Building an ethical corporate culture

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"There is a lot of good evidence now that you can enhance your business performance through having an ethical culture."

Dr Helen Parker ● Lecturer ● The University of Sydney Business School

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Susan Rochester ● Managing director ● Balance at Work

Overview

An ethical corporate culture that permeates all strata of an organisation is at the core of good corporate governance. It also has a positive impact on employee engagement and profitability.

The process of implementing cultural change within a business must be actively led by those at the top. Senior management should set the tone for the organisation, and their actions will ultimately decide whether an ethical culture survives or not.

Those coordinating a change need to implement a thorough training process to overcome likely challenges such as cultural differences and entrenched attitudes of resistance to change.

Note: This article contains embedded audio-visual footage that is an integral part of its content and may be used in relation to the assessment questions.

Learning objectives

After reading this article, you should be able to:

› explain the typical characteristics of an ethical corporate culture

› discuss the importance of a strong ethical corporate culture

› demonstrate how a strong ethical corporate culture can be established\

› outline the challenges when establishing an ethical corporate culture.

Characteristics of a strong ethical corporate culture

A workplace culture that practises and promotes ethical values and integrity is central to good corporate governance as well as contributing to higher levels of employee engagement and company performance. The simple fact is that companies without an ethical culture will always be at risk.

But how realistic is it to expect that companies will operate ethically 100% of the time when increasing shareholder value is considered the ultimate measure of corporate success? For instance, it may be legal to use offshore tax havens or outsource certain functions to countries where labour costs are lower, but is this behaviour really ethical?

Financial services firms find themselves in a challenging position where the public increasingly expects that corporate entities adhere to the "triple bottom line" framework — where social, environmental and financial concerns are given equal weight — while continuing to deliver shareholder value.

There has been a tendency for Australian financial services firms to take a reactive approach to negative impacts on company culture, rather than proactively establish a culture of compliance and integrity.

A 2015 report by Deloitte, *Corporate culture: The second ingredient in a world-class ethics and compliance program*, highlighted the importance of an ethical culture to an organisation:

Strong cultures have two common elements: there is a high level of agreement about what is valued, and a high level of intensity with regard to those values. Of course, not all cultures encourage good or ethical behaviours. When it comes to developing world-class ethics and compliance programs, the starting point is a positive culture of integrity.

The Deloitte report noted that a corporate culture of integrity is typically characterised by the following aspects:

› A clear set of organisational values that emphasise a commitment to operating in a compliant and ethical manner.

› C-suite executives (i.e. top senior executives and senior management) encouraging employees to behave ethically

› Consistency between business operations and leadership messages in relation to ethics and compliance.

› Middle management 'carrying the banner'.

› Employees being comfortable about coming forward with questions and concerns.

› All employees being held accountable for their actions.

› Employees being hired according to character as well as competence.

› Rewards and promotions being based, in part, on an employees' adherence to ethical values.

› Internal matters being dealt with through an equitable process that is applied across all levels of seniority within the organisation.

University of Sydney Business School lecturer Dr Helen Parker believed a culture of integrity must permeate all aspects of business operations, and led by those at the top.

"It really depends on the [attitudes of the] board and senior management. They set the tone and it depends on their own personal ethical stance. That ethical stance has to be … modelled by them to the rest of the organisation, be it big or small," she said.

"There can be formal processes, but just as importantly I think of the informal processes and procedures — things like rituals and stories. The language around integrity and ethics in the organisation is also very important and again, this needs to be modelled and widely communicated by senior management."

Parker also highlighted the importance of establishing appropriate rewards for good behavior, and penalties for engaging in improper activities.

"There needs to be sanctions. People have to be very clear about what the rewards and potential consequences will be for unethical behavior. If they feel they can get away with something, they may well do that, so you've got to have a positive stance towards ethics. You need to have rewards [for displaying ethical behavior] and punishments put in place for wrongdoing," she said.

Balance at Work's managing director Susan Rochester used the analogy of an iceberg to describe the difference between organisational culture internally and externally.

"If you imagine a tip that's above the waterline, they're the outcomes, that's what the outside world will see. Underlying that are the behaviours, so how is your staff behaving? That is also guided by various levers within the business, be they policies and procedures, your KPIs [key performance indicators], what gets rewarded and what doesn't. A culture of integrity needs to have all those things aligned. Is what you're saying to the outside world really the way that you're behaving?" she said.

