DEVELOPING A CODE OF ETHICS

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Codes of ethics have long been a feature of corporate life, particularly in regulated entities. However, reported ethical malpractice among some of the companies does not seem to be abating. Recent corporate scandals, such as Wells Fargo's cross-selling scandal and Volkswagen's "Dieselgate", demonstrate disconnect between compelling ethical statements and actual corporate behavior.

Despite companies' proliferation of codes of ethics, codes oftentimes suffer from weaknesses that undermine their effectiveness and place a company's reputation for integrity at risk. The purpose of this article is to explore the process of designing a code of ethics in order to improve its effectiveness.

Code of ethics and its purpose

The definition of a code of ethics is a collection of principles and practices that a business believes in and aims to live by. It formalizes an ideal of expected behavior patterns to managers and employees of organizations, and as such, it should serve as a central guide to support day-to-day decision making at work. It usually covers behavior that, while not illegal, is nevertheless harmful to the company and/or its clients. Perhaps most fundamentally, a good code of ethics provides guidance to employees when faced with a moral or ethical challenge.

Codes of ethics are specific to each organization

It is important to recognize that codes of ethics should be tailored to each company. Codes should be linked to the risks inherent to the individual company, its

markets and its operations. For example, a bank will have different risk areas than a pharmaceutical company.

When developing or reviewing a code of ethics, it is important to set the context. This should include elements such as what has gone wrong in the past, what else could go wrong, what guidance should be offered to employees and what are the grey areas in the business.

The code should also be reflective of the company's stakeholders and addressed to their needs. For example, should the code of ethics be targeted to employees only, or should it also include other stakeholders such as suppliers (or should there be a separate code of ethics for suppliers).

Board support is fundamental
Corporate values, ethics and culture are matters of governance. Without senior leadership endorsement, embedding a code of business ethics is unlikely to be effective.

Boards should specifically oversee the development of the code of ethics, and formally appoint a senior manager to supervise that development.

But board engagement should not stop at merely overseeing the code development. It is fundamental that boards set the right tone at the top and demonstrate their ownership of the code. Boards should also make clear to the rest of the organization that the code not only addresses employee behavior but also the behavior of board members.

Define values
The code of ethics should be based on values, and these values and their relative emphasis are likely to differ between organizations. For example, in a government institution, the following principles would be appropriate (based on the Seven Principles of Public Life):

Selflessness: Decisions must be taken with due regard for the public interest.

Integrity: Those governed by the code must not allow themselves to be placed under any obligation to people or organizations that might try inappropriately to influence them in the performance of their duties.

Objectivity: Actions and decisions must be taken impartially, fairly and on merit, using the best evidence and without discrimination or bias.

Accountability: Those governed by the code are accountable for their decisions and actions and must submit themselves to the scrutiny necessary to ensure this.

Openness: Decisions must be taken in an open and transparent manner. Information should not be withheld from the public unless there are clear and lawful reasons for doing so.

Honesty: Those governed by the code must be truthful.

Leadership: All those governed by the code must exhibit these principles in their own behavior. They must actively promote and robustly support the principles and be willing to challenge poor behavior wherever it occurs.

Consult widely
A multi-disciplinary and cross-functional group should lead code development. Groups of employees and other key stakeholders can help identify risks to corporate culture and business conduct and consider potential vulnerabilities arising from these risks and can usefully assist in defining and reviewing code content.

If employees are not consulted as part of the code development, it is less likely that it will cover all important areas in which ethical issues can arise. Similarly, if they are not part of the process, the resulting code may feel irrelevant to them and not reflecting their experiences.

It would be equally beneficial for companies

to consult external parties such as customers, regulators, investors, and communities on what ethical risks and opportunities it might face. The consultation process can help better inform the company about its ethical profile.

Draft the code

A well-written code of conduct clarifies an organization's mission, values and principles, linking them with standards of professional conduct. The code should be written in a language and style that is universally comprehensible. When developing a code, the range of users that must be considered might include junior employees, middle management, senior executives, board members and etc.

Another key element is that it should be as practical as possible, as opposed to vague or legalistic. It should clarify how the company's values translate into everyday decisions, behaviors and actions.

A good practice is that the code of ethics provides practical examples of situations that require decision-making to help employees do the right thing when faced with problems that could result in misconduct.

The code of General Motors, for example, includes a decision-making model that employees can follow when facing ethical dilemmas. Nokia's code identifies potential red flags for employees in specific situations, while Unilever has included lists of "Musts" and "Must Nots" that employees can refer to for clarification about the company's expectations.

The code cannot address all of an organization's ethics needs, nor can it answer every ethical question or issue that may arise. Therefore it would be important that the code includes a section on where employees can go for advice and guidance.

