

Whereas personal trading is not considered illegal, insider trading is “(...) prosecuted as fraud under Section 10 (b) of the Securities Exchange Act (SEA)<sup>17</sup> on the grounds that any material non-public information ought to be revealed before trading.”<sup>18</sup> Insider trading is “a trading in the stock of publicly held corporations on the basis of material, non-public information”.<sup>19</sup> This can be the case when eg, executives invest strongly in their own company’s stock after having learnt about an event that may positively influence the share price. However, the term insider does not only refer to those people inside an enterprise but also to those who through these persons get relevant information.

16 REGAN, 1993, in BOATRRIGHT, 1999, p. 20

17 The SEA and related statutes form the basis of regulation of the financial markets and their participants in the United States. It is commonly referred to as ‘the Exchange Act’ or ‘the ,34 Act’.

18 BOATRRIGHT, 1999, p. 33

19 BOATRRIGHT, 2003, p. 350

A convincing argument for insider trading being ethically wrong is that “(...) an insider has not acquired the information legitimately but has stolen information that rightly belong to the firm.”<sup>20</sup>

### **Responsibilities to the customer and unfair sales practices**

In the end, most of the ethical aspects in the banking business are connected with the right treatment of the clients. Thus, fairness is a crucial virtue eg, when selling securities to a customer, because investment decisions are based on information that is difficult to verify.<sup>21</sup> Therefore, “the ethical treatment of clients requires salespeople to explain all of the relevant information truthfully, and in an understandable and nonmisleading manner”<sup>22</sup>. This is also valid for advertising and excludes false and misleading claims, expressions and descriptions in order to give the customer a clear picture of what kind of contract he closes.

A similar aspect is loyalty and giving loyal advice to the customers. This refers to not giving wrong information or evaluation and giving advice when customers have to be informed of the potential legal or business risk which they may experience due to their lack of experience or professionalism.<sup>23</sup>

Also in the lending business, there are responsibilities towards the client, eg, the responsibility of the banker to accurately check the request for a loan and to check whether the clients will be able to repay their debts. Furthermore, also in the lending business, every customer should be treated equally. In the US, still in the 1990s the rejection rate of credit of non-white people was much higher than the one of white people despite the same credit worthiness derived from calculations.

### **Responsibilities in the lending business**

“Banks are often criticised for basing their decisions about credit for entrepreneurial projects on the aspects of profitability and security only. Criteria transcending economic efficiency in the narrow sense like considerations of the environmental effects of investments or the common good are said not to be taken into account sufficiently.”<sup>24</sup>

By a bank’s lending decision, its customers’ use of the money may have an impact eg, on the environment. Especially bigger banks have been accused recently to finance projects where pollution, damage of environment, exploitation of

20 BOATRRIGHT, 1999, p. 35

21 cf. BOATRRIGHT, 2003, p. 33

22 BOATRRIGHT, 2003, p. 14

23 BASANEZ, 1995, p. 49

24 KOSLOWSKI, 1995, p. 199

people, and the violation of human rights, have taken place. If banks eg, included the evaluation of their customers' environmental performance into the credit decision, their customers would be indirectly asked to think more of environmental and social issues within their projects.<sup>25</sup>

Though it may seem that ethics in the lending business is only about avoiding negative consequences, there are also positive effects that can result from lending. In this context, "(...) the institution of banking needs to show that not only does it accumulate large quantities of money (...) but that it really knows how to use it fairly, by providing opportunities for those who wish to start business, by using it for the good of the society (...)"<sup>26</sup>. One example are micro credits which are very small loans to unemployed people or poor entrepreneurs and to others living in poverty who are not credit-worthy as they lack collateral, employment and a verifiable credit history and would therefore not be granted traditional credit. 94% of the credits are granted to women, trying to raise their status in their families.<sup>27</sup> One bank that grants micro loans in Bangladesh is the Grameen Bank (GB) which in 2006 arose attention as its founder Mohammed Yunus had been awarded with the Nobel Peace Prize. The bank provides small loans mainly to women who form groups of five in which they repay their debts. Special about these loans is that they are given without collateral, they are repaid in weekly installments, and a subsequent loan is granted depending on whether the first one has been repaid or not. Offering the credit to groups of people from the same community, GB contributes to two key factors of sustainable development: economic development and community development.<sup>28, 29</sup>

### **Environmental aspects and sustainability in banking**

During the last couple of years global players, such as ABN Amro and HVB Group have been involved in financing controversial projects, not taking into consideration environmental and other damages in their decision making process. These two banks, eg, had been involved in building the Baku-Tbilisi-Ceyhan-pipeline in Georgia, which has been criticised for leading to environmental damages and undermining human rights. Furthermore, the pipeline passes through a national park in Georgia and threatens several other ecologically sensitive areas. Moreover, earthquakes threaten the area where the pipeline is built.<sup>30</sup>

25 GIUSEPPI, 2001, p. 112

26 ORTIZ, 1995, p. 70

27 cf. [www.wikipedia.org](http://www.wikipedia.org)

28 cf. SIDDIQUI / NEWMAN, 2001

29 cf. cf. SIDDIQUI / NEWMAN, 2001

30 cf. oekom research AG, 2006

Regarding sustainability in banking, one has to consider internal and external environmental impacts of banking. In this context, internal impacts are related to business processes within the bank and are affected by a bank's water, paper and energy use. Credit Suisse has found out with the help of a special tool that energy use is its most serious impact, "accounting for 90% of all cumulative pollution"<sup>31</sup>. As a measure, some banks have already replaced some energy sources by solar energy and implemented measures to use water more efficiently. Regarding external impacts of the banking business, one could say that "(...) all pollution caused by companies who are financed by banks is the responsibility of banks".<sup>32</sup> Thus, as already mentioned, banks should integrate environmental issues in their credit decision process. Some banks already do so, however Giuseppi (p. 31) criticises that "(...) the incorporation of environmental aspects into the bank's products and services is currently made to reduce their financial risk" and not under aspects to protect the environment. Therefore, Bouma (2001, p. 28) claims that a responsible bank should consider sustainability due to ideological reasons as well as based on a proper risk assessment. An international initiative regarding environmental aspects in banking is for example the United Nations Environment Programme Financial Initiative on the Environment and Sustainable Development (UNEPFI) which was established at the Earth Summit in 1992 to initiate a constructive dialogue between UNEP and financial institutions. A 'Statement by Financial Institutions on the Environment and Sustainable Development' had been set up which was signed by originally about 30 banks.<sup>33</sup> Nowadays, among the approximately 170 signatories are Deutsche Bank AG, Dresdner Bank, Kreditanstalt für Wiederaufbau, Polski Bank Inwestycyjni, and Svenska Handelsbanken.<sup>34</sup>

### **Socially responsible investment (SRI)**

Investing socially responsible is said to have begun with the religious community of the Quakers. In 1758, the Quaker Philadelphia Yearly Meeting asked its members to not participate in the business of buying or selling humans. In general, religious institutions were among the first who cared about investing socially responsible. They have been especially interested in:

- environmentally responsible business practices,
- practices that support diversity of the workforce,
- and practices that lead to higher product safety and

31 BOUMA/ JEUCKEN, p. 30

32 *ibid.*, p. 31

33 cf. KELLY / HUHTALA, 2001, p. 390

34 *ibid.*, pp. 398 f.

quality.<sup>35</sup>

At the beginning, an approach was used which is nowadays comparable to the 'avoidance approach'. Certain sectors were excluded, eg, alcohol, tobacco, defence, and gambling.<sup>36</sup> Ethical investment nowadays refers "an investment philosophy that combines ethical or environmental goals with financial ones"<sup>37</sup>.

### Definition

Put very simple, ethical or socially responsible investment<sup>38</sup> refers to investing in companies that are behaving responsibly, are good corporate citizens or are not involved in certain businesses, eg, nuclear power or pornography. More specifically, Cowton (1994 in SPARKES, 2003, p.24) states that "Ethical investment may be defined as the exercise of ethical and social criteria in the selection and management of investment portfolios, generally consisting of company shares". According to him, ethically conscious investors are not only interested in the maximisation of their profits but also in the way they were generated by the respective companies which may refer to activity, location, or kind of business.

### Components of SRI

Sparkes identifies four core components of socially responsible investment (SRI): "the environment, human rights, corporate social responsibility and investment returns"<sup>39</sup>, with the environmental component being the most fundamental one.<sup>40</sup> Whereas the first three are assessed within the corporate responsibility rating, the latter is taken into consideration in conventional credit ratings. Though returns seem to be rather neglected when investing ethically, Sparkes argues that "(...) SRI will never become a credible investment strategy for pension funds and charitable foundations unless they feel comfortable that it meets the legal requirement of fiduciary duty, i.e to get a good financial return on the funds invested"<sup>41</sup>. In many studies it has been proved that there is a "demonstrable link between good environmental performance and high corporate profitability".<sup>42</sup>

35 cf. CUNNINGHAM, 2001, p. 71

36 SPARKES, 2003, p.27

37 SPARKES, 2003, p. 22

38 In the following, the terms ethical investment and SRI will be used interchangeably because according to Sparkes, SRI and ethical investment are equivalent and the term 'ethical investment' is replaced by socially 'responsible investment' gradually. As does Sparkes in his book, within my thesis both words refer to the same concept.

39 SPARKES, 2003, p. 241

40 cf. SPARKES, 2003, p. 119

41 SPARKES, 2003, p. 119

42 cf. RUSSO/ FOUTS; SPARKES, 2003, p.241, also see the concept of 'Dou-

### Ethical and green banking products

Besides offering SRI, more and more financial institutions develop environment-related products and services. In the banking sector, specifically green products have been developed. Those include 'green' credit cards where parts of the turnover generated are donated to eg, environmental NGOs. Other products are environmental mortgages that guarantee low interest rates for buyers of houses built according to sustainability requirements.<sup>43</sup> In Germany and Austria, the EthikBank, eg, offers an ecological credit which finances environmental responsible rebuilding measures.<sup>44</sup>

Similarly, the German Umweltbank offers environmentally friendly products. Thereby, it guarantees its customers that credits are exclusively given to environmental projects. This is checked up by an environmental council. Thus, money mainly flows into projects including solar energy, ecological real estate, wind power, bio gas, ecological farming, and water power.<sup>45</sup> In order to obtain the money, which is then lent to these projects, the bank has developed an ecological savings account ('UmweltSparbuch') with average interest.<sup>46</sup>

### Ethical-ecological ratings

#### Importance of ethical-ecological ratings

The idea of rating securities was originated by John Moody in 1909 with the aim to "provide investors with a simple system of gradation by which relative creditworthiness of securities may be noted"<sup>47</sup>. Together with Standard & Poors, Moody's is among the two most important and most influencing credit rating agencies. In other words, ratings can be described as evaluations by giving marks with the objective to be able to compare an issue. Nowadays, financial (credit) ratings are the most common form of these evaluations.

Information on the ethical, ecological and social performance of companies is needed as it "enables conscious purchasing and investment decisions"<sup>48</sup>. With respect to this statement, not only the social and ecological qualities of products and services are of interest but also those of the respective enterprises offering them.<sup>49</sup> However, consumers who are willing to invest socially responsible often face the problem that they do not know whether they can approve an investment

ble Dividend' at oekom research (chapter Fehler! Verweisquelle konnte nicht gefunden werden.)

43 cf. TARNA, 2001, p. 161

44 cf. [www.ethikbank.de](http://www.ethikbank.de)

45 cf. [http://www.umweltbank.de/umweltbank/index\\_produktdgarantie.html](http://www.umweltbank.de/umweltbank/index_produktdgarantie.html)

46 cf. [http://www.umweltbank.de/geldanlage/index\\_umweltsparbuch.html](http://www.umweltbank.de/geldanlage/index_umweltsparbuch.html)

47 cf. MOODY'S, 2004, p.8 (pdf)

48 TSCHANDL, 2005, p. 19

49 cf. *ibid*, p. 19

under ethical aspects.

Critics of SRI often refer to it being based upon 'soft' or 'mushy' metrics as SRI issues seem to be "subjective, vaguely defined and impossible to measure accurately".<sup>50</sup> This critique is met with tools which offer measuring methods for SRI. However, the problem remains that these measurements are not easily comparable. In recent years, several instruments have been developed which see to that consumers get the information they need. Besides ethical-ecological ratings these include corporate environmental reports, magazines and books on ethical and green investment, consumer protection magazines, product tests (eg, 'Stiftung Warentest' in Germany) and environmental accounting.<sup>51</sup>

### **Dimensions and emphasis of ethical-ecological rating agencies**

For investors it is difficult to evaluate the success of companies to integrate sustainability in their activities.<sup>52</sup> Sustainability and ethical-ecological rating agencies like oekom research have set up principles according to which they assess the company's ability to include aspects of sustainability in their operations. These ratings consist in general of the following dimensions:

#### 1. Eco-Rating

Eco-Ratings were the first kind of ethical ratings in Germany. With the integration of ethics into the decision-making process regarding investments, agencies were set up, that focused on the ecological consciousness of enterprises and their impact on the eco-system.<sup>53</sup>

#### 2. Ratings considering social soundness

Regarding social soundness, the following fields are covered and measured:

- social soundness of the company's organisation
- internal stakeholders and their general interests (eg, safeguarding jobs)
- internal stakeholders and their specific interests (eg, disabled people)
- product responsibility<sup>54</sup>

#### 3. Cultural soundness within the ethical-ecological rating

Knowing about cultures and their particularities is important when developing products which have to be not only naturally but also socially sound. Integrating this aspect in an ethical-ecological rating is quite difficult. However, according to Haß-

ler (2001, p. 62), intercultural problems are among the greatest challenges rating agencies have to meet. He states that, "oekom research AG has adopted a number of measures in this context including consulting with panels of scientific experts from a wide variety of cultural areas (...)" in order to include those criteria in the corporate responsibility rating. Nowadays, an ethical-ecological rating normally comprises all of these three dimensions.

### **Screening**

In connection with sustainability or corporate responsibility ratings, there are two ways of screening: positive and negative screening. Positive screening is often brought into relation with the 'best in class' approach. This refers to choosing to invest in companies that are considered the best in their sectors and is thus supposed to stimulate an ethical competition between companies in the same sector.<sup>55</sup>

Negative screening refers to excluding a branch of business or a complete industry sector (eg, enterprises including weapons, pornography, nuclear energy, gambling, tobacco or alcohol) to invest in. In practice, there are different ways of excluding controversial business areas. The exclusionary criteria can be set internally by research institutes or rating agencies.

### **Corporate Responsibility Rating of oekom research**

#### **oekom research AG**

oekom research is an independent rating agency which has its roots in environmental and social research. From 1994 on, oekom research (then: Ökom Gesellschaft für ökologische Kommunikation GmbH) has analysed enterprises according to ecological criteria.<sup>56, 57</sup> Nowadays, it evaluates the corporate responsibility (comprising social-cultural and ecological aspects) of companies with its Corporate Responsibility Rating which around 20 analysts carry out for different sectors. These sectors comprise Insurances, Oil & Gas, Paper & Forest Products, Banking & Financial Services etc., which make a research universe of about 1000 securities.

Institutional investors who would like to consider ethical, social and environmental criteria in making their investment decisions use oekom's research. Furthermore, companies can evaluate their environmental and social performance with the help of the research and consultancies as well as other organisations regard the research as underlying data for their

50 SPARKES, 200, p. 177

51 cf. KAHLNBORN, 2001, p. 185

52 SPARKES, 2003, p. 148

53 cf. REINHARD, 1995 in JAHN, 2004

54 cf. JAHN, 2004

55 cf. *ibid*, p. 65

56 cf. oekom research AG, 2003, p. 62

57 cf. EVERLING/ SARCHER, 2003, p. 18



own work.<sup>58</sup> Nowadays the company deals with 60 portfolios of different customers with a volume of around EUR 4.5 billion. Among its customers are financial services provider, specialised ethics banks and institutional investors (eg, dioceses, foundations, and pension funds).