Rochester referred to the work of Australian psychologist and social researcher, Hugh Mackay, who theorised that customers and clients judge an organisation on two factors to determine whether they are ethical or not.

"Those two things are how they treat their customers, which of course is staff behaviour, and executive behaviour, but equally important is how they treat each other — so how the team treats each other. All those factors need to be aligned and in place to have a culture of integrity and ethical culture," she said.

The importance of a strong ethical corporate culture

A strong ethical corporate culture is the driver of an organisation's degree of compliance and adherence to values of integrity. The Governance Institute of Australia's 2017 Ethics Index revealed that 78% of Australians believe that corporate culture is important to ensuring ethical practices are maintained in the banking and finance sector.

Parker noted that there was also evidence that companies with strong ethical cultures tended to outperform those without.

"The research is really clear about this. There is a lot of good evidence now that you can enhance your business performance through having an ethical culture. Obviously, you can attract and retain better employees — people that want to do the right thing will be attracted to come and work for you and they will then make a collaborative ethical culture happen for you," she said.

"Also, surprisingly a 2012 study ["The ethical culture of organisations and organisational innovativeness*" — published in the *European Journal of Innovation Management*] showed it's really linked to innovativeness, so that's something perhaps a bit unexpected — that you could actually be more innovative as a company if you have an ethical culture. Also, ethical culture means that downstream you'll have ethical decision-making and behaviours which are good for

business. So, long term you get a better reputation, you create more value for your stakeholders and you will have this long-term value created in your company."

Parker reflected on the importance of a strong ethical and compliance culture with regard to the success of risk management programs.

How can a strong ethical corporate culture be established?

Implementing cultural change within an organisation is a complex long-term process requiring commitment from the entire organisation for success. A key starting point is establishing a set of company values and ensuring they are implemented and practised.

Engendering company values begins at the top with the leadership team cascading them to the rest of the organisation. The Governance Institute of Australia's 2017 Ethics Index revealed that 82% of Australians saw the role of leadership in ethical conduct in the business sector as crucial. Parker highlighted the necessity to effectively integrate ethical practices within business processes.

"Upfront you do need a code of ethics and that should be a living document that is widely communicated to staff. Everyone must understand that they've got buy-in to that document and that senior management are walking and talking that document as well. That code of ethics has to permeate all levels of the organisation," she said.

"It needs to be reporting back on various compliance issues and there needs to be a firm process put in place with employees, so they know what's expected of them. Things like wrongdoing hotlines or some sort of confidential reporting [facility] where people feel respected and that their complaints are going to be taken seriously."

Rochester explained that even though the law may set minimum ethical standards, companies should not fall into the trap of thinking that meeting those minimum standards is sufficient.

"We have to have laws and rules, but they're not a guarantee on their own that people will behave ethically. We have evidence of that every day in the news — look at the current spate of sexual harassment allegations. The issue is that ethical behaviour comes down to individual choice, so having the laws in place are no guarantee that an individual will choose to behave ethically in a given situation," she said.

Parker suggested that the setting of minimum ethical standards should be approached as a creative solution rather than a punitive one.

"[It can help to be] solution-focused in coming up with an ethical stance and really driving values and behaviour from a positive perspective. That's important [so staff do not just] see it as, 'oh my gosh, not another compliance measure', but 'something that will actually really enhance my behaviour as a person and also our overall performance as a business'," she said.

Parker added that ethics training is also a key element of establishing an ethical culture within an organisation.

"Not just paying lip service to ethics with [an attitude of] 'you must all tick this mandatory training requirement'. It's really good to have senior management actively involved in that training with the frontline employees," she said.

"What's particularly useful in ethics training is looking at real ethical dilemmas, little vignettes that people can actually consider and work through with senior management. Talk about, 'What ought we do in that situation?' Make it real for them with dilemmas that they will actually face in real life.

"I would expect the organisation to help me see what my personal ethics stance is and whether that is going to be in line with the organisation's stance. The organisation has responsibility not just to provide the ethical code, but help employees internalise that ethical stance. So it's not just a matter of the values hanging on the wall, but really internalising the values, which helps [employees] enact them better."