Test the code

Before launching the code of ethics, companies should run trials on the code and gain an understanding of how well it works in practice. This testing could be limited to a cross section of departments or operations, and this should be done to assess the code's usefulness and clarity as well as to identify any major obstacles.
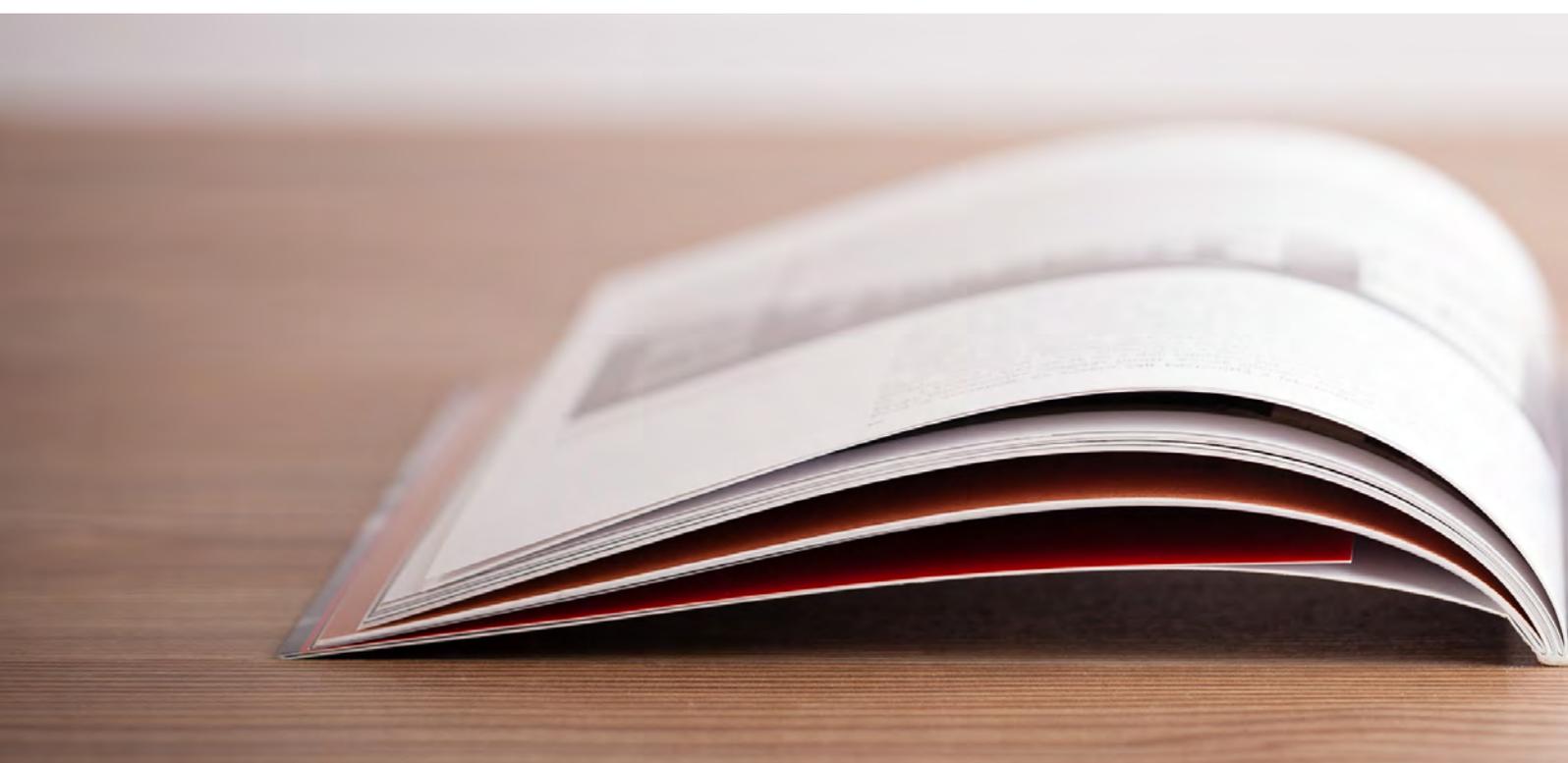
Launch the code

It is not sufficient for companies to send out a code of ethics to all staff and expect them to adhere to its contents. The launching of the code should be communicated widely and it should coincide with training sessions for employees to raise awareness on ethical matters.

It is vital that companies communicate with their employees on the sanctions that will be imposed for violating the code of ethics. Depending on the violation, these sanctions can include a letter of reprimand, dismissal and possible criminal chargers or civil lawsuits.

But rather than just listing the potential penalties for code violations, boards and senior management teams should actively promote the code within their organizations and articulate their commitment to pursue potential violations of the code, to investigate them fairly and promptly, and to impose appropriate discipline for any violations of the code.

A code of ethics is a beginning, not an end

It is important that the establishment of a code of ethics does not lead to complacency, to the idea that the company has now sorted out its ethics. The code is really the beginning of the journey for companies. The real challenge is how to embed core ethical values in a way that affects decision making at all levels throughout the organization, and this requires boards to give high priority to ethical standards and ethically sound strategic goals.

Boards should also review the code annually. This is because ethical challenges faced by businesses vary over time on the basis of the legal context, social trends, practices followed by other companies, and changes in the organizational structure and its leaders.

Conclusion

The above sets out the key steps for developing a code of ethics. It would be naïve to assume that codes on their own will be beneficial for organizations. However, a well-written code, addressing key issues, which is communicated widely and which is actively promoted by business leaders is necessary, while not sufficient, to create ethical business practices. ■