### Corporate Responsibility Rating (CRR)

With the help of the CRR companies, eg, as issuers of securities are analysed and evaluated according to ethical, social and ecological criteria. When the first ratings were carried out, oekom research worked closely according to the principles set out in the Frankfurt-Hohenheim Guidelines (FHG). The CRR, comprising around 200 criteria is “acknowledged one of the most thorough” and has been developed by the project group ‘Ethical-Ecological Rating’.<sup>59</sup> Until now, more than 1,000 enterprises from over 25 sectors have been assessed.<sup>60</sup>

The ratings in the respective industries are regularly updated and there is a half-yearly review.

### Frankfurt-Hohenheim Guidelines as basis for the CRR

The FHG which have been the basis for the CRR from the beginning are a “set of criteria for the ethical assessment of enterprises”.<sup>61</sup> Initially, the FHG were applied through the Corporate Responsibility Rating with oekom research. The rating includes about 1000 criteria in the three dimensions of corporate responsibility as developed by Ortwin Renn’s value tree analysis (VTA) covering

1. the natural environment
2. persons affected by corporate activities
3. society and culture

From the value tree analysis (VTA) developed by Ortwin Renn, three dimensions of sustainability can be derived:

1. Cultural sustainability
2. Social sustainability
3. Environmental sustainability<sup>62</sup>

The first dimension is considered especially important as “the moral understanding inherent in cultures plays an important role in the development and realisation of environmentally and socially compatible products and methods of production”<sup>63</sup>. With the help of the CRR, the performance of companies is measured for the concepts of corporate social responsibility, sustainability, corporate governance, and business ethics.

58 oekom research AG, 2003, p. 22

59 cf. HÄBLER, p. 55

60 cf. HOFFMANN/ SCHERHORN, p. 5

61 HOFFMANN/ SCHERHORN, 2003, p. 5

62 cf. HOFFMANN/ SCHERHORN, 2003, p. 5

63 BALZ et al. 2003, p. 20

The Corporate Responsibility Rating of oekom research is divided into the social rating (comprising criteria regarding working conditions and community involvement) and the environmental rating (comprising criteria regarding environmental management systems and the environmental soundness of the respective company’s products).

The weightings of the social and the environmental part depend on the industry that is considered. While eg, environmental issues prevail in the automobile industry due to high emissions and are considered more important than social-cultural aspects, the focus is on social-cultural issues in, eg, the textile industry, where child labour and the not-keeping of labour standards are of relevance. As can be seen in the Sustainability Matrix designed by oekom research (Figure 1), the banking business has a rather low direct impact on environment and on social and cultural issues as labour standards are usually high. So, in this sector, the factors environmental soundness and social-cultural soundness have the same weight.

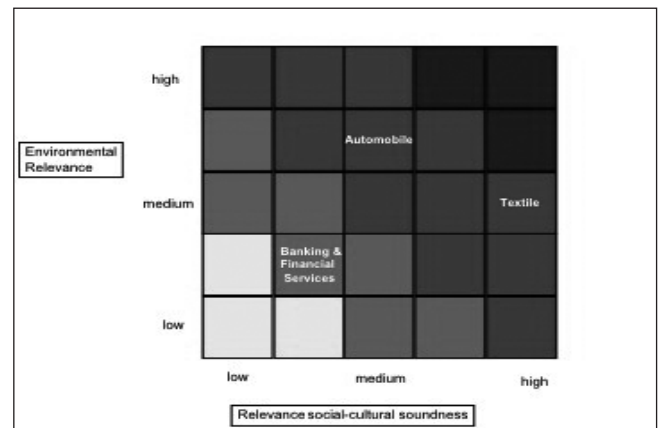


Figure 1 Sustainability Matrix

### THE RATING PROCESS

#### Screening

Either as a part of the CRR or by request, oekom carries out a negative screening which refers to exclusionary criteria as used for socially responsible investment. In Figure 2 Exclusionary Criteria used by oekom research, it can be seen which business areas and which business practices the company scans. These criteria can also be adapted to what a customer wants to have excluded.<sup>64</sup> Whether a company is involved in a controversial business area or not, is found out through a process called ‘external research’ at oekom research. Thereby,

64 SCHÄFER/ HAUSER-DITZ/ PRELLER, 2004, p. 44

Exclusionary Criteria					
Business Areas					
	Risk Industry	Yes Producer	Yes User/ Retailer	No	No Info
Abortion	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	
Alcohol	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Biocides	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Chlororganic Mass Products	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	
Embryonic Research	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	
Furs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Gambling	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
GMOs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Military	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Nuclear Power	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Pornography	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Tobacco	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Business Practices					
	Risk Industry	Yes Company	Yes Supplier	No	No Info
Animal Testing	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	
Business Malpractice	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	2005: USD 80m settlement in the United States related to alleged violations of money laundering laws.
Controversial Env. Practices	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	2001-2004: Controversial Project Financing, e.g. Chad-Cameroon pipeline, Baku-Tbilisi-Ceyhan pipeline.
Violations of Human Rights	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Violations of Labor Rights	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	

Figure 2 Exclusionary Criteria used by oekom research

information is gathered through a comprehensive research, including searching websites of different relevant NGOs (eg, Greenpeace, WWF, Fair Finance Watch) and other information services. As the research relies mainly on sources that are from outside the company, the negative screening adds an external component to the company assessment.

As can be seen in Figure 2, banking and financial services is identified as a risk industry in terms of controversial environmental practices. An industry is considered a risk industry if the probability for a controversy in this business area is higher than for other industries.

Furthermore, it can be seen that the bank in question is not involved in any exclusionary business area but that through a conflict of interest and the participation in controversial project finance activities, the company is involved in the field of business malpractice and controversial environmental practice. After a certain period of time these entries are deleted. The length of this period depends on the seriousness of the company's malpractice and its measures against it. As soon as oekom research learns that an enterprise offends against an exclusionary criterion, this will be integrated into the rating and will be communicated to the customer with the next report.

The positive screening ('best in class' approach) does not only offer the investors the opportunity to make their decisions according to ethical-ecological criteria but it has an impact on the economic development. The thought behind this approach is not to exclude the securities of certain enterprises

or industrial sectors but to evaluate all of the enterprises of one sector, get the companies in the right order regarding the ecological and social performance and identify the CSR or sustainability leader.<sup>65</sup> Special about this approach is that even if the performance of a company is rated only average, it can still be best in class.<sup>66</sup> Figure 2 shows the Exclusionary Criteria used by oekom research<sup>67</sup>.

### The rating

As described above, the actual CRR is separated into two parts: the social and the ecological part, which are further subdivided. Within these two parts, some of the criteria used are sector-specific (eg, lending practices in banking & financial services) and a big part of them general (business ethics, working conditions, eco-efficiency, the existence and adherence to a code of conduct).<sup>68</sup>

During the evaluation process, emphasis is put on co-operating with the company being rated. First, a draft rating is created with the help of information material provided by the company or publicly available, eg, from the company's website. This draft rating is sent to the company indicating where more information would be needed. Thus, feedback is expected which the company may provide in the form of interviews or through sending more information. Often, this feedback leads to an upgrading of the company as the company may also provide company which is not publicly available.

Finally, the performance of the rated companies is evaluated on a twelve-point scale ranging from A+ to D-, A+ being best.<sup>69</sup>

Rating the companies, it is not only vital that they have set up respective guidelines or taken measures in order to ensure fair business conduct or to carry out business in a sustainable way. It is also of importance how many of the company's employees or locations are covered by these statements and measures. Thus, for most items of the rating, the respective result is a combination of the score for the content and the coverage.

### Information sources

At the very beginning, oekom's ratings were generated with the help of questionnaires that the evaluated companies had

65 cf. SCHÄFER/ HAUSER-DITZ/ PRELLER, 2004

66 cf. JAHN, 2004, p. 99

67 oekom research AG, 2005, p. 398 (pdf)

68 cf. SCHÄFER/ HAUSER-DITZ/ PRELLER, 2004, p. 44

69 oekom resarch AG, 2003, p. 67

to fill in. Nowadays, assessing the companies' ethical performance, oekom research uses a variety of sources of information, which are mostly publicly available. These include information from within the company being evaluated, internet and database research, media screening, feedback from the company in interviews and consultation of experts from scientific communities and international NGOs.<sup>70</sup>

Among the information from within the company, first of all, annual reports serve as the basic information source. Recently, more and more companies publish sustainability, social responsibility or environmental reports. The focus of the latter reports is different and often also depends on the cultural background of the company. Whereas, eg, American companies emphasise cultural and social aspect (equality, working conditions, health and safety), Japanese companies mainly stress their environmental efforts more detailed in their environmental reporting, eg, on the existence of an environmental management system, environmental considerations in products.<sup>71</sup>

### **The CRR as a tool to evaluate the corporate responsibility of enterprises**

Carrying out the CRR for companies in banking and financial services, issues such as money-laundering, conflict of interests and insider trading are dealt with when assessing the existence and the content of the bank's code of conduct, but not separately and not in detail. In the CRR of financial institutions, much is about product responsibility and responsibility towards the customer. Furthermore, the rating puts emphasis on providing and managing socially responsible investment. In banking & financial services the indirect environmental and social impacts by the offered products and services are considered more important than the direct ones, which are measured as well. Therefore, in this evaluation, more weight is put upon products and services.

The assessed criteria and their evaluation are communicated to the respective customers and the evaluated company, so it can always be clearly seen where the company has potential for improvements. Generating this rating, oekom research relies on information published or provided by the respective company. Thus, it trusts in the respective enterprise to provide truthful and honest information. Of course, more exact and validated information could be obtained by visiting the company or making surveys among customers, employees and other stakeholders. However, then the generation times for one rating would be much longer and the rating would be

<sup>70</sup> cf. HÄBLER, 2001, p. 57

<sup>71</sup> HÄBLER, 2001, p. 61

connected with more costs.

### **Conclusion**

Banks are among the most powerful institutions in the economy. Often, their decisions have large-scale consequences and the actions of people in finance can have large impacts on the wealth of customers. Therefore, people involved in banking have to know how to conduct business properly in order to satisfy all stakeholders connected to their business. In this context business ethics supports people in enterprises to find the way to act appropriate. Ethical aspects are taken more and more into consideration when conducting business, also in the banking sector. Ethics in finance is not only about the conduct of the people involved but also about the products a financial intermediary offers. Acting as intermediaries, banks bring together people with surpluses of money (the bank's creditors) and people with shortages of money (the bank's debtors). Thus, responsible behaviour towards the customer is indispensable.

Furthermore, socially responsible investment is spread more and more. To be included in the socially responsible investment universe of banks, companies have to fulfil certain criteria and their performance regarding ethical, ecological and social criteria is evaluated.

There are different ways to obtain information on this performance. Here, the focus was on ethical-ecological ratings, which evaluate companies according to the respective criteria and express the performance by a rating mark. One agency that carries out ethical-ecological ratings is oekom research in Munich/ Germany. This is done with the corporate responsibility rating (CRR) through which companies in more than 25 different sectors are assessed. One of the rating's major benefits is that it makes the ethical, ecological and social performance of enterprises measurable and comparable and, thus, helps investors to place funds socially responsible and companies to learn about their performance compared to other entities. The rating consists of an external research as well as the actual rating process with information as given by the company.

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# THE CORPORATE ETHICS AUDIT AS A TOOL FOR MANAGEMENT BY VALUES

## CASE: BETAPHARM ARZNEIMITTEL GMBH, AUGSBURG

Teresa M. Beste

**Abstract.** The social responsibility of companies, especially in the pharmaceutical sector is increasingly in the focus of businesses and their stakeholders. After the development of effective tools for managing values in a business, one of the most important challenges is to measure the extent to which ethics have been implemented in the daily business routine. Conducting an ethics audit can provide a way to monitor and assess a company's values and their implementation. This text tries to shed light on the concept of an ethics audit, first by outlining some theoretical approaches, and secondly by looking at the case of the German pharmaceutical company betapharm and how the ethics audit can be applied to the specific business.

### JEL Classification A13, G34, M14

### Introduction

Defining business ethics is “like nailing jello to a wall”<sup>1</sup>. Values and beliefs in companies are hard to grasp. Nevertheless, ethics play an important role in managing an organisation and can be the point of pride in an organisation. Concepts like Corporate Social Responsibility, Corporate Citizenship, or Business Ethics are of more and more importance to businesses and their stakeholders. But at the same time, all business activities and processes have to be made measurable and comparable in order to assess the direct impact of ethics on the business. Thus, there are attempts to find tools to make management understand the influence of ethics on the economy and on the individual company. Currently, formal ethics approaches such as rules and regulations, codes of ethics, vision statements or codes of conducts, prevail. Nonetheless, little attention has been paid to measure whether those tools are really implemented and accepted by the employees of a business. One of the most important challenges

1 LEWIS, P. V. (1985). Defining “Business Ethics”: Like nailing jello to a wall. In: *Journal of Business Ethics*, 04/1985, pp. 377-383. Kluwer Academic Publishers, Dordrecht. Quoted in: McEwan, Tom (2001). *Managing Values and Beliefs in Organisations*. FT Prentice Hall, Harlow

today is to measure the extent to which ethics have been implemented in a day-to-day business and the effect ethics have on the company's performance. Auditing the ethical performance is one approach to make people aware of the existence of ethical issues in business and to make those reachable. In that way, weak points of ethics concepts can be detected and an organisation's ethics can be improved. An ethics audit accounts for the fact that it is not enough to develop an ethics management system or single ethics tools, but that the system has to be monitored and assessed continuously and adapted if weak points are detected. The following text tries to shed light on the concept of an ethics audit, first by outlining some theoretical approaches, and secondly by looking at the case of the German pharmaceutical company betapharm and how the ethics audit can be applied to the specific business.

### The ethics audit

“The word ‘audit’ is derived from the Latin word ‘audire’ meaning ‘to listen / to hear’.”<sup>2</sup>. The task of an auditor in the Ancient Rome was to listen to problems of soldiers in the army, to detect emerging problems and to give advice on a strategy how to solve the problems.

The ethics audit stands in the logic sequence of established auditing concepts: the financial audit, the environmental audit, the social audit and the quality audit. In the concept of triple bottom line accounting, financial success is measured by the financial and the quality audit, the contributions to a liveable environment with the environmental audit and the ability to solve social problems externally with the social audit and internally with the ethics audit<sup>3</sup>.

### Ethics audit – a definition

Structured instruments allow assessing the ethical effectiveness of the organisation systematically. Diagnostic tools, of which the ethics audit can be one, are used to characterise the present state of the organisation by examining the formal and informal ethical systems and to measure the impact of training and consulting services over time<sup>4</sup>. Although the concept of the ethics audit is still in the development process and not yet widely known, there have been several attempts

2 KAPTEIN, M. (1998). *Ethics Management – Auditing and Developing the Ethical Content of Organizations*. Kluwer Academic Publishers, Dordrecht, p. 48

3 BOWIE, N. E. / WERHANE, P. H. (2005). *Management Ethics*. Blackwell Publishing, Oxford

4 NAVRAN, F. (2002). *Ethical conflicts in Ethical Companies*. Ethics Resource Center. [http://www.ethics.org/resources/article\\_detail-cfm?ID=766](http://www.ethics.org/resources/article_detail-cfm?ID=766) (viewed 06/12/05)

to define and describe it. Kaptein gives the following extensive definition of the term “ethics audit”:

*I would like to define an ethics audit as a systematic approach which makes a description, analysis, and evaluation of the relevant aspects of the ethics of a corporation. The systematic and methodologically valid and reliable approach of the examination is characteristic of an audit. The method used should result in eliciting valid and reliable information which can serve as a basis for the evaluation by the principal. The choice of which aspects are included in an examination depends on what the audit is designed to achieve<sup>5</sup>.*

For Frank Navran, the ethics audit is mainly a tool to prevent unethical behaviour of employees that undermines the effectiveness of a company from inside.

