Matching company codes and stakeholders' expectations

By John Donaldson[*] & Irene Fafaliou[**]

Abstract

The growth of business codes of practice has been largely in response to public criticism of many business activities. Few studies seek both to identify and to reconcile the perspectives of the various stakeholders. Codes of practice (also called codes of ethics) often give rise to public cynicism or indifference. This is important in the light of continuing evidence that long-standing codes and standards, such as those of the ILO appear to be honoured more in the breach than in the observance by multinational corporations.

This paper offers a review of theory and practice in the area, and seeks to identify how businesses could identify and reconcile the 'proper' aspirations of various relevant parties. Examples are drawn from the regulation and control of financial services, but the issues have wider application. The need for a more pluralistic model for business to complement that of multinational corporations is considered.

Key words: Company Codes; Stakeholders; Multinationals; Responsive Codes;

1. Introduction: the issue in context

In the era of the global supply-chain, *codes of practice* and *codes of ethics* have become part of business life, especially as regards transnational firms[1]. However, as yet, codes' growth of international large companies have been largely in response to negative images and reporting of many business practices, and to the impact of some business behaviours for the public and for the physical environment[2]. According to various analysts of international business behaviour, most individual companies' codes till the late 90s, tended to claim commitment to particular aspects of international standards that were justifiable, for example, by consumer groups or the media, and to neglect those they disagreed with (Ferguson, 1998). Although the case appears to change gradually due to the fact that some companies have started to incorporate in their codes internationally

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[1] For examples of codes of practice and codes of ethics, see The Conference Board (1988); Kolk, A., van Tulder, R. and Welters, C. (1999).
[2] See for example Bhopal accident in India, various oil spills and discoveries of sweatshops in Asia. For an extensive discussion on sweatshops, see Varley (1998).

agreed standards, the question on the practical value of codes still remains. To overcome the various shortcomings surrounding the functioning of the mechanism provided by codes of practice, academic observers have developed theories of stakeholders as relevant parties to business activities in addition to company boards. By including societal actors – other than financial interests – in the formulation and implementation of codes of practice, the multi-stakeholder model assumes that the international enterprise has a social responsibility[3].

There are, however, few studies that seek both to identify and to reconcile the perspectives of the various stakeholders such as those representing investors, consumers, public and employees' interests, and no business methods for doing so. Surveys, consumer panels and management-labour negotiating arrangements are consciously limited and usually bipartite in nature. Codes of practice are almost invariably top-down in origin and control, often giving rise to public cynicism or indifference. This paper offers a critical review of theory and practice in the area, and seeks to identify how businesses, who wish to do so, could identify the 'proper aspirations' of various relevant parties and develop ways of matching them acceptably.

2. Codes of practice: a review of current trends

In the last thirty years, there has been an explosion of private codes of practice in a variety of contexts, accompanied by an increasing number of commentaries. Some of these commentaries favour the use of codes, and others reject them on various grounds. Code initiatives, codes of practice, sets of working rules, model procedures and procedure agreements are applied for example in industrial relations, in health and safety encouragement, and in general company policies related to environment, consumer protection, genetic engineering, labour issues etc. They are applied by governments, as in highway codes or codes of behaviour in financial services, health services and many others. They are applied by trade associations, non-governmental organizations (NGOs), and most notably by professional bodies for regulating the behaviour of

[3] For a review of "stakeholder" theory, see Freeman (1991).

their members[4]. They are applied by business organizations such as the International Chamber of Commerce, the chemical industry etc.

Codes can be formal, as when statutes are set out systematically in an attempt to avoid inconsistencies. Sometimes codes are expressed attitudinally rather than formally, as in 'codes of honour', and are in this form sometimes enforced as something extra or superior to the law, and, often, enforced more rigorously than the law itself, as was the case with duelling codes in bygone times. Company codes are sometimes called 'codes of ethics', but are often expressed as policy statements, for example, towards 'responsibility', or related to the 'social responsibility of business', or just as 'company philosophies.'

The creation and propagation of codes and standards have been occasioned by a variety of events and pressures. The international labour standards published by the International Labour Organisation (ILO, 1988), and readily available since the 1920s, resulted from the disruptions of the two world wars. The major increase in the number of corporate codes in the United States, may well have been, in part, a result of legal incentives in the wake of major, expensive litigation, where substantial discounts in corporate fines were made where corporations had ethical codes and ethical officers and systems in place. (Hagar,1991; Vogel, 1992).