Rochester explained that following up on training and maintaining vigilance is crucial to ensuring the longevity of an ethical culture.

"When people are weighing up the choice between profit and the client's interests, that's where a lot of the ethical grey areas and difficulties in decision making happen. With regard to that, I like a quote that comes from the Bank of England's deputy governor for markets, Minouche Shafik, who said that we often think it's a few bad apples when things go wrong in relation to ethics, but we should really be looking at how to fix the barrel those apples are in," she said.

Rochester shared her thoughts on how an organisation should arrange its structure and processes to streamline the move towards an ethical culture.

Parker noted that large companies are increasingly employing senior staff to oversee the creation and maintenance of an ethical culture and raising the profile of existing positions such as compliance officer.

"A lot of big companies now have a VP [vice president] of sustainability and ethics or at least an ESG [environmental, social and governance] manager. It's important for that person to have a high profile and not just be about sanctions and compliance. They should also have a focus on creative solutions to ethical issues and be part of the senior management team — not just an adjunct or an afterthought," she said.

Consider

Parker highlighted the importance of acknowledging ethical behavior within the organisation as a means of promoting cultural change.

"Not only do we need to sanction people that are doing the wrong thing, we also need to celebrate people that are doing the right thing — positive reinforcement. Informal processes such as stories and heroes and language, and actually celebrating people in the organisation that are doing the right thing, can be really important for reinforcing the process."

Parker offered some key considerations with regard to what KPIs needed to be in place for executives in relation to operating in an ethical manner

Challenges when establishing a strong ethical corporate culture

Establishing and maintaining a strong culture of ethics and integrity within an organisation is always a challenging process, particularly when engendering wholesale cultural change. Issues such as cultural differences and entrenched attitudes can disrupt or even inhibit the change process. Parker elaborated on the challenges that can arise through different cultural attitudes to ethics.

"There are huge intercultural issues to be considered. It's really important for multinationals to obviously abide by the laws of their parent company. Maybe they're subject to Sarbanes-Oxley [Act, which prevents investors from fraudulent activity] in the US, for example, but what happens when real ethical dilemmas arise?" she said.

[For instance], when you're asked to perhaps pay extra to an overseas supplier, you really have to consider how you are going to do this? What are the ethical implications? How will this fit in with your current business model and whether this is what you ought to be doing? I think that's huge for a lot of multinational companies on the ground."

Parker explained that when implementing cultural change within an organisation there will inevitably be resistance from parties with entrenched attitudes.

"Any sort of change is hard and you're always going to find people that will fight you. "[There will be comments such as] 'I don't want to change. I don't see this as relevant to my job. This is someone else's responsibility,'" she said.

"You might also have managers who think that business practices are different from societal norms, for example, greed is good. It's not that they are trying to be amoral or immoral, it's just that they see business expectations as separate from societal expectations [with regard to] norms of behaviour. Those people will need some education around what's expected of them.

"People are going to fight you on the change, so you're going to have to put in place a really clear change process. There are many good change frameworks such as [Harvard Business School's professor of leadership, Dr John] Kotter's "Eight Stages of Change" (see Figure 1) that you might need to take the company through to ensure that the change is embedded.

"The framework can help with things like making sure that the tone is set by the board and senior management, and that you get a 'coalition of the willing' that can actually help drive change through the organisation."

Figure 1: Kotter's eight-step process for leading change

Source: www.kotterinc.com.

Parker discussed how a sense of urgency is useful to establish momentum in relation to the change management process?

A key component of the cultural change process is hiring staff that share the organisation's cultural values. Rochester explained that this is crucial for influencing choices and sustaining cultural change over the long term.

"If you've got someone whose values are aligned with those of the organisation, it's not going to be such a big deal to try and influence or understand why they would make certain choices. Ethical behaviour comes down to the person in the moment choosing to do the right thing, so by having people who are aligned to your expectations within the organisation, that becomes a lot easier," she said.

Conclusion

To be successful, it is critical that an ethical corporate culture is led from the top of the managerial chain and enacted in all business operations. However to be truly effective, there also needs to be full commitment from company staff.

Ethical behaviour ultimately comes down to individual choices. Legislation and regulations establish minimum standards, but this does not guarantee that employees will behave ethically. In fact in some cases they can be counterproductive.