*The process used to examine the impact of the organization’s formal systems on its ethical effectiveness is known as an ethics audit. A typical ethics audit consists of a series of complimentary [sic] interviews and structured surveys or questionnaires that get at such issues as the perceived importance and effectiveness of:*

- *Stated organizational values.*
- *Ethics strategies.*
- *Ethics goals and objectives.*
- *Ethics policies and procedures.*
- *Ethics measurement systems.*
- *Rewards for ethical behaviour.*
- *Consistency between the above factors.*

*The audit process measures the effectiveness of the organization in defining and implementing its overall ethics strategy<sup>6</sup>.*

The ethics audit is part of a compliance approach in business ethics, because it serves to examine in how far the employees and the company as a whole comply with the values and standards. In order to avoid that employees only feel controlled by the audit process, the ethics audit shall be conducted as a help for finding ways how to implement the company values.

## Functions of an ethics audit

According to Kaptein<sup>7</sup>, an ethics audit can fulfil five func-

5 KAPTEIN, M. (1998). Ethics Management – Auditing and Developing the Ethical Content of Organizations. Kluwer Academic Publishers, Dordrecht, p. 50

6 NAVRAN, F. (2002). Ethical conflicts in Ethical Companies. Ethics Resource Center. [http://www.ethics.org/resources/article\\_detail-cfm?ID=766](http://www.ethics.org/resources/article_detail-cfm?ID=766) (viewed 06/12/05)

7 KAPTEIN, M. (1998). Ethics Management – Auditing and Developing the Ethical Content of Organizations. Kluwer Academic Publishers, Dordrecht, p. 62

tions, namely

- “descriptive” by showing the current situation,
- “normative” by formulating the desired situation on the basis of the current situation,
- “discrepancy-identifying” by showing the discrepancy between the current and the desired situation,
- “sanctioning” by providing information for sanctioning individuals and departments, and
- “evaluative” by determining suggestions for improvement regarding the aspects under review.

These functions may all be fulfilled separately or at the same time. Nevertheless, there are audit types which can only accomplish some of the purposes. A basic function all ethics audits serve is to be a part of the process of awareness for values in business. But to lead to an improvement of the company culture, an ethics audit can only be perceived as complete if the evaluative purpose is considered.

Karcher / Pfungst<sup>8</sup> examine two main functions which an ethics audit is meant to fulfil: to deal with ethics intensively in order to bring it to mind, and to examine the degree of the implementation of ethical guidelines. Other authors identify solving ethical conflicts as the main function of an ethics audit i.e. in situations “where the values of the organization, the values of the employees and the perceived criteria for success (as manifested in the formal and informal systems of the organization) are misaligned”<sup>9</sup>. The ethics audit can establish “ethical congruence”, which is “the organizational state where values, behaviours and perceptions are aligned” (ibid.).

## The auditing process

Kaptein describes in detail a six steps ethics audit:

1. *The Qualities Monitor*: The qualities monitor “determines the degree to which the corporation possesses certain relevant moral characteristics”<sup>10</sup>. This is ideally done in the form of a written survey and supplementary interviews<sup>11</sup>.
2. *Measures Scan*: A measures scan “is a method for identifying and analyzing the formal organizational context insofar as it could impact the corporate ethics” consisting of “procedures, systems, rules, instruments, written codes,

8 KARCHER, M. / PFINGST, I. (2004). Verhaltensstandards. In: Wieland, Josef (ed.). Handbuch Wertemanagement. Murmann, Hamburg

9 NAVRAN, F. (2002). Ethical conflicts in Ethical Companies. Ethics Resource Center. [http://www.ethics.org/resources/article\\_detail-cfm?ID=766](http://www.ethics.org/resources/article_detail-cfm?ID=766) (viewed 06/12/05)

10 KAPTEIN, M. (1998). Ethics Management – Auditing and Developing the Ethical Content of Organizations. Kluwer Academic Publishers, Dordrecht, p. 61

11 KAPTEIN, M. (1998). Ethics Management – Auditing and Developing the Ethical Content of Organizations. Kluwer Academic Publishers, Dordrecht, p. 120



handbooks, organizational charts, duty and job descriptions, and mission statements” (ibid.).

3. *The Individual Characteristics and Circumstances Assessment*: This assessment focuses on the individual intentions, intuitions and abilities of the personnel as well as the private circumstances affecting the (un)ethical conduct of the employees.
4. *Dilemmas Decoder*: The dilemmas decoder consists of formulating dilemmas employees are confronted with, thus unravelling conflicting expectations and converting them into productive problem solutions.
5. *Conduct Detector*: A conduct detector “is the method which the auditor can use to reveal the actual (un)ethical conduct of the personnel and the corporation as a whole” (ibid.).
6. *Stakeholders Reflector*: The stakeholder reflector serves to reveal the stakeholders’ expectations and the degree to which the organisation fulfils these expectations.

In addition, an “Ethics Thermometer”, a survey among employees, is used to describe the perceived context, conduct, and consequences. It tries to measure results on a quantitative scale in a short measurement period and to calculate the correlation between the qualities and the unethical conduct and consequences observed. In form of an ethics team test, it can also be applied on a smaller scale and thus identify sensitive issues within each team<sup>12</sup>.

Nelson / Treviño have split up their “audit of the ethical culture”<sup>13</sup> as part of a proactive development of an ethical organisational culture in two parts. “The audit should include probes into the formal and informal organizational systems that are maintaining the ethics culture in its current state.”<sup>14</sup>. The tools for the evaluation of the effectiveness of formal systems are surveys, interviews, observation at meetings, training sessions, or the analysis of organizational documents. The organization’s heroes and the behaviour reinforced by stories, rituals and language can be identified through open-end interviews and observation of informal processes in the company.

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12 KAPTEIN, M. (1998). Ethics Management – Auditing and Developing the Ethical Content of Organizations. Kluwer Academic Publishers, Dordrecht, p. 134

13 NELSON, K. A. / TREVINO, L. K. (2004). Managing Business Ethics – Straight Talk About How To Do It Right. Third Edition. John Wiley & Sons Inc., Hoboken, p. 227

14 NELSON, K. A. / TREVINO, L. K. (2004). Managing Business Ethics – Straight Talk About How To Do It Right. Third Edition. John Wiley & Sons Inc., Hoboken, p. 258

## Audit responsibility

When planning an ethics audit, the important decision whether to conduct the ethics audit internally or with the help of an external agency has to be taken. In larger organisations, there are often ethics departments, ethics offices or a CSR manager in charge of the company’s ethics. In consequence, there would be qualified personnel to conduct an ethics audit internally. They have insider knowledge of the structure, the processes and the employees of the company and thus know what the company needs. But it is more difficult for them to step back and see the company from an objective point of view and to generate new ideas. Furthermore, employees might fear reprimands or sanctions and could thus be influenced in their answers. An external audit service agency could provide experienced impartial auditing. Although the discipline of auditing a company’s ethics is quite young, several agencies are working in that field, mainly engaged in testing and rating corporate social responsibility of companies with the aim to provide information for clients seeking socially responsible investment.

A concept of compromise would be to leave the audit responsibility at the company, but to outsource the execution of the audit to an external agency or an ethics consultant. In this approach, the benefits of both an external and an internal audit can be combined. The auditors are external and thus impartial persons and bring new ideas into the company. The employees might respond more frankly to external persons than they would to internal employees – thus the most objective and candid results will be achieved. But nevertheless, the responsibility is kept in the hand of the company – first of all with the senior management in order to show the top priority of the audit and secondly at the responsible department. This department might be the ethics department, the department of corporate communications or the personnel department – depending on the type and size of the company. It would be best, if the company and the external agency work closely together when adapting the audit process to the respective company. In that way, the agency can contribute its competence and the company itself can determine the specific needs the ethics audits shall serve for them.

## Benefits and challenges of an ethics audit

“An annual ethics audit is as important as an annual fiscal audit. It helps bring the association’s core values and ethics into focus and conveys the importance of sharing organizational values and ethics.”<sup>15</sup>. The ethics audit serves the pur-

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15 GRAY, S. T. (n.d.). Audit Your Ethics. Centerpoint for Leaders. <http://www.cen->

pose to “evaluate the extent to which the association’s daily performance complies with its code of ethics” (ibid.). “Ideally, the ethics audit process fosters open discussion of the association’s values and ethics code among all levels of staff members, board members, and volunteers.” (ibid.). According to Navran<sup>16</sup>, the company can reduce indirect tangible and intangible costs by conducting an ethics audit as it increases “ethical congruence” which at the same time “reduces the motivation for counterproductive or retaliatory behaviour” and increases “ethical and organizational effectiveness”.

Also Gross-Schafer / Swenson<sup>17</sup> stress the helpfulness of an ethics audit:

*[I]ndividuals and organizations have great difficulty implementing a holistic self-examination (...)*

*(1) Few organizations step back often enough to assess the character of their workplace;*

*(2) If such an assessment were properly and effectively conducted, it could be very revealing as to the organization’s character; and*

*(3) An assessment of an organization’s workplace character is probably the most serious exercise an organization will ever perform.*

However, the benefits of an ethics audit do not stop with the mere inspection of the company character and the extent to which values are implemented in the company. A major benefit will be achieved if the management draws conclusions from the results of the ethics audit by adapting the code of ethics of the company in order to incorporate the values which govern the behaviour and decisions of the employees. If the company carefully assesses inconsistencies detected in the audit and brings the values of the company and the personal ethics (values and behaviour) of the employees together, employee satisfaction and motivation can be substantially enhanced. Navran<sup>18</sup> also argues that the result of an ethics audit, namely a reduction of ethical conflicts, helps to increase productivity, quality and customer satisfaction, because employees are more committed to organisational goals and objectives. Through the institutionalisation of an ethics audit, the results of the consecutive audits can be compared and

the success can be measured.

Grüninger and John<sup>19</sup> additionally state that the willingness to conduct an ethics audit is an investment into the trustworthiness of the corporation. Furthermore, the audit enhances the authenticity of a company’s written voluntary commitment to values. Also DuFrene<sup>20</sup> underlines the benefits of an ethics audit as an assessment of the ethical practices: “Reduction in the risk of legal proceedings”, “improvement of employee morale, productivity, and retention”, “the effective management of values associated with quality, strategic planning, diversity and equity programs”, the “improvement in the organization’s ability to manage any crisis with strength and confidence” as well as the “promotion of a strong, positive public image”.

Nevertheless, also the difficulties behind the establishment of an ethics audit should be considered. Gill<sup>21</sup> mentions the negative connotation of the word “audit” and proposes to rename the process into “ethics assessment” or “ethics inventory”. In contrast to the financial audit, the ethics audit tries to figure out the implementation of soft factors such as values. These are not as easily to grasp as the numbers which are controlled in a financial audit or as the emissions of carbon-dioxide in an environmental audit. Thus, different measures have to be found which are suited for checking the effects of compliance or non-compliance with the values of the company. As the ethics audit is not yet a compulsory duty for companies, managers might at first consider it as a waste of time, money and other resources due to the fact that the effects of an ethics audit cannot be seen immediately and cannot be evaluated with directly related figures. Possibly, there will be a standard in the near future which helps companies to assess their ethics. The International Organisation for Standardisation (ISO) currently develops the ISO 26000, a guidance standard for social responsibility. This guideline can set the framework for comprehensive ethics audits. At the moment, the ISO is not aiming at creating a certificate for this new standard. Nevertheless, a certification of ethics might follow in some years and thus provide a comparable basis for benchmarking companies in terms of ethics.

terpointforleaders.org/articles\_0303/audit\_ethics.html (viewed 09/11/05)

16 NAVRAN, F. (2002). Ethical conflicts in Ethical Companies. Ethics Resource Center. [http://www.ethics.org/resources/article\\_detail-cfm?ID=766](http://www.ethics.org/resources/article_detail-cfm?ID=766) (viewed 06/12/05)

17 GROSS-SCHAEFER, A. G. / SWENSON, L. (2005). Contrasting the Vision and the Reality: Core Ethical Values, Ethics Audit and Ethics Decision Models for Attorneys. In: Pepperdine Law Review, pp. 459-481. HeinOnline, Malibu, p. 478

18 NAVRAN, F. (2002). Ethical conflicts in Ethical Companies. Ethics Resource Center. [http://www.ethics.org/resources/article\\_detail-cfm?ID=766](http://www.ethics.org/resources/article_detail-cfm?ID=766) (viewed 06/12/05)

19 GRÜNINGER, S. / JOHN, D. (2004). Corporate Governance und Vertrauensmanagement. In: Wieland, Josef (ed.). Handbuch Wertemanagement. Murmann, Hamburg

20 DUFRENE, D. D. (2001). The External Ethics Audit: A Guided Experience in Self-Directed Web-Inquiry. In: Teaching Business Ethics 05/2001, pp. 71-77. Kluwer Academic Publishers, Dordrecht

21 GILL, D. W. (2002). Time for Your Corporate Ethics Audit? In: ethix, issue 21, Jan.-Febr. 2002, p. 15. Institute for Business, Technology & Ethics, Berkeley

## Different approaches to an ethics audit in the USA and in Europe

### ONLINE ETHICS AUDIT (WWW.SURVEY-SERVER2.COM)

The Centre for Applied Research of Human Synergistics International provides an online ethics audits for organisations. The audit, which is created in form of a survey, consists of three parts with questions which can be answered online. Part I presents 48 statements in which the personal styles required by members is assessed, because the styles reflect the culture of the organisation and are directly related to the ethical principles and standard operating procedures. This section includes questions such as "To what extent are people like yourself expected or implicitly required to critically scrutinize current policies and practices?" Part II focuses on the organisation and its ethical standards, documents and behaviour with questions such as "To what extent does this organization consistently maintain the highest ethical standards in its financial and accounting practices?" In part III, the company is requested to give background information about its business and the person who has answered the question. This is done in order to assess the data and to conduct a survey in order to improve the ethics audit, as this edition only constitutes a research version.

### ETHICS AUDIT FOR SPECIFIC LINES OF BUSINESS

In the USA, there are some concepts of an ethics audit which focus on specific lines of businesses, such as the "ethics audit for a law firm" outlined by Gross-Schaefer and Swenson<sup>22</sup>. Especially lawyers and attorneys have "a public relations problem regarding the public's view of them"<sup>23</sup>. People do not assign integrity to them, as legal practitioners aggressively have to defend the "client's case, even if such representation is contrary to the lawyer's own personal beliefs"<sup>24</sup>. In this audit, questions are asked in the key categories of "areas of social responsibility, open communication, treatment of employees, confidentiality, respect of employees, community values, vendor relationships, leadership by example, human in-

vestment, and ecology."<sup>25</sup>. Sample questions in this context are: "Does the firm take public stands and contribute its resources to public issues?" (ibid.) or "Does the firm provide fair benefits (pension, social security, medical, etc.) for all of its employees?" (ibid.). The ethics audit shall serve as a tool to help to measure and understand "dissonance between a person's values and a person's actual activities" (ibid.). This can contribute to cultivating a healthy workforce and good working climate and is even considered as a "wellness device(..)" for a law firm<sup>26</sup>.

### ETHIKAUDITSYSTEM BY JOSEF WIELAND

In 1999, Josef Wieland<sup>27</sup> developed his "EthikManagement-System" (EMS, ethics management system) and "EthikAudit-System" (EAS, ethics audit system) in order to provide tools for the assessment of the implementation of ethical management. The EAS is based on process observation, where weak spots of the EMS are revealed through questionnaires and qualitative interviews<sup>28</sup>. The audit is conducted in a twofold procedure by external auditors: The first step is the documentary part, in which the company fills in a questionnaire stating in how far the EMS has been implemented. The statements of the questionnaire are checked by the auditors through the examination of important company documents such as the values statement, the code of conduct or protocols of relevant meetings of the management. The second part is called validating part and focuses on the feedback about the actual implementation of the values programme in daily business procedures by interviewing selected persons of the company. The aim of this part is to check if the documents of the company audited in the first part really are lively documents<sup>29</sup>.