A representative sample of critical attitudes towards codes would certainly include the idea that they are at best irrelevant to business, but more likely to be harmful, because they miss the main point of business. On this view, the 'purpose' of business is to make, or often to m*aximise* profit, on the grounds that all persons and institutions should do what they are best at, and business is held to be best at making profit, or offering goods and services with a view to making profit[5].

According to various sceptical views, codes have poor practical value since throughout history there have been many examples of *opposing codes.* Where there is a major disparity in power, the

[4] The Ethical Trading Initiative in the UK provides an example of such groups participating in code initiative. More info can be found in the web site: www.eti.org.uk.

[5] See for example the claims of Prof. Milton Friedman from 1970 onwards that: "The social responsibility of business is to increase its profits; shareholders are the only claimants on managerial concern, and that to suggest anything else is subversive", quoted in Maclagan, 1998, p. 149.

codes of the weak have rarely been seen at the same time as the prevailing values, even if they have later become so, as with the rise of the great religions[6].

A further view would say that there is not, as yet, a free market in ideas. They tend to be filtered through a mass of institutional pressures and norms. This can no doubt help to generate stability in the dominant values, but is also a potent source for missed opportunities, as demonstrated by the recurrent financial scandals[7].

Although a cost-benefit evaluation of the practical value of codes is still an open question, in general their strengths can be summarised as follows:

1. They inform people of what is expected of them
2. They give guidance as to how it can be done
3. They express values that many participants aspire to, or claim to do so; and
4. They can and often do raise standards.

Their weaknesses- limitations are:

1. The expression of values can be vague, general and bland
2. The ethical content can be minimal
3. Although it would be difficult to argue that ethical codes are or ought to be designed for, or providing opportunities for displaying their moral worth, if people only do 'the right thing' because they are sheltered by a code, or by the backing of some powerful body, their actions are not likely to be done with much conviction, and may even be perfunctory. Even in this context, the morally strongest persons can easily have higher standards than those of the code (and especially of informal codes), and can thus find themselves at odds ethically, with their profession. *Claiming higher loyalties* is a common form of ethical argument and there is much evidence from case studies of conflict between personal and professional codes[8].

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[6] For an updated discussion on how one group can become dominated by another even within the same multi-stakeholder alliance, see for example Zeldenrust & Ascoly (1998).

[7] See for example ENRON's case.

[8] For example, the Integrity principle in the professional code of the (British) Institute of Personnel Management (now the Institute of Personnel and Development) states "Where there is a conflict between these obligations, the practitioner will make a personal decision after considering the options, of which resignation may be one". (IPM c.1990)

4. When codes are *voluntary* they apply only to some of the relevant persons. This can put them at a disadvantage, and let the promoters of the codes 'off the hook'.
5. The enforcement of moral codes without agreement is the enforcement of one person's, or one group's values on another.
6. If codes are not enforced, their effectiveness can be reduced, sometimes to zero. Most arguments, from compulsory union membership to professional standards, state or imply that there is a moral obligation to comply.
7. Non-enforced codes can easily be evaded, even when pretending to operate them. The (British) Advisory, Conciliation and Arbitration Service was established by statute in 1974. The ACAS Code on unfair dismissals was not *required* to be observed until the Employment Appeals Tribunal's precedent-setting decision in 1998 (*Lock v. Cardiff Railway Company Ltd* (1998 *Industrial Relations Law Report* 358, EAT).

One of the purposes of this paper is to explain why these serious weaknesses in codes persist, and to suggest ways in which they may be overcome.

3. The content of codes

An overview of existing codes reveals great disparities in terms of content. Codes generally cover official organisational attitudes towards markets, government regulations and relations with their various "stakeholders", including employees and local labour markets among others. They usually open with a statement that in its dealings, the corporation (or member of a professional body) will always act with integrity, fairly and reasonably, the acceptance of a social responsibility to the community. American codes tend to emphasise anti-bribery clauses. Since 1977, USA firms have to obey the requirements set under the FCPA (Foreign Corrupt Practices Act). The law was enacted due to repeated discoveries of a number of questionable payments made be the USA firms to foreign government officials to gain an advantage in bidding for contracts. See for example the disclosure of the IBM case who admitted that its executives had paid millions of dollars to Mexico City officials in order to sell computer programmes without competitive bidding (Dillon, 1998).

Some produce ethical decision-making checklists[9]. One professional institute for managers recognises possible conflicts of interest between the professional and employer, and adds that a members of the profession may find that duties towards employees and employer may conflict, adding that resolution of the conflict may only be possible through resignation (See Footnote 8).