22 GROSS-SCHAEFER, A. G. / SWENSON, L. (2005). *Contrasting the Vision and the Reality: Core Ethical Values, Ethics Audit and Ethics Decision Models for Attorneys*. In: *Pepperdine Law Review*, pp. 479. HeinOnline, Malibu

23 GROSS-SCHAEFER, A. G. / SWENSON, L. (2005). *Contrasting the Vision and the Reality: Core Ethical Values, Ethics Audit and Ethics Decision Models for Attorneys*. In: *Pepperdine Law Review*, pp. 459. HeinOnline, Malibu

24 GROSS-SCHAEFER, A. G. / SWENSON, L. (2005). *Contrasting the Vision and the Reality: Core Ethical Values, Ethics Audit and Ethics Decision Models for Attorneys*. In: *Pepperdine Law Review*, pp. 460. HeinOnline, Malibu

25 GROSS-SCHAEFER, A. G. / SWENSON, L. (2005). *Contrasting the Vision and the Reality: Core Ethical Values, Ethics Audit and Ethics Decision Models for Attorneys*. In: *Pepperdine Law Review*, p. 479. HeinOnline, Malibu

26 GROSS-SCHAEFER, A. G. / SWENSON, L. (2005). *Contrasting the Vision and the Reality: Core Ethical Values, Ethics Audit and Ethics Decision Models for Attorneys*. In: *Pepperdine Law Review*, p. 480. HeinOnline, Malibu

27 Prof. Dr. Josef Wieland, FH Konstanz and director of research at the Zentrum für Wirtschaftsethik (ZfW) created the EthikManagementSystem and EthikAuditSystem in 1999, but developed it further to the certified WertManagementSystemZfW (ValueManagementSystem) with the objective to "provide a sustainable safeguard of a firm and its development, in all dimensions (legal, economic, ecological, social)" ([www.dnwe.de](http://www.dnwe.de)).

28 KÖNIG, M. (1999). *EthikManagement- und -AuditSystem: Kritische Bemerkungen zum Konzept von Wieland*. In: *Forum Wirtschaftsethik*, 4/1999. Deutsches Netzwerk Wirtschaftsethik – EBEN

29 FÜRST, M. / WIELAND, J. (2004). *WertManagementSysteme in der Praxis*. In: Wieland, J. (2004, ed.). *Handbuch Wertmanagement – Erfolgsstrategien einer modernen Corporate Governance*. Murmann Verlag GmbH, Hamburg, pp. 417-431

## BUSINESS ETHICS AUDITING BY JOHN ROSTHORN

John Rosthorn<sup>30</sup> underlines that there have been growing attempts to think of “tools to better manage business risk exposures within the corporation” from the middle of the 1990s on. For him, “[t]he more serious survival issue (...) is not the ‘competition’, but the enemies within the corporation” (ibid.), e.g. to eliminate concerns about the integrity of the senior management team. In addition to social and ethical reporting or social auditing, a General Business Ethics Audit (GBEA) can be an effective measure to provide information about the corporate responsibility and social performance of companies to stakeholders. The audit is done internally on the basis of the statements of business principles (as well as mission statement, values statement or business ethics codes) and audits the business conduct (ibid.).

Rosthorn also addresses the problem that business ethics codes are not designed for being audited and furthermore explains how the audit can work:

*At the time when high level company policy documents such as its business ethics code were being prepared, little thought was given to subsequent internal auditing of compliance with the policies. (...) The auditor works with a diagonal slice through the levels of management in the business (...) from (...) three levels – top, middle and junior management. The major functions of the business e.g. marketing, operations, logistics, human resources, financial – should likewise be represented in the interview sample” as well as “distinct strategic business units”<sup>31</sup>.*

This provides a three-dimensional sample frame with 10 to 15 interviews with discussions lasting from 60 to 90 minutes. An example for an audit question, in the subject area of equal opportunities in internal promotion, could be: “How well are women and minority groups represented in junior, middle and senior management positions?”.

Experience from audits in Europe and Asia shows that an auditor is able to identify and also to quantify the business risk exposure. With the help of well-edited questions and an elaborated evaluation of the results, “[t]he risk analysis leads into a consideration of the business processes which have given rise to the risk exposure”<sup>32</sup>. “As corporate experience in busi-

30 ROSTHORN, J. R. (2000). Business Ethics Auditing – More Than a Stakeholder’s Toy. In: Journal of Business Ethics, 27/2000, p. 9. Kluwer Academic Publishers, Dordrecht

31 ROSTHORN, J. R. (2000). Business Ethics Auditing – More Than a Stakeholder’s Toy. In: Journal of Business Ethics, 27/2000, p. 14. Kluwer Academic Publishers, Dordrecht

32 ROSTHORN, J. R. (2000). Business Ethics Auditing – More Than a Stakeholder’s Toy. In: Journal of Business Ethics, 27/2000, p. 15. Kluwer Academic Publishers, Dordrecht

ness ethics audit cycle grows, the auditors will be allowed to contribute more substantially to the preparation of subsequent generations of business ethics policies and codes of business conduct.”<sup>33</sup>.

The GBEA is a “powerful (...) tool for shifting management awareness and performance”<sup>34</sup>, and auditors can “make some suggestions about needed improvements to key processes which impact on conduct within the business”<sup>35</sup> and “set out supportable conclusions and recommended improvement plans” (ibid.).

## THE BUSINESS ETHICS STRATEGY SURVEY (BESS)

Another precise instrument for auditing the Chief Executive Officer (CEO) and the senior management team is the Business Ethics Strategy Survey, in which information about the integrity of the CEO and the ethical robustness of the business is assessed. The survey is conducted internally through “audit type questions for the CEO (...) designed to lead to the discovery of management information, documentation, attitudes and (...) actual behaviour”<sup>36</sup>. BESS works with a model (Illustration 1) which provides a good way to compare either the results of one company in consecutive audits or to do benchmarking among several companies of the same line of business. The results of the survey are plotted in a cob-web consisting of seven categories which are assessed in the BESS, called a “seven-axis performance display” (ibid.). In this example it is assumed that the best result would be the outer heptagon. The red line links the hypothetical results in the various categories in the year 2003 and the green line the results of 2004 (both in company X). It can easily be seen that the company improved during this year in almost all areas except controls and leadership. This tool is accompanied by a numerical report and a short written commentary identifying points of improvement.

## COMPANY TEST (GERMAN: UNTERNEHMENSTEST)

The company test<sup>37</sup> is an instrument with which businesses

33 ROSTHORN, J. R. (2000). Business Ethics Auditing – More Than a Stakeholder’s Toy. In: Journal of Business Ethics, 27/2000, p. 14. Kluwer Academic Publishers, Dordrecht

34 ROSTHORN, J. R. (2000). Business Ethics Auditing – More Than a Stakeholder’s Toy. In: Journal of Business Ethics, 27/2000, p. 17. Kluwer Academic Publishers, Dordrecht

35 ROSTHORN, J. R. (2000). Business Ethics Auditing – More Than a Stakeholder’s Toy. In: Journal of Business Ethics, 27/2000, p. 15. Kluwer Academic Publishers, Dordrecht

36 ROSTHORN, J. R. (2000). Business Ethics Auditing – More Than a Stakeholder’s Toy. In: Journal of Business Ethics, 27/2000, p. 18. Kluwer Academic Publishers, Dordrecht

37 SCHOENHEIT, I. (2000). Unternehmenstest. In: Diller, H. (ed.). Vahlens

can be independently measured, assessed and compared by an external agency, in how far they act socially and ecologically in selected areas according to specific criteria (socio-ecological company test). The growing interest of consumers in such tests as a complement to product tests underline that the public sees businesses as quasi-official entities which have to contribute to the solution of societal problems. The three main functions of a company test are:

- Incentive (German: Anreizfunktion): Based on a common understanding of a responsible business behaviour within an industry sector, good results in the published test can give the respective company a competitive advantage vis-à-vis other businesses.
- Catalyst (German: Katalysatorfunktion): Company tests act as a societal catalyst if enterprises, experts and different stakeholder groups discuss their understanding of a socially and ecologically responsible business policy in conversational processes.
- Control (German: Kontrollfunktion): The tests also fulfil a function of control by inspecting critically important elements of the corporate image.

When conducting the company test, a mix of information sources guarantees the highest validity and credibility. Information can be obtained from databases (internet, scientific research institutes) non-governmental organisations (NGOs), the businesses themselves (questionnaires, documents, interviews) or by experiment (mystery calls / letters / emails). Consumers and investors can use the results of comparative company tests for their purchase and investment decisions<sup>38</sup>.

First examples for such company tests in Germany have been developed and conducted in 2004/2005 by the imug-Institute for Market-Environment-Society and the Stiftung Warentest. The extensive core criteria for the assessment of the socio-ecological corporate responsibility by the Stiftung Warentest range in the four subject areas of social aspects / employees, social aspects / suppliers, environment and consumer / society, which are further divided into sub-categories<sup>39</sup>. The forerunners of this concept can be found in the USA, where already in the 1980s, two publications for consumers: "Rating Americas Corporate's Conscience" and the popular shopping guide "Shopping for a Better World" were issued<sup>40</sup>.

großes Marketinglexikon, 2nd edition, München

38 SCHOENHEIT, I. (2000). Unternehmenstest. In: Diller, H. (ed.). Vahlens großes Marketinglexikon, 2nd edition, München

39 The complete criteria for the assessment can be found at [http://www.stiftung-warentest.de/download/protected/csr\\_kernkriterien.pdf?pool=online&type=protectedfile&id=csr\\_kernkriterien&lang=de&filetype=protectedfile&sid=rhqlv455r4bukyl4a1umr55](http://www.stiftung-warentest.de/download/protected/csr_kernkriterien.pdf?pool=online&type=protectedfile&id=csr_kernkriterien&lang=de&filetype=protectedfile&sid=rhqlv455r4bukyl4a1umr55).

40 HANSEN, U. / SCHOENHEIT, I. (2004). Corporate Social Responsibility – eine neue Herausforderung für den vergleichenden Unternehmenstest. In:

## Ethics of the pharmaceutical industry and the implications for an ethics audit

Medical ethics has been important since the Ancient Greece, when all doctors had to swear the Hippocratic Oath, which defined rules about the respect to teachers and colleagues on the one hand and generalized rules about the care for the patient on the other hand. There have been modern adaptations of this oath, e.g. in the Declaration of Geneva from 1948 or the Declaration of Helsinki from 1964<sup>41</sup>. But this mainly concerns doctors, whereas pharmaceutical ethics – especially of pharmaceutical companies – have long been neglected<sup>42</sup>.

The pharmaceutical industry finds itself in a dilemma: On the one hand, health is a precious good and should be available for all people without making any difference. But on the other hand, the production of pharmaceuticals is also subject to the rules of the market. Thus, responsible pharmaceutical companies face the challenge of reconciling their moral attitude with the practical constraints of the economy. It has to be questioned if companies may be accused if they act according to the demand of the market "just" because the lives of people are concerned. The public calls for responsible behaviour of the companies and thus, scandals can destroy the image of big multinational groups when they conduct non-authorized tests with unlicensed medicines, are accused of corruption, surreptitious advertising or the abuse of their market power by excluding poor people or whole countries from badly needed medication. Also the state tries to assure the ethical behaviour of pharmaceutical companies by setting severe advertising laws or regulations against corruption<sup>43</sup>.

Nevertheless, there are many examples of responsibly acting pharmaceutical companies. betapharm researches into socio-medical care, Novartis distributes medicines for the treatment of leprosy free of charge and Merck developed a medicine against river blindness, an illness occurring in some of the poorest regions in Africa – an investment which they knew they could never cover to the full amount, as most people would not be able to pay for the medicine (ibid.).

There are attempts to create voluntary commitments of the industry by forming public-private-partnerships in order to

Wiedman, K.P. / Fritz, W. / Abel, B. (eds.). Management mit Visionen und Verantwortung. Wiesbaden, p. 233-258

41 MERRILLS, J. (2002). The Basis of Ethics. In: Edgar, A. / Salek, S. (eds.). Pharmaceutical Ethics. John Wiley & Sons, Ltd., Chichester

42 EDGAR, A. / SALEK, S. (2002). Preface. In: Edgar, A. / Salek, S. (eds.). Pharmaceutical Ethics. John Wiley & Sons, Ltd., Chichester

43 GAZDAR, K. (2005). Die Pharma-Branche: Lebensretter oder Abzocker. Thesenpapier zur Veranstaltung des Literaturhauses München, Literatur und Wirtschaft im Dialog, [http://literaturhaus.webteam.de/lithausData/dateien/pdf/thesenpapier\\_7.4.05.pdf](http://literaturhaus.webteam.de/lithausData/dateien/pdf/thesenpapier_7.4.05.pdf) (viewed 16/11/05)

solve the problem of fair access to medical supply (ibid.). Other initiatives try to underline “that the pharmacy profession would benefit from a list of ‘core values’”<sup>44</sup> and “that pharmacy is a ‘values-based’ as well as a knowledge-based profession”<sup>45</sup> with many ethical dilemmas occurring in the daily business. This is basically meant for pharmacies, but can also be transferred to the whole health sector and the pharmaceutical industry.

Another aspect to be considered is the research on new medicines and how it is conducted. In this context, questions such as: “Do companies have the responsibility to conduct research on products which are urgently needed but which won’t yield any return on investment?” or “Are drug tests on humans or animals legitimate and absolutely necessary?”<sup>46</sup>. Companies not engaging in research but producing generic drugs have to ask the question if it is justifiable to copy pharmaceuticals which other companies have developed by spending a lot of money and resources – even if the patent has expired and the reproduction is legally permitted.

According to Leisinger, the responsibility of pharmaceutical companies can be divided into three categories<sup>47</sup>. The must-dimension (German: “Muss”-Dimension) is not negotiable and means that the pharmaceutical industry shall provide goods and services, which satisfy existing customer needs, to competitive prices. Laws and regulations as well as human rights, workers rights and environmental protection have to be observed. The special task of pharmaceutical companies is to save lives or improve the quality of life of sick people – through research into and provision of medicines. But also those businesses have a right and a necessity to work profitably. The should-dimension (German: “Soll”-Dimension) includes measures which go beyond legal regulations but which are expected from the companies by the society. These measures are e.g. the avoidance of dubious practices, the payment of “living wages” instead of “minimum wages”, environmental protection in areas not regulated by law, the adjustment of pri-

44 BARBER, N. / CRIBB, A. (2000). Developing Pharma Values: Stimulating the Debate – A Discussion Paper. Royal Pharmaceutical Society of Great Britain, London. <http://www.rpsgb.org/pdfs/corval.pdf> (viewed 24/11/05), p. 7

45 BARBER, N. / CRIBB, A. (2000). Developing Pharma Values: Stimulating the Debate – A Discussion Paper. Royal Pharmaceutical Society of Great Britain, London. <http://www.rpsgb.org/pdfs/corval.pdf> (viewed 24/11/05), p.9

46 BOLTON, R. G. (2002). The Ethics of the Drug Discovery and Development Process. In: Edgar, A. / Salek, S. (eds.). Pharmaceutical Ethics. John Wiley & Sons, Ltd., Chichester

47 LEISINGER, K. M. (2003). Die soziale Verantwortung der pharmazeutischen Industrie: Idealismus ohne Illusion und Realismus ohne Resignation. In: Forum Wirtschaftsethik, 2/2003. Deutsches Netzwerk Wirtschaftsethik – EBEN Deutschland e.V., Zittau

ces to the flexible, specific needs and standards or the provision of drug donations in the case of acute emergencies. Voluntary measures of companies in the sense of corporate citizenship<sup>48</sup> or corporate philanthropy<sup>49</sup> go beyond compliance with laws and standards and are included in the can-dimension (German: “Kann”-Dimension). Examples for such activities are the offer of child care for employees, training free of charge, but also the sponsoring or realisation of humanitarian projects, the establishment of independent foundations or drug donations for sick people in developing nations. Leisinger furthermore argues that the pharmaceutical industry has to go beyond the must-dimension, because they are concerned with business regarding health – an area affecting life and death of people and because they have the outstanding possibility to work on the improvement of basic health of all people, especially in developing countries.

Werhane tries to summarize health care ethics in the style of Milton Friedman (1970):

*There is only one social responsibility of any healthcare organization: to use its professional and economic resources and engage in activities designed to treat and improve the health of its patient populations so long as it stays within the rules of the game*<sup>50</sup>.

The pharmaceutical industry is very sensitive to value issues, as it deals with health – maybe peoples’ most important personal asset. Thus, the standard of an ethics audit in pharmaceutical companies must be high and has to take into account the dilemma between profit-making and guaranteeing better health for everybody. Ethical guidelines have to consider those facts from the very beginning in order to provide the employees with guidance for decisions in dilemma situations. Value statements and other fundamental documents concerning ethics in the company serve as the basis for the ethics audit as the behaviour is measured against those.

## **betapharm Arzneimittel GmbH**

### **Company profile ([www.betapharm.com](http://www.betapharm.com))**

betapharm Arzneimittel GmbH was founded in Augsburg (Bavaria, Germany) in 1993. The generic pharmaceuticals company distributes a broad product portfolio of high-quality ge-

48 Here, corporate citizenship includes all voluntary social activities directly connected to the core business of the company.

49 In contrast to corporate citizenship, Leisinger defines corporate philanthropy as voluntary social actions lying beyond the field of activity of the company.

50 WERHANE, P. H. (2002). Business Ethics, Organization Ethics, and Systems Ethics for Health Care. In: Bowie, N. E. (2002, ed.). The Blackwell Guide to Business Ethics. Blackwell Publishers, Malden, p. 295

nerics<sup>51</sup> (unpatented medicines) at affordable prices. With around 150 active pharmaceutical ingredients, the medicines cover illnesses from the common cold to serious cardiovascular diseases. The main share of the products is prescription-only drugs, and only a small proportion is sold over-the-counter (OTC). The company is not engaged in the production itself, but works with subcontractors producing the pharmaceuticals and is solely occupied with sales and marketing. betapharm is certified according to DIN ISO 9001:2000 and runs several quality programmes.

The current managers are Dr. Wolfgang Niedermaier and Thomas Nedtwig. The company employs a workforce of more than 350 people, of which over 200 are in field service, supplying and consulting pharmacies and doctors. In 2005, betapharm achieved a gross turnover of EUR 186 million (INSIGHT Health, NationalePharmaInformation) which makes it number four of the generic pharmaceuticals companies in Germany with a current market share of 5.5%. The growth prospect is favourable (currently around 10%) and there are plans for extensive new product launches, the employment of new staff and the construction of a new office building to accommodate the new employees.

From 2004 to 2006, the company was owned by the US-based corporation 3i, a world leader in private equity and venture capital ([www.3i.com](http://www.3i.com)). 3i originally planned to keep betapharm for four to five years, but sold it due to betapharm's good development ahead of schedule in February 2006 to the Indian pharmaceutical company Dr. Reddy's.

betapharm's main competitors in the German generics market are the three big generic pharmaceutical companies Sandoz/Hexal, Ratiopharm and Stada, who divide approximately half of the turnover of the German generics market among them. The whole market comprises approximately 50-60 more or less small companies some providing a wide range of products and others focussing on special segments of the pharmaceuticals market. In the total ranking of pharmaceutical companies (originators and generics), betapharm holds

51 "A generic drug is a drug which is bioequivalent to a brand name drug (...), but is normally sold for a lower price. Generic medicines must contain the same active ingredient at the same strength as the 'innovator' brand (...), therefore, generics are identical in dose, strength, route of administration, safety, efficacy, and intended use. The principal reason for the reduced cost of generic medicines is that these are manufactured by smaller pharmaceutical companies which do not invest in research and development into new drugs. (...) Generics can be legally produced for drugs where: 1) the patent has expired [in Germany, usually after 20 years, A.N.], 2) the generic company certifies the brand companies patents are either invalid, unenforceable or will not be infringed, 3) for drugs which have never held patents, or 4) in countries where a patent(s) is/are not in force. (...) About half of the current drugs have a generic equivalent." ([www.wiseinfo.info](http://www.wiseinfo.info))

the 30th place.

### **A company built on corporate citizenship<sup>52</sup>**

A statement from the betapharm website summarizes the spirit in which the company acts:

*betapharm's commitment is rooted in the company philosophy: 'People first', setting the tone for open and socially responsible treatment of employees and customers right from the beginning. In addition, it also forces us to make sure that our marketing conforms to ethical standards. ([www.betapharm.com](http://www.betapharm.com)).*

At the end of the 1990s, betapharm was in a slight crisis as the low price strategy no longer worked out. The CEO Peter Walter, who had been building up the company since 1993, was looking for a way out of this crisis and wanted to give meaning to the company and thus established co-operation with the "Bunter Kreis", a parents' action group for children with cancer and their families at the clinic Augsburg. betapharm's following engagement can be illustrated by the model of the forms of corporate citizenship developed by Prof. Dr. Habisch shown below in Illustration 2.

Sponsor: Classical sponsoring marked the beginning when betapharm gave five pfennig of every drug box sold to the Bunter Kreis, which motivated salesclerks and inspired customers and thus made the turnover rocket upwards. betapharm's ethical fundamental conviction "People first" was reflected in the engagement and was perceived as the unique selling proposition of the company in a market with exchangeable products concerning substances of content, quality and price.

Partner: Following the sponsoring activity, betapharm became a real partner of the Bunter Kreis. betapharm and the Bunter Kreis jointly initiated other action groups according to the model of the Bunter Kreis throughout Germany. The betapharm Nachsorgestiftung (foundation for aftercare) was established in 1998 and since 1999, betapharm and the Bunter Kreis have been organising the biennial Augsburger Nachsorgesymposium (symposium for aftercare).

Citizen: In a third step, betapharm developed to a real corporate citizen by tackling the problem of the social gap in the health system. betapharm initiates and supports innovative social projects in the health system, which promote to cope holistically with illnesses. In order to avoid a conflict of interests, the "beta Institut" for socio-medical research and development was established to provide education and training of employees in the health sector, consulting for aftercare or

52 WILLENBROCK, H. (2004). Profit mit Non-Profit. In: Brand Eins, 10/2004. Brand Eins Verlag, Hamburg

organisations and the information service "betaCare" with the "betafon", "betaliste" and "betanet" – all designed to provide assistance in socio-medical questions for doctors, pharmacists and patients.

Figure 1 shows Forms of Corporate Citizenship (Centre for Corporate Citizenship, 2002, quoted in Habisch 2003 – translation T.B.)

Without thinking too much about strategy, betapharm has found a way to be a good corporate citizen by engaging in a field which fits thematically to the business. This enables to build a real win-win situation and makes the engagement highly plausible to both employees and customers (www.betapharm.de). While the beginning was marked by the fact that betapharm simply followed the self-imposed duty to social responsibility, the commitment was strategically planned and professionalized later<sup>53</sup>, resulting in several honours such as the first prize in the competition "Freiheit und Verantwortung" of the leading trade associations in Germany in 2002 or the seal of quality "Ethics in Business 2005" for the sustainable social commitment in the health sector.

betapharm has developed "10 Guidelines for successful Corporate Citizenship" (the so-called "Golden Rules") with which it wants to help other companies to establish a form of corporate citizenship that really makes sense (www.betapharm.de).

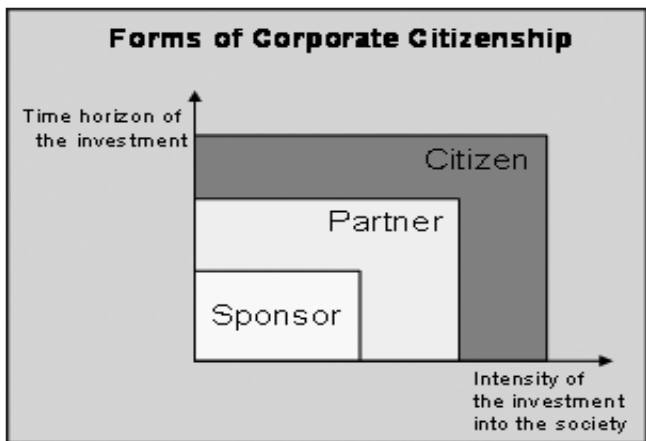


Figure 1

On the corporate website, it is also stated what social commitment should mean to employees:

Within the company, social responsibility means: high personal responsibility of the employees, development opportunities according to the respective capabilities, a working atmosphere stimulating communication, in short: a corpo-

53 ANON (2005). beta Institut – Jahresbericht 2004. beta Institutsverlag, Augsburg, p. 57

rate culture which appreciates the individual. (www.betapharm.de).

### Basics for the betapharm ethics audit

#### Ethical guidelines of betapharm

Since February 2001, betapharm has given itself a vision (see figure 3).

To guarantee that the vision is widely known throughout the whole company, it is placed on the kitchen desk on every floor, on the general company server and as well shown on the corporate website. There is currently a discussion about the betapharm vision in order to adapt it to the changes happening in the company, especially on the organisational level as the company plans to enlarge its workforce extensively and also build a new building to accommodate the new employees. The new vision will be based on the vision statement of 2001, but it will be a vision for the whole beta group comprising betapharm and the beta Institut, and focus more on the concept of holistic healthcare. The senior management has already approved the draft of the new vision. In a workshop with formal and informal leaders within the company, the draft will be discussed and strategies for the communication and implementation, which is expected for spring 2006, will be worked out.

#### *The Betapharm Vision*

*At Betapharm we aim to make everyone feel part of the community and give everyone a sense of purpose in a happy working climate. We are open with one another, we are reliable working together in a spirit of partnership – both within the company and with our customers.*

*Social responsibility is something we take seriously. This is why we are concerned about psychosocial issues in the health sector and actively promote socio medical projects for a better future.*

*On the basis of our economic success we continue to develop our values in this we put our trust in our employees' creativity, high performance and sense of personal responsibility.*

*Our aim is success through trust.*

Figure 2 Our philosophy / our vision (www.betapharm.com)



## The betapharm atmosphere

betapharm is a company which puts the human being first in all decisions. Employee empowerment is very important for the company culture. There are many activities to create a feeling of shared identity e.g. a day out skiing in the Alps, a sumptuous Christmas party or a weekly badminton evenings. Every Friday, the managing director sends out an e-mail to all employees with a short summary of the major events of the week in order to keep the employees informed. All the brochures betapharm issues are distributed to all employees. The works council plays an active role – it is present in the company and the members are known to everybody because they communicate to all employees e.g. by being represented in plenary assemblies, by conducting regular staff satisfaction surveys, but also by distributing Christmas cards to them. They take part in important decisions such as the current development of a new company value statement and business principles.

An ethics audit can only work if as many employees as possible participate in the process. Consequently, it is of vital importance to integrate all employees into the ethics audit. The two different groups of employees at betapharm have to be taken into account: Two thirds work in the field service visiting pharmacies and physicians all over Germany and one third works in the office in Augsburg. As the employees are accustomed to participating actively in the events in the business and to talk about values, it will not be very difficult to motivate them to fill out questionnaires or to answer to questions in an interview. Nevertheless, sufficient communication has to be assured in order to make the ethics audit a priority topic which is taken seriously. The employees have a right to know why the audit helps the company.

The betapharm atmosphere is favourable for ethical behaviour – people act within a culture of trust which is based on respect for people. However, there are inconsistencies within the company. Some employees claim that betapharm focuses too much on CC to the outside whereas the atmosphere inside the company is not in line with the outside commitment. The points of critique are a lack of efficient and transparent internal communication and the absence of clear behaviour guidelines. Some personal disagreements and the uneasy atmosphere in the open-plan offices sometimes make working life of the employees difficult. There is the fear that the former excellent “betapharm-spirit” will be lost over time. 3i has not interfered much in the decisions and betapharm could follow its strategy of corporate citizenship. After the sale to Dr. Reddy’s, the employees are worried because the further strategy is not known. Nevertheless, a favourable develop-

ment can be expected as Dr. Reddy’s is a company which has itself a high commitment to CSR-activities.

## Aspects to consider for an ethics audit at betapharm

As betapharm is a medium-sized company and not a global player, the employees know each other quite well. There are no departments, but the company is structured into teams according to the different tasks (e.g. corporate communications, customer service, product management, betaCare). Also the different teams work together very closely. Thus, the company lacks anonymity – an aspect which has to be taken into account in the ethics audit. Employees must have the possibility to state their opinion and ideas freely and anonymously. Thus, it might be better to let an external person take care of conducting the audit. It is crucial to take some preventive measures in order to avoid that the employees consider the audit as a type of control system, but understand it as an auxiliary means in the implementation of ethics for the company and for themselves.

Additionally, the aspects of the pharmaceutical industry also apply for betapharm – except that betapharm is not researching into medicines. betapharm’s ethics have already been audited in the framework of the contests “Freiheit und Verantwortung” and “Ethics in Business”<sup>54</sup>. These initiatives have examined indicators such as environmental management, the diversity within the company, social aspects or adequate remuneration of the employees – all aspects which can be put into numbers. The questionnaires for the two initiatives have been completed almost only by one person from the responsible team, and did not include interviews with or statements from single employees. Nevertheless, the results from the two evaluations show how the company fulfils its ethical obligations and fills the value statement with life.

Furthermore, the workers’ council already conducts an annual survey into the employee satisfaction and the well-being of the individual in the company. Close to 100% of the staff actively participated in the survey, thus the results are representative for the business. In recent years, the employee satisfaction as evaluated by the questionnaires was around the excellent value of 98%.

An ethics audit for betapharm can incorporate the results of the initiatives “Freiheit und Verantwortung” and “Ethics in Business” as well as of the employee survey as a basis and only audit the specifically ethical component, which has not been asked in the questionnaire of the workers’ council. The

<sup>54</sup> ANON (2005). beta Institut – Jahresbericht 2004. beta Institutsverlag, Augsburg, chapter 6.3

ethics audit specifically focuses on the values and the behaviour of the single employee. But the evaluation after the audit takes into account the results of all the three components. In that way, already existing results can be used and time and financial resources can be saved.

### **The suitability of current ethics audit approaches for betapharm**

Before designing an ethics audit for betapharm, it has to be examined which elements of existing approaches can provide a basis to start from.

The online ethics audit is simply too superficial to effectively provide help for a company as advanced in managing with values as betapharm currently is. This type of audit can only serve as a first measure for businesses who want to start to consider values actively in the company.

The EthikAuditSystem by Josef Wieland is too theoretical for betapharm. As this is a quite sophisticated and accepted system, which is also quite expensive, it is more suitable for larger companies. Furthermore, the approach of the EAS is too compliance-oriented as the company culture of betapharm focuses more on the integrity of the individual.

betapharm could follow certain elements of the general ethics audit approach described by Muel Kaptein. Especially helpful is the "ethics thermometer" – a questionnaire among employees. Some questions may be adapted from the company test of the Stiftung Warentest and imug. From his approach, also the longitudinal BESS web plot is a useful tool which betapharm can use for consecutive (e.g. annual) ethics audits in order to monitor the developments of the results. It might be possible to take some of the audit questions of Rosthorn's concept, but as betapharm has no explicit code of ethics, but rather a value statement, it will be difficult to identify the control objectives for the code of conduct ethics. It also seems that Rosthorn's audit is more appropriate for larger companies, as it is a quite extensive and time-consuming procedure. Thus, the betapharm ethics audit cannot be a direct copy of one of the above-mentioned approaches, but a mixture of elements from the different concepts in order to allow for betapharm's needs.

### **The betapharm ethics audit**

#### **Time frame and responsibility**

As the new company vision is still under discussion, it would be best to wait with the ethics audit until the vision has been approved, communicated and consolidated. The consolidation can be expected after approximately one year, thus the

first ethics audit could start in spring 2007. Furthermore after the sale of betapharm in February 2006, it is not clear if this will entrain huge changes in the company culture. Rumours influenced the atmosphere in a company and confounded the implementation of the company values. It has to be seen how the strategy and vision change due to the sale to Dr. Reddy's. As described above, the basic decision is between conducting the ethics audit internally or with the help of an external agency. The main responsibility within the company has to be with the senior management in order to make the importance of the topic obvious. Furthermore, an ethics audit can only work if the senior management makes the audit a priority issue. The responsibility for the implementation is within the team of Corporate Communications as they take care of the company's social responsibility. betapharm has already acquired a certain level of competence in the auditing process by conducting yearly quality audits at Salutas, the main manufacturing subcontractor. Nevertheless, auditing values and behaviour of people is so delicate that it would be best to seek advice from an external management consultant. An external auditor has an unprejudiced view of the company's state of ethics from the outside. betapharm has experience in working together with external consultants in the field of ethics. If the implementation responsibility rests with the team of Corporate Communication, the company can keep control of the audit and can influence how it is conducted.

### **General approach and procedure**

The major aim of the betapharm ethics audit is to detect discrepancies between the company's value statement and the internal implementation i.e. the ethical reality at betapharm. In a second step, those discrepancies should be improved. Within this evaluation, the interpersonal component is in closer focus at betapharm. Interpersonal aspects such as the integrity, loyalty, responsibility and reliability of the employees play an important role in the betapharm company culture. They deserve a special focus in the ethics audit, because the employees and the co-operation among them is the key company asset. The team spirit and the mutual respect should be examined and enhanced.

Furthermore, the interrelations between betapharm and its partners (especially to suppliers and clients) are a topic which has to be addressed in more detail in the future. One audit cannot fulfil both of these aims – thus, this paper will concentrate on the interpersonal aspect. The stakeholder relations may be addressed in a second step in a separate audit which

also includes other stakeholders. A stakeholder dialogue has already taken place recently which has shown that the relations to other stakeholders are favourable, but which can also serve as the basis for the improvement in that field.

The betapharm ethics audit will be executed with three elements: a questionnaire addressed to all the employees as well as interviews and workshops for smaller groups of people. The workshops will be the framework of the audit and constitute the preparation phase as well as the wrap-up. The audit starts with a first round of three small workshops moderated by an ethics consultant. Then, a questionnaire is distributed to the employees, who have approximately ten days to fill it out anonymously and return it. It covers elements like company and personal values, the knowledge and acceptance of the company vision, decision-making processes, the perception of equal opportunities, the relationship with team leaders and senior staff, general satisfaction, and suggestions for improvement. The answers to the questionnaire are evaluated by the ethics consultant with the assistance of the team of corporate communications. As employee questionnaires are used frequently in the company, a response rate close to 100% is expected. Additional interviews with executives and team members supplement the questionnaire. They serve to provide deeper information in addition to the questionnaire. Employees have the chance to speak freely about their ethical concerns. The results of the questionnaires and the interviews are then discussed in workshops in order to find ways how to improve the weak points. This round of workshops can serve to jointly develop a company value pyramid, and to discuss discrepancies which emerged from the questionnaire feedback. The results of the audit can be published in the employee journal "betanews" which is issued approximately every three months. The general positive and negative results have to be communicated, if the audit aims at an improvement process. Another possibility might be the organisation of an ethics hotline where employees can call and get help when they encounter dilemma situations in the company which they want to discuss in private.

At betapharm, the importance of ethics for a company is taken seriously. Thus, it will not suffice to conduct an ethics audit just once. Especially for a company like betapharm which is strongly based on values and which is in a constant process of change (enlargement, change of owner etc.), a continuous monitoring of the implementation of the company values is indispensable. For the assessment of the results, it will be helpful to adopt the concept of the longitudinal "BESS" web plots in order to visualise and compare the results of consecutive years.

## Recommendations and expected results

As mentioned above, betapharm is currently in a period of transition concerning the company vision. Furthermore, the situation of the company is somewhat uncertain because of the new owner and the doubt of the further development. This also leads to a process of changing values, thus the ethics audit can provide a way to assist in the evaluation if the change has been successful. The results are expected to be rather favourable for betapharm. The impression that people like to work at betapharm and feel accepted by their colleagues is felt throughout the company, and it is also shown by the good results of the employee satisfaction surveys. In addition, the company vision is widely known among employees and they implement it rather automatically in their daily working routine. Nevertheless, there are some problems in the company culture which could be revealed through the ethics audit. The communication flow is sometimes not good enough which leads to dissatisfaction in the affected teams, especially in lower positions. A solution might be to define a clear communication strategy in which is recorded who gives the information on to whom.

The audit might also result in a revelation of the desire for clearer behaviour guidelines. At the moment, the betapharm culture is based on trust and autonomy. But as the world grows more complicated every day, it becomes more difficult to decide in morally difficult situations. Therefore, guidelines for behaviour might offer a help and provide moral backing for them. When developing them, it is essential to involve the employees in the development phase to avoid that it is perceived as an authoritarian measure to limit the independence of the employees. The answers to some questions of the questionnaire can serve as a basis for the development of these guidelines.

One result of the ethics audit will definitely be the heightened awareness of the values of the company. It is always beneficial to bring values into the focus and to think about ways how to implement values into the daily working routine. The employees will profit from this process, because it will be made easier for them to cope with dilemma situations. They will also feel that their values and feelings are taken seriously and thus identify themselves still more with the company.

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## SPIRITUALITY IN BUSINESS

Valeriya Krasteva

**Abstract.** Spirituality in Business - this is an open name, not focusing on a single religion, single spiritual path, and single truth. It is an attempt to reflect in the best way the reality nowadays and the need for tolerance and mutual respect since the multicultural society cannot afford to propagate narrow beliefs, not considering those of the whole; running down the other's faiths. At the same time, the striving towards a higher consciousness is a natural force in man. That is why; the purpose of this article is to introduce the field of spirituality as a whole, offering a mixture of different spiritual practices applicable in the office. Furthermore, the business environment will be discussed and the many positive aspects spirituality can do for the working individual, the manager, the leader, the company will be outlined. All these will be supported by real-life examples. Some attention will be turned to the ultimate intelligence – the spiritual intelligence, associated with excellent leadership. In addition, a successful style of leadership will be discussed guaranteeing the balance between business and nature; providing the possibility for personal development. The central question will be whether spirituality and business are able to co-exist and, if yes, is such co-existence realistic and practical?

**JEL Classification A13, G34, M14**

### Spirituality vs. religion

Spirituality includes a wide range of human experience and takes on many expressions - from the rain dances of Native Americans through the celebratory dances of Hasidic Jews and the whirling dervishes of Islam to the meditating monks of Zen Buddhism.<sup>1</sup> Thus, there is no one, clear comprehensive definition of spirituality in the literature.<sup>2</sup> The aim of spirituality is to bring about compassion and its effect - good physical and mental health.<sup>3</sup> It is the cultivation of a personal relationship with the sacred<sup>4</sup> and implies that there is a deeper

1 Article Elkinsh, D.; 1999; Psychology Today; Spirituality; [http://www.findarticles.com/p/articles/mi\\_m1175/is\\_5\\_32/ai\\_55625500/pg\\_1](http://www.findarticles.com/p/articles/mi_m1175/is_5_32/ai_55625500/pg_1) (viewed on 24.04.07)

2 Testerman, J.; 1997; Spirituality vs. Religion: Implications for Healthcare; [http://www.aiias.edu/ict/vol\\_19/19cc\\_283-297.pdf](http://www.aiias.edu/ict/vol_19/19cc_283-297.pdf) (viewed on 15.02.07)

3 Article [http://www.findarticles.com/p/articles/mi\\_m1058/is\\_19\\_122/ai\\_n15631804](http://www.findarticles.com/p/articles/mi_m1058/is_19_122/ai_n15631804)

4 Tacey, D.; 2002; The Rising Interest in Spirituality Today; <http://www.austheos.org.au/topics/tacey-website.html.htm> (viewed on 24.03.07)

dimension to human life, an inner world of the soul. It assumes that humans are fundamentally spiritual beings living in a spiritual, as well as physical universe. It is seeing and living far beyond the material world to deeper truths and eternal values; beyond person's own ego and intellect. Spirituality has to do with a sense of connectedness and interrelatedness of all; with the search for meaning and purpose in life.<sup>5</sup>

Like "spirituality" the term „religion“ has also multiple definitions.<sup>6</sup> As a whole, it is seen as a set of dogmas, sacred books, practices, worship, sacrament, moral prescriptions, that define the relations between the human being and the sacred and normally begins from a revelation of a prophet or a wise man.<sup>7</sup>

As a result, "spiritual" does not mean the same as "religious". Spirituality is an inner, personal experience to search, encounter and reply to God; universal and without boundaries. Religion, however, is communal, particular and defined by boundaries. It is spirituality incarnated at the social and cultural level.<sup>8</sup> For some people, their spirituality is found through organized religion, but for others their spirituality is a more personal affair.<sup>9</sup> In other words, if spirituality is the journey, then a religious tradition functions as a map of the territory, containing in its beliefs and symbols the accumulated wisdom of those who have travelled the way. However, it is possible to spend all one's time mapmaking and never take the journey, or one may try to undertake the journey on one's own, and risk getting lost.<sup>10</sup>

### Effects of applying spirituality

It is worth mentioning that there is a connection between the health of a person and his/her spirituality. This knowledge is also valuable for the business, because it shows a way to an increased efficiency. With Harvard University - pioneer in the field of spirituality and mental health, more than 200 medical studies have demonstrated the effects of mental attitudes on health<sup>11</sup> showing positive effects of spirituality to:

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- org.au/topics/tacey-website.html.htm (viewed on 24.03.07)
- 5 Testerman, J.; 1997; Spirituality vs. Religion: Implications for Healthcare; [http://www.aiias.edu/ict/vol\\_19/19cc\\_283-297.pdf](http://www.aiias.edu/ict/vol_19/19cc_283-297.pdf) (viewed on 15.02.07)
- 6 Testerman, J.; 1997; Spirituality vs. Religion: Implications for Healthcare; [http://www.aiias.edu/ict/vol\\_19/19cc\\_283-297.pdf](http://www.aiias.edu/ict/vol_19/19cc_283-297.pdf) (viewed on 15.02.07)
- 7 What is Religion; <http://atheisme.free.fr/Religion/What-is-religion-1.htm> (viewed on 26.04.07)
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- 9 László Zsolnai; 2001; Spirituality in Management; <http://ethics.bkae.hu/html/documents/Spir-abstr.pdf> (viewed on 19.12.06)
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- 11 Testerman, J.; 1997; Spirituality vs. Religion: Implications for Healthcare; [http://www.aiias.edu/ict/vol\\_19/19cc\\_283-297.pdf](http://www.aiias.edu/ict/vol_19/19cc_283-297.pdf) (viewed on 15.02.07)

- Linder stress over finances, health and other daily concerns<sup>12</sup>
- Lower blood pressure<sup>13</sup>
- Lower mortality rate<sup>14</sup>
- Improve lifestyle: low suicide rates, less alcohol and drug abuse, less criminal behaviour, fewer divorces and higher marital satisfaction.<sup>15</sup>

Furthermore, there is a rising body of evidence that spirituality may provide a positive influence on business outcomes.<sup>16</sup>

The following studies are outlining this:

- Lloyd found that organizations high in workplace spirituality out perform those without it by 86%. A link has also been established between workplace spirituality and individual creativity. Another survey found that organizations high in workplace spirituality grow faster, increase efficiencies, and produce higher rates of return on investments.<sup>17</sup>
- There was a study by Toney & Oster of 200 CEOs in which those using religious principles in daily decision-making had more successful companies than those that did not.<sup>18</sup>
- Influential longitudinal research by Collins and Porras in 1997 on 18 visionary companies (emphasizing non-economic beliefs and an empowering culture) that had been leaders in their industries for 50 years showed that their success was due to focusing on non-economic values and an empowering culture. They actually outperformed their competitors by as much as 16:1.<sup>19</sup>
- According to a study at Harvard Business School published in *The Harvard Business Review*, business owners credit 80% of their success to acting on their intuition.<sup>20</sup>

12 Elkinsh, D.; 1999; Psychology Today; Spirituality; [http://www.findarticles.com/p/articles/mi\\_m1175/is\\_5\\_32/ai\\_55625500/pg\\_1](http://www.findarticles.com/p/articles/mi_m1175/is_5_32/ai_55625500/pg_1) (viewed on 24.04.07)

13 Elkinsh, D.; 1999; Psychology Today; Spirituality; [http://www.findarticles.com/p/articles/mi\\_m1175/is\\_5\\_32/ai\\_55625500/pg\\_1](http://www.findarticles.com/p/articles/mi_m1175/is_5_32/ai_55625500/pg_1) (viewed on 24.04.07)

14 Elkinsh, D.; 1999; Psychology Today; Spirituality; [http://www.findarticles.com/p/articles/mi\\_m1175/is\\_5\\_32/ai\\_55625500/pg\\_1](http://www.findarticles.com/p/articles/mi_m1175/is_5_32/ai_55625500/pg_1) (viewed on 24.04.07)

15 Elkinsh, D.; 1999; Psychology Today; Spirituality; [http://www.findarticles.com/p/articles/mi\\_m1175/is\\_5\\_32/ai\\_55625500/pg\\_1](http://www.findarticles.com/p/articles/mi_m1175/is_5_32/ai_55625500/pg_1) (viewed on 24.04.07)

16 Pielstick, D.; 2003; Authentic Leading: Where the Blue Sky Hits the Road; Spirituality in Business; <http://www.cba.nau.edu/pielstick-d/Leadership/Spirituality%20in%20Business.html> (viewed on 14.11.06)

17 Moore-Davis, F.; 2007; Cy-Fair College; Spirituality and Leadership: Can They Coexist?; [http://www.mc.maricopa.edu/community/chair/conference/2007/papers/spirituality\\_and\\_leadership.pdf](http://www.mc.maricopa.edu/community/chair/conference/2007/papers/spirituality_and_leadership.pdf) (viewed on 04.05.07)

18 Pielstick, D.; 2003; Authentic Leading: Where the Blue Sky Hits the Road; Spirituality in Business; <http://www.cba.nau.edu/pielstick-d/Leadership/Spirituality%20in%20Business.html> (viewed on 14.11.06)

19 James, R.; 2004; Reflections on Current Thinking on Spirituality in Organizations; [http://www.missioncouncil.se/download/18.5b4c3f30107c27e2cd580009779/04\\_1\\_reflections.pdf](http://www.missioncouncil.se/download/18.5b4c3f30107c27e2cd580009779/04_1_reflections.pdf) (viewed on 02.05.07)

20 McLaughlin, C.; 2004; The Centre for Visionary Leadership (Helping People Develop the Inner, Spiritual Resources to be Effective Leaders); Spiritu-

evidence suggests spirituality may impact organizational effectiveness. There appears to be a high correlation between spiritual well being and organizational openness, self-efficacy and organizational commitment. People increasingly want to bring a greater sense of meaning and purpose into their work life. They want their work to reflect their personal mission in life.<sup>21</sup> A workplace high in spirituality gives this possibility.

### Challenging the global business system

Applying spirituality in business can help overcoming the flaws of the global business world nowadays; flaws such as the materialism, the consumerism, the progress paradox, the depersonalisation of the person in society, or the generational ecological tyranny. Bringing spirituality into business provides the opportunity for improvement as it grants the business a heart and shifts its attention in the direction of the triple bottom line - people, planet, profit.

### Materialism

*People are disturbed not by things but by the view they take of them.*

*Epictetus, c 200 AD<sup>22</sup>*

The primary motivation of the global free enterprise and the modern business system is to create wealth for individuals and corporations. A distortion occurs when money, material goods, and economic status become the primary measures of personal worth, and when shareholder profits are seen as the exclusive aim of managerial attention. When managers within the economic system consider employees only as instruments of production, individual employees also tend to focus only on their "market value."<sup>23</sup> So, business decisions are made solely on the basis of profit. Material possessions thereby become the highest value. Everything else—one's personal relationships and health, the well being of other people, and the environment—is subordinated to materialism. Success is generally correlated with income and wealth in the business world.<sup>24</sup>

ality and Ethics in Business; <http://www.visionarylead.org/articles/spbus.htm> (viewed on 23.04.07)

21 McLaughlin, C.; 1999; Spirituality in Business; [http://www.everymanedict.com/e10a\\_corporate-spirituality.htm](http://www.everymanedict.com/e10a_corporate-spirituality.htm) (viewed on 27.02.07)

22 <http://www.people.ubr.com/authors/by-first-name/a/anatole-france/anatole-france-quotes/i-thank-fate-for.aspx> (viewed on 30.05.07)

23 Delbecq; A.; 2001; Bridging the Gap Between Spirituality and Business [http://www.syflow.de/Ressourcen/Hintergr/Gute\\_Wirtschaft/so/Bridging\\_Gap.pdf](http://www.syflow.de/Ressourcen/Hintergr/Gute_Wirtschaft/so/Bridging_Gap.pdf) (viewed on 16.02.07)

24 Delbecq; A.; 2001; Bridging the Gap Between Spirituality and Business [http://www.syflow.de/Ressourcen/Hintergr/Gute\\_Wirtschaft/so/Bridging\\_Gap.pdf](http://www.syflow.de/Ressourcen/Hintergr/Gute_Wirtschaft/so/Bridging_Gap.pdf) (viewed on 16.02.07)



## Consumerism

*There is enough for everybody's need,  
but not enough for everybody's greed.*

*Mahatma Gandhi*<sup>25</sup>

In economics, consumerism refers to economic policies that place an emphasis on consumption, and that the free choice of consumers should dictate the economic structure of a society.<sup>26</sup> In many critical contexts however, consumerism is used to describe the tendency of people to identify strongly with products or services they consume, especially those with commercial brand names and obvious status-enhancing appeal. Little attention is paid to the true need, durability, product origin or the environmental consequences of manufacture and disposal.<sup>27</sup>

Approximately 1.7 billion people worldwide now belong to the „consumer class“—the group of people characterized by diets of highly processed food, desire for bigger houses, more and bigger cars, higher levels of debt, and lifestyles devoted to the accumulation of non-essential goods. Americans and Western Europeans have had a lock on unsustainable over-consumption for decades but now developing countries (India, China) are catching up rapidly, to the detriment of the environment, health, and happiness, according to the Worldwatch Institute in its annual report, State of the World 2004. The same report says that the rising consumption has helped meet basic needs and create jobs, but as people enter a new century, this unprecedented consumer appetite is undermining the natural systems everyone depends on, and making it even harder for the world's poor to meet their basic needs.<sup>28</sup>

## The progress paradox

*Why are you so unhappy?  
Why are we so unhappy?  
Because everything you do  
and 99 percent of what you think  
is for yourself.*

*Wu Wei, 12th Century*<sup>29</sup>

The citizens of the developed nations consume more products,

25 Hill, J.; Badiner, A.; 2002; Mindfulness in the Marketplace: Compassionate Responses to Consumerism; Parallax Press; p.1

26 Wikipedia the Free Encyclopaedia; Consumerism; <http://en.wikipedia.org/wiki/Consumerism> (viewed on 29.03.07)

27 Chomsky, N.; Manufacturing Consent; Why Overcoming Consumerism? <http://www.verdant.net/society.htm> (viewed on 28.03.07)

28 Article Mayell, H.; 2004; National Geographic News; As Consumerism Spreads, Earth Suffers; [http://news.nationalgeographic.com/news/2004/01/0111\\_040112\\_consumerism.html](http://news.nationalgeographic.com/news/2004/01/0111_040112_consumerism.html) (viewed on 29.03.07)

29 Senge, P.; 2004; Excerpt; Spirituality in Business and Life: Asking the Right Questions

live in bigger houses, and use more consumer durables than those of the rest of the world. They have a higher material standard of living. However, family breakdown, stress, loneliness and depression are much higher in the developed countries. This is both a result of and a cause of increased economic activity.<sup>30</sup> The paradox is that the increase in prosperity is not making humans happier or healthier. Findings from a survey of life satisfaction in more than 65 countries indicate that income and happiness tend to track well until about \$13,000 of annual income per person (in 1995 dollars). After that, additional income appears to produce only modest increments in self-reported happiness.<sup>31</sup>

## Depersonalization

*The essence is always invisible, always behind the rainbow  
on the horizon  
- the front line of the life.*

*Slchlomo Schafir*<sup>32</sup>

National and global firms encourage managers to gain experience in a variety of cities and countries, and seek skilled knowledge workers from all over the world to join their economic endeavours. However, frequent moves for economic opportunity and patterns of economic migration separate the mobile family from relatives and friends. Because of the time pressures of work and often long commutes, there is insufficient time to develop new close friendships either at work or outside. Together labour and managerial mobility fosters the attitude that people are merely parts of an impersonal system, parts that can be moved about or discarded with consideration only for the bottom line. Such a business „system mentality“ does not focus respect for the dignity and value of each person.<sup>33</sup>

30 Consumerism & Altruism; Re-Establishing Altruism As A Viable Social Norm; <http://www.altruists.org/ideas/society/consumerism/> (viewed on 29.03.07)

31 Article Mayell, H.; 2004; National Geographic News; As Consumerism Spreads, Earth Suffers; [http://news.nationalgeographic.com/news/2004/01/0111\\_040112\\_consumerism.html](http://news.nationalgeographic.com/news/2004/01/0111_040112_consumerism.html) (viewed on 29.03.07)

32 Schafir, S.; Schmetterlinge; Original text: Das Wesen ist immer unsichtbar, immer hinter dem Regenbogen am Horizont – / der Frontlinie des Lebens. (Translation – Valeriya Krasteva)

33 Delbecq; A.; 2001; Bridging the Gap Between Spirituality and Business [http://www.syflow.de/Ressourcen/Hintergr/Gute\\_Wirtschaft/so/Bridging\\_Gap.pdf](http://www.syflow.de/Ressourcen/Hintergr/Gute_Wirtschaft/so/Bridging_Gap.pdf) (viewed on 16.02.07)

## Generational ecological tyranny

*We do not inherit the Earth from our Ancestors;  
we borrow it from our Children.*

*Ancient Indian Proverb<sup>34</sup>*

Generational ecological tyranny is the destroying of the planet without the consent of the unborn grandchildren who will have to live and survive in the conditions of serious ecological problems.<sup>35</sup> Even regions, not directly threatened by the climate change will face significant challenges due to the waves of people leaving their homes in the crisis regions. The pop-it-drink-it-and-throw-it-away mentality, often termed “consumerism” has become a universal phenomenon in the Industrialized World<sup>36</sup> and the documentary film of the ex-vice president of USA Al Gore, *The Inconvenient Truth*, outlines the grave legacy the coming generations will have to bear.

## Spiritual Intelligence – the ultimate intelligence

Spiritual Intelligence (SI) is the ability to act with wisdom and compassion while maintaining inner and outer peace (equanimity), regardless of the circumstances. It is the intelligence that can address and solve problems of meaning and value. It is an innate human intelligence – but like any intelligence it can be developed.<sup>37</sup>

Those who have Spiritual Intelligence: have the capacity for transcendence; have heightened consciousness; have the capacity to endow everyday activity with a sense of the sacred; use spiritual resources on practical problems; engage in virtuous behaviour (forgiveness, gratitude, humility, compassion and wisdom). The characteristics of Spiritual Intelligence are: awareness of others; wisdom; ability to listen; commitment; faith; a sense of being a player in a large whole; generosity of spirit and action; a seeking of being “in tune” with nature, and being comfortable with being alone without being lonely.<sup>38</sup>

As shown in Figure 1 in the simple model of the multiple intelligences<sup>39</sup>, the Spiritual Intelligence is in the top. Physical Intelligence (PQ) is the simplest intelligence (example: intelligence needed for the baby to learn crawling). IQ is the logical and verbal intelligence – which is the focus of the edu-

34 <http://www.indigenouspeople.net/quotes.htm> (viewed on 22.03.07)

35 Article LaSalle, M.; 2004; San Francisco Chronicle; *The Corporation*; <http://www.sfgate.com/cgi-bin/article.cgi?file=/chronicle/reviews/movies/CORPORATION.DTL&type=movies> (viewed on 26.03.07)

36 Bjornnes, R.; 2003; *Consuming the Planet: Is There a Way Out?*; <http://www.proutworld.org/features/consum.htm> (viewed on 28.03.07)

37 Spiritual Intelligence; 2005; <http://www.consciouspursuits.com/spiritual/default.asp> (viewed on 12.01.07)

38 Mindwise; 2004; *Spiritual Intelligence*; [http://www.mindwise.com.au/spiritual\\_intelligence.shtml](http://www.mindwise.com.au/spiritual_intelligence.shtml) (viewed on 12.01.07)

39 Spiritual Intelligence; 2005; <http://www.consciouspursuits.com/spiritual/default.asp> (viewed on 12.01.07)

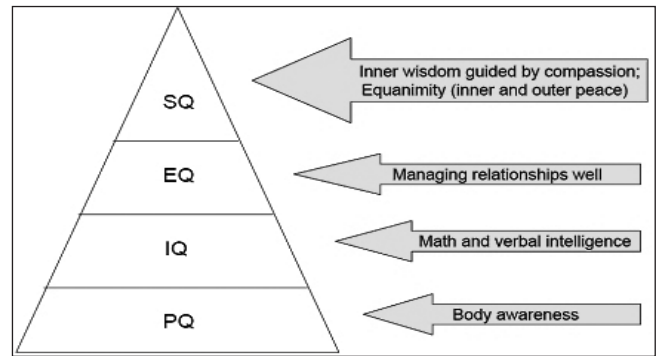


Figure 1 A Simple Model of Multiple Intelligences

cational system. The Emotional Intelligence (EQ) describes an ability to perceive, assess, and manage the emotions of one’s self, of others, and of groups. EQ has been found to be more predictive of success in the business world than IQ (IQ appears to only act as a “gateway to entry”).<sup>40</sup> The Spiritual Intelligence makes out the good leader.

The development of SQ not only benefits individuals, it also benefits their families, communities, and the companies they work for. An individual and group SQ growth leads to creating more meaningful work, improved products and services, and ensuring responsible corporate behaviour.<sup>41</sup>

## Selected spiritual practices and their office applicability

A spiritual practice (discipline or exercise) includes any activity that one associates with cultivating spirituality.<sup>42</sup> There are different spiritual practices. Many of them find their place in office conditions.

## Meditation

Meditation is a practice of concentrated focus upon a sound, object, visualization, the breath, movement, or attention itself in order to increase awareness of the present moment, reduce stress, promote relaxation, and enhance personal and spiritual growth. People who meditate regularly feel less anxiety and depression, experience more enjoyment and appreciation of life and that their relationships with others are improved. Meditation produces a state of deep relaxation and a sense of balance or calmness.<sup>43</sup>

40 Spiritual Intelligence; <http://www.consciouspursuits.com/spiritual/default.asp> (viewed on 12.01.07)

41 Wigglesworth, C.; 2004; *Spiritual Intelligence and Why It Matters* [http://209.85.135.104/search?q=cache:Nzm\\_PjWiCWoj:wx10.registered-site.com/user888199/pdfs/spi.pdf+spiritual+intelligence+in+business&hl=de&ct=clnk&cd=26&gl=de&client=firefox-a](http://209.85.135.104/search?q=cache:Nzm_PjWiCWoj:wx10.registered-site.com/user888199/pdfs/spi.pdf+spiritual+intelligence+in+business&hl=de&ct=clnk&cd=26&gl=de&client=firefox-a) (viewed on 27.02.07)

42 Answers.com; *Spiritual practice*; <http://www.answers.com/spiritual%20practice> (viewed on 09.05.07)

43 Answers.com; *Meditation*; <http://www.answers.com/meditation> (viewed on 09.05.07)

## Prayer

Prayer is an active effort to communicate with a deity or spirit either to offer praise, to make a request, seek guidance, confess sins, or simply to express one's thoughts and emotions. The words of the prayer may either be a set hymn, or a spontaneous utterance in the praying person's own words.<sup>44</sup> Prayer has been practiced in all religions throughout history.<sup>45</sup> Sabbath

Also recommended is the Jewish practice of the Sabbath, followed by some Christians as well. Following the 4th commandment in the Hebrew Bible, one avoids work or any activity that would cause another to work from sundown on Friday until sundown on Saturday. During Friday evening, a family may enjoy dining together, or one may choose to dine with other similarly minded persons. Scriptures may be read, candles lit, etc., according to the particular tradition or preference. The next day may include religious services and/or study of scripture or other spiritual texts, together with other spiritual practices. It is a day of rest – a full day without work: no household tasks, no shopping, no TV.<sup>46</sup>

## Right livelihood

Right livelihood is the Buddhist principle of choosing work that does not cause people or animals to suffer. The National Council of Catholic Bishops, for instance, urges American Catholics working in the nuclear weapons industry to examine seriously their consciences about their work.<sup>47</sup>

## Examples of spirituality in the workplace

Spiritual practices are being integrated into business life. One organization starts every meeting with a minute of silence, an executive of another organization lights a candle when a visitor comes to talk.<sup>48</sup> Here are some practical examples:

- Boeing practices poetry readings to stimulate creativity by setting up a series of weeklong trainings with poet

44 Answers.com; Prayer; <http://www.answers.com/topic/prayer> (viewed on 09.05.07)

45 McLaughlin, C.; 2004;The Centre for Visionary Leadership (Helping People Develop the Inner, Spiritual Resources to be Effective Leaders); Spirituality and Ethics in Business; <http://www.visionarylead.org/articles/spbus.htm> (viewed on 23.04.07)

46Pielstick, D.; 2003; Authentic Leading: Where the Blue Sky Hits the Road; Spirituality in Business; <http://www.cba.nau.edu/pielstick-d/Leadership/Spirituality%20in%20Business.html> (viewed on 14.11.06)

47McCormick, D.; 1994; University of Canterbury; Spirituality and Management; [http://www.mang.canterbury.ac.nz/people/nilakant/spirit/Don\\_McCormick.html](http://www.mang.canterbury.ac.nz/people/nilakant/spirit/Don_McCormick.html) (viewed on 3.05.07)

48 Halal, W.; 2007; Herb Rubenstein Consulting - Dynamic Leadership Consulting; Beyond Knowledge: The Coming Spiritual Revolution; <http://www.growth-strategies.com/subpages/articles/076.html> (viewed on 16.02.07)

David Whyte for 600 of its top executives to unleash feelings, take risks, and be excited by change - instead of terrified of it.<sup>49</sup>

- According to the ABC Evening News, The American Stock Exchange has a Torah study group; Boeing has Christian, Jewish and Muslim prayer groups; Microsoft has an on-line prayer service. Koran classes, as well as other religious classes, are featured at defence giant Northrop Grumman. Wheat International Communications in Reston, Virginia has morning prayers open to all employees, but not required. Spiritual study groups at noon are sometimes called "Higher Power Lunches"—instead of the usual "power lunches."
- Fast food companies such as Taco Bell and Pizza Hut hire chaplains from many faiths to minister to employees with problems, and credit them with reducing turnover rates by one half.<sup>50</sup>
- Apple Computer's offices in California have a meditation room and employees are actually given a half hour a day on company time to meditate or pray, as they find it improves productivity and creativity. A former manager who is now a Buddhist monk leads regular meditations there.
- Aetna International Chairman Michael A. Stephen praises the benefits of meditation and talks with Aetna employees about using spirituality in their careers. Avaya, a global communications firm that is a spin-off of Lucent/AT&T, has a room set aside for prayer and meditation that is especially appreciated by Muslims, as they pray five times a day.<sup>51</sup>
- Prentice-Hall publishing company created a meditation room at their headquarters which they call the "Quiet Room, where employees can sit quietly and take a mental retreat when they feel too much stress in the job.
- Sounds True in Colorado, which produces audio and video tapes, has a meditation room, meditation classes and begins meetings with a moment of silence. Employees can take Personal Days to attend retreats or pursue other spiritual interests.<sup>52</sup>

49 McLaughlin, C.; 2004;The Centre for Visionary Leadership (Helping People Develop the Inner, Spiritual Resources to be Effective Leaders); Spirituality and Ethics in Business; <http://www.visionarylead.org/articles/spbus.htm> (viewed on 23.04.07)

50 McLaughlin, C.; 2004;The Centre for Visionary Leadership (Helping People Develop the Inner, Spiritual Resources to be Effective Leaders); Spirituality and Ethics in Business; <http://www.visionarylead.org/articles/spbus.htm> (viewed on 23.04.07)

51 McLaughlin, C.; 2004;The Centre for Visionary Leadership (Helping People Develop the Inner, Spiritual Resources to be Effective Leaders); Spirituality and Ethics in Business; <http://www.visionarylead.org/articles/spbus.htm> (viewed on 23.04.07)

52 McLaughlin, C.; 2004;The Centre for Visionary Leadership (Helping People

- Greystone Bakery in upstate New York has a period silence before meetings begin so people can get in touch with their inner state and focus on the issues to be discussed.<sup>53</sup>
- A Spiritual Unfoldment Society has been meeting regularly at The World Bank for years, with lectures on topics such as meditation and reincarnation.<sup>54</sup>
- Executives of Xerox have gone on week-long retreats led by Marlowe Hotchkiss of the Ojai Foundation to learn a Native American model of council meetings and experience vision quests. The vision quests inspired one manager with the idea to create Xerox's hottest seller, a 97% recyclable machine.
- The CEO of Rockport Shoes, Angel Martinez, talks openly of the spiritual mission of his company and encourages employees to spend work time envisioning ways to express their deepest selves in their work.
- The ServiceMaster Company, with million customers worldwide, providing cleaning, maintenance, lawncare and food services puts its spiritual values upfront in its annual report. It begins with a biblical quote, "Each of us should use whatever gift he has received to serve others, faithfully administering God's grace in its various forms."<sup>55</sup>

Spirituality is entering the workplace because it can produce results. According to Lawrence Perlman CEO of the Ceridian Corporation, the combination of head and heart will be the competitive advantage.<sup>56</sup>

## Servant leadership

Servant leadership is an approach to leadership development, coined and defined by Robert Greenleaf. Servant leadership emphasizes the leader's role as steward in the organization. It encourages leaders to serve others while staying focused on achieving results in line with the organization's values and

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Develop the Inner, Spiritual Resources to be Effective Leaders); Spirituality and Ethics in Business; <http://www.visionarylead.org/articles/spbus.htm> (viewed on 23.04.07)

53 McLaughlin, C.; 2004;The Centre for Visionary Leadership (Helping People Develop the Inner, Spiritual Resources to be Effective Leaders); Spirituality and Ethics in Business; <http://www.visionarylead.org/articles/spbus.htm> (viewed on 23.04.07)

54 McLaughlin, C.; 2004;The Centre for Visionary Leadership (Helping People Develop the Inner, Spiritual Resources to be Effective Leaders); Spirituality and Ethics in Business; <http://www.visionarylead.org/articles/spbus.htm> (viewed on 23.04.07)

55 McLaughlin, C.; 2004;The Centre for Visionary Leadership (Helping People Develop the Inner, Spiritual Resources to be Effective Leaders); Spirituality and Ethics in Business; <http://www.visionarylead.org/articles/spbus.htm> (viewed on 23.04.07)

56 Halal, W.; 2007; Herb Rubenstein Consulting - Dynamic Leadership Consulting; Beyond Knowledge: The Coming Spiritual Revolution; <http://www.growth-strategies.com/subpages/articles/076.html> (viewed on 16.02.07)

integrity. Several companies have based or incorporated servant leadership into their corporate culture, including Herman Miller, Toro Company, Southwest Airlines, TDIndustries, Starbucks Coffee, Men's Warehouse, ServiceMaster.<sup>57</sup>

Servant leadership serves others by investing in their development and well being for the benefit of the common good.<sup>58</sup> The servant leader is the one who is the first to volunteer to help, never too proud to do work, even the difficult or unpopular jobs in order for the team to succeed. The servant leader is reliably and consistently a servant for the others. He/she has enough self confidence and is not afraid of being first, of potential failure and of looking silly. He/she does not feel threatened by the success of others and is the first to take responsibility for mistakes. A sincere, and self-confident, "my fault", brings others together. The servant leader has embraced the self-discipline of being part of a successful team and can avoid immature and unhealthy situations. His/her ego and individual goals do not get in the way of the larger picture of team goals. The servant leader is a positive role model for others by action and word.<sup>59</sup>

In short, servant-leaders aspire to be great only in their service to others. Such leaders are committed to serving others with integrity; humility; sincere concern; a generous, forgiving and giving heart; and self-discipline. They relate to others by investing, empowering, caring for, and consulting others. They are willing to sacrifice personally for the well being of others.<sup>60</sup> Servant leadership however, must not be understood as servanthood.

One of the best examples for servant leadership is the leadership style of Jesus. Jesus explained his style of servant leadership in relation to the self-seeking and domineering method of leadership that his followers were used to. Jesus taught that the one who rules should be like the one who serves. Greatness in Gods sight is not found in how many people serve the leader but rather in how faithfully the leaders serves others. Jesus washing the feet of the disciples is the classic Christian model of how a leader must be a servant.<sup>61</sup> Jesus was prepared to serve everyone, even the one who would ultimately betray

57 Servant Leadership; [http://en.wikipedia.org/wiki/Servant\\_leadership](http://en.wikipedia.org/wiki/Servant_leadership) (viewed on 04.05.07)

58 Trinity Western University; 2000; Servant Leadership as a Way of Life; <http://www.twu.ca/about/values/servant-leadership-life.aspx> (viewed on 04.05.07)

59Brown, B.; Servant Leadership; <http://www.3and2baseball.com/Sportsmanship/Servant%20Leadership.pdf> (viewed on 11.05.07)

60 Trinity Western University; 2000; Servant Leadership as a Way of Life; <http://www.twu.ca/about/values/servant-leadership-life.aspx> (viewed on 04.05.07)

61 Trinity Western University; 2000; Servant Leadership as a Way of Life; <http://www.twu.ca/about/values/servant-leadership-life.aspx> (viewed on 04.05.07)

him. In washing his disciples' feet he did not diminish but rather enhanced his position and influence as their teacher. Servant leadership is a way of life rooted in one's character that translates values and dispositions into behaviour that serves without seeking after external rewards. It frequently requires giving up one's rights and desires in order to serve God and others before and over self. The heart of servant leadership is genuine care for others and their well-being, not in using them for the leader's benefit or ignoring them because they do not fit naturally into the leader's plans or vision.<sup>62</sup>

9. Successful use of servant leaderships – company stories  
Servant leadership has been widely used in all types of organizations: for-profit businesses, not-for-profit organizations, churches, universities and foundations.<sup>63</sup> Here is the excellent example of two for-profit companies, regularly listed in Fortune 500<sup>64</sup> - the annual ranking of America's largest corporations from the Fortune Magazine.

### **TDIndustries (TDI)**

TDIndustries is a construction company that works on new and existing commercial, industrial and large multifamily buildings.<sup>65</sup>

TDIndustries were pioneers in practicing servant leadership in business and now the company conducts all its business based on a deeply held philosophy of servant leadership.<sup>66</sup> All started in 1971 when TDI's founder Jack Lowe, Sr. stumbled upon Greenleaf's classic essay "The Servant as Leader." Greenleaf was inspired by Hermann Hesse's novel *Journey to the East* in which a young man named Leo accompanies a band of men on a long journey sponsored by "The Order." Leo performs all of the group's necessary menial chores. All during the journey he sustains their morale with his joyfulness, uplifting spirit and jubilant singing. The trip proceeds well until Leo mysteriously disappears. Upon his exit the group almost immediately falls apart and the journey is quickly abandoned. Years later one of the party is admitted into "The Order" only

to discover that the person whom he had previously known as Leo the servant was in fact the head of the organization and revered as great and noble leader.<sup>67</sup>

The senior Lowe was entranced by the tale and the essential lesson Greenleaf drew from it: leaders are first servants of those they lead. Jack Lowe, Sr. acquired copies of the essay for all of his employees. All TDI employees at the time gathered at the Lowe's house to discuss the meaning for their work and personal lives. This became a monthly ritual and, with appropriate changes has become a corporate tradition.<sup>68</sup> In the ensuing years the company has grown to about 1400 employees and Jack Lowe Jr. now meet at the corporate headquarters with every partner at least once every two years in groups of 25 called "Partner Roundtables." During these meetings TDI's culture and the vision and values philosophy is thoroughly reviewed and debated. Today any TD Partner who supervises at least one person must go through training in servant leadership and every new employee is given a copy of "The Servant as Leader" essay and expected to read it.<sup>69</sup>

Servant leadership is at the heart of TDI's business theory, which is based on a metaphor of the construction industry in which they work. A building is erected in steps. Accordingly, so too must an ethical corporate culture. Servant leadership in TDI's practice is the essential process for preparing a firm, bedrock site upon which to build. This provides the necessary grounding for laying down a foundation of trust.<sup>70</sup>

As part of the recognition of TDIndustries is one of three 1998 Texas Quality Awards and Fortune ranked the company fifth on its "100 Best Companies to Work for in America" list. The top 100 companies are identified by randomly selecting employees to complete surveys, which include a Great Place to Work Trust Index. Being ranked fifth indicates TDIndustries employees trust their leaders.<sup>71</sup>

*"High trust results in lower costs, and low trust results in higher costs of operation. If you are doing servant leadership to make*

62 Trinity Western University; 2000; Servant Leadership as a Way of Life; <http://www.twu.ca/about/values/servant-leadership-life.aspx> (viewed on 04.05.07)

63 Bounds, G.; 1998; Dallas Business Journal; Servant Leadership: a Model that Can Pay Great Dividends; <http://dallas.bizjournals.com/dallas/stories/1998/08/31/smallb4.html> (viewed on 11.05.07)

64 CNN Money.com; 2007; Fortune 500; <http://money.cnn.com/magazines/fortune/fortune500/2007/index.html> (viewed on 31.05.07)

65 The Virtuous Organization: The Value of Happiness in the Workplace; Joanne H. Gavin; Richard O. Mason <http://www.bus-val-strat.com/PDF%20files/The%20Virtuous%20Organization.pdf> (viewed on 14.05.07)

66 Bounds, G.; 1998; Dallas Business Journal; Servant Leadership: a Model that Can Pay Great Dividends; <http://dallas.bizjournals.com/dallas/stories/1998/08/31/smallb4.html> (viewed on 11.05.07)

67 The Virtuous Organization: The Value of Happiness in the Workplace; Joanne H. Gavin; Richard O. Mason <http://www.bus-val-strat.com/PDF%20files/The%20Virtuous%20Organization.pdf> (viewed on 14.05.07)

68 The Virtuous Organization: The Value of Happiness in the Workplace; Joanne H. Gavin; Richard O. Mason <http://www.bus-val-strat.com/PDF%20files/The%20Virtuous%20Organization.pdf> (viewed on 14.05.07)

69 The Virtuous Organization: The Value of Happiness in the Workplace; Joanne H. Gavin; Richard O. Mason <http://www.bus-val-strat.com/PDF%20files/The%20Virtuous%20Organization.pdf> (viewed on 14.05.07)

70 The Virtuous Organization: The Value of Happiness in the Workplace; Joanne H. Gavin; Richard O. Mason <http://www.bus-val-strat.com/PDF%20files/The%20Virtuous%20Organization.pdf> (viewed on 14.05.07)

71 Bounds, G.; 1998; Dallas Business Journal; Servant Leadership: a Model that Can Pay Great Dividends; <http://dallas.bizjournals.com/dallas/stories/1998/08/31/smallb4.html> (viewed on 11.05.07)

money, it won't work. If you are doing it for the right reasons - the honest desire to help others - it pays great dividends." Jack Lowe Jr.<sup>72</sup>

## ServiceMaster

ServiceMaster was first established in the United States in 1929 as a small, one man business in the Chicago area. The business had a carpet cleaning plant but introduced the innovation of cleaning carpets onsite at customer's houses. Rapid growth followed over the next 20 years and in 1949 the Company began expanding across the USA through the Franchising business model.<sup>73</sup> ServiceMaster now provides service to more than 10.5 million residential and commercial customers in the US each year and generates nearly \$6 billion a year in revenues.<sup>74</sup>

The company is best known for a spiritual culture. Service Master strives to be perceived as a Christian-oriented company. Representatives explain that the name ServiceMaster comes from a Christian concept called „service thy master“ as its founder, dedicated his business to serving the Lord. That is why; the company has been talking openly about God and business. Even outside its headquarters in Downers Grove, Ill, stands a statue of Christ washing the feet of his disciples. “We can't, and shouldn't, and don't want to drive people to a particular religious belief,” says Bill Pollard, chairman of ServiceMaster. “But we do want people to ask the fundamental questions. What's driving them? What is this life all about?”<sup>75</sup>

The ServiceMaster philosophy is expressed in their first and main objective through which the company lives its spirituality and is successful:<sup>76</sup>

- “Honour God in All We Do” which is achieved through:
  - Doing the right thing
  - Treating each person with dignity and respect
  - Respecting each person's spirituality
  - Protect and maintain our world.

## Conclusion

Spirituality is today the fastest growing sector of the publishing

<sup>72</sup> Bounds, G.; 1998; Dallas Business Journal; Servant Leadership: a Model that Can Pay Great Dividends; <http://dallas.bizjournals.com/dallas/stories/1998/08/31/smallb4.html> (viewed on 11.05.07)

<sup>73</sup> ServiceMaster Clean; [http://www.servicemaster.co.uk/main\\_aboutus.htm](http://www.servicemaster.co.uk/main_aboutus.htm) (viewed on 14.05.07)

<sup>74</sup> ServiceMaster; <http://www.servicemaster.com/library/aboutUs/default.dsp> (viewed on 14.05.07)

<sup>75</sup> God and Business; 2001; Gunther, M.; [http://www.marcgunther.com/?page\\_id=37](http://www.marcgunther.com/?page_id=37) (viewed on 14.05.07)

<sup>76</sup> [http://corporate.servicemaster.com/overview\\_objectives.asp](http://corporate.servicemaster.com/overview_objectives.asp) (viewed on 14.05.07)

industry.<sup>77</sup> Newspapers and magazines, including Newsweek, Time and the New York Times Magazine publish stories such as „Faith and Healing“, „Science, God, and Man“ and „Choosing My Religion“.<sup>78</sup> Books on spiritual topics are constantly at the top of the Bestseller List.<sup>79</sup> Still, the subject of spirituality in business is not taken seriously enough, especially in Europe. The aim of this paper was to encourage more discussions on the topic, to inform and make aware of the increased quality of life and excellence of business, spirituality can bring.

Furthermore, the goal was to introduce the different possibilities discussed in the literature in view of the need for a spiritual workplace, how can it be achieved, what is the leadership style to support it, who is already implementing it. Much attention was turned to the fact that the person is as surely a spiritual being, as he/she is a physical one. The body requires proper physical nourishment to survive, but the soul needs the proper spiritual nourishment to thrive.

In total, the question if spirituality and business are able to co-exist and if such co-existence is realistic and rational can be answered only positively. Spirituality in business is definitely a field with future because it offers the employee the possibility of being a whole person at work; the possibility of working with less stress and dissatisfaction but more joy and fulfillment; the possibility of being honest to oneself and others and feeling good about it. Nice additional features are the increased profitability of the company and the aspect of a cleaner nature. So why not give spirituality the chance?

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<sup>78</sup> Elkinsh, D.; 1999; Psychology Today; Spirituality; [http://www.findarticles.com/p/articles/mi\\_m1175/is\\_5\\_32/ai\\_55625500/pg\\_1](http://www.findarticles.com/p/articles/mi_m1175/is_5_32/ai_55625500/pg_1) (viewed on 24.04.07)

<sup>79</sup> Testerman, J.; 1997; Spirituality vs. Religion: Implications for Healthcare; [http://www.aiias.edu/ict/vol\\_19/19cc\\_283-297.pdf](http://www.aiias.edu/ict/vol_19/19cc_283-297.pdf) (viewed on 15.02.07)

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