3.1. Legal status of codes

In Britain, as already noted, the codes issued by *ACAS (the Advisory, Conciliation and Arbitration Service* for employers) are not legally binding, but are "required" since 1998 to be consulted. *The UK Stock* Exchange provides another example.

The *British Financial Services Authority* issued a pamphlet on Market Abuse (1999) to apply to Stock Exchange. The purposes of the code are: 1) to provide a fair place to do business; 2) to enhance confidence; and 3) to promote the efficiency imposed by free trade and profit maximisation.

The Code is admissible as evidence concerning any breach of statutory precepts.

The code's approach to market conduct was formed in consultation with practitioners and other interested groups. It aimed to "capture the principles and standards (that practitioners are) expected to observe; to help to avoid breaches of the precepts laid down in the legislation and to protect investors from market manipulation."

Particular concerns are possession of Relevant Information.

3.2.Formation and monitoring

On the formation of codes:

The (American) Conference Board (1988) surveyed 2100 businesses. To a particular question on how the codes were drawn up, 225 replies were received. Of these, the drafting procedures of three companies were studied in detail. All three said that they "relied on a carefully-orchestrated series of meetings that involved managers and employees from various levels from within the corporation".

The general results (Report, p. 15) showed involvement as (%)

[9] See for example the Web-side, www.nortel.com/cool/ethics/decision7html, Living the commitments: Guidelines for ethical decision making, p. 5.

Figures 1 & 2 to be inserted here

One company sought to find out what employees' feelings were about the code, and insisted on a follow-up that included focus groups, surveys and interviews.

According to Maclagan (1998, p. 166):

"...., codes are typically introduced to ensure that an ethically acceptable organisation has a good image. It is widely believed among both managers and academics that codes must be enforced if they are to be of any value."

Codes remain top-down and often contain uncertainties if not contradictions. It can be added that they lack provision for those who are subject to them or are their intended beneficiaries to influence their content, application, enforcement or revision. Until recently, they have also lacked provision for external validation. There is a need for studies that trace their operation, show how they seek participation by subjects or intended beneficiaries. Methods have recently been developed for evaluating the influence of codes on performance (IDS/Eldis, 2002)). According to the IDS/Eldis (2002)

"But there is a need for standards which can be externally/independently verified. One option is to expand the regular company accounting practices to include extra features".

These extra features include social and environmental accounting research and social and ethical accounting. But the authors note that:

" ... campaigners have argued that there are problems with relying on accountancy firms to provide this kind of monitoring … (*loc.cit).*

The authors cite *voluntary codes* (e.g. monitored by individual companies, or *external* monitoring, e.g. by national or international law or by independent agencies).

In our view, these developments in monitoring are advances on the practices in which codes were established with little or no monitoring and little or no external validation. Our view is that the *processes* of establishing, monitoring and amending, validation and ensuring compliance are at least as important as the detailed rules. The rules themselves can be vague (e.g. "We shall act with

integrity in all we do") or specific, (e.g. "We will support employees who refuse to take part in activities that are in breach of the code").

It seems to us that a defensible code ought, logically, to encourage "ownership commitment" by those who are subject to the code or are its intended beneficiaries. External validation is important, and so is the *kind* of external validation. We have already referred to the problems encountered so far by current methods of external validation. We now turn to the problems of ownership commitment.

The people who are directly and indirectly affected in varying degrees by the operation of companies or institutions are usually thought of as *Stakeholders.* In this context we take the view that the existence of codes implies a sense of obligation to behave in certain ways towards groups of people. Matters as to whether stakeholders have a legal right to expect behaviour that is consistent with codes, and whether production of codes does or does not interfere with the maximisation of economic gain are not directly relevant to the present argument. We start from the insistence by companies and institutions on having formal codes, and attempt to draw the inferences for their design and operation.

3.3. Codes and Multinational Corporations

The international labour standards published by the International Labour Organisation (ILO, 1988), and readily available since the 1920s resulted from the disruptions of the two world wars. The United Nations Charter of Human Rights has been published since the 1940s. Yet these standards are, reportedly, frequently and systematically flouted by some multinational corporations. The ILO Minimum Wage Convention gives the minimum school leaving age as the minimum age for employment. The use of long working hours, toxic chemicals and primitive tools puts children at risk. The Brazilian government, for example has expressed disapproval of the practices, but enforcement is held to be problematic (Amnestoy & Crosbie, 2000). Some countries have cut links with growers who disregard the child labour laws.

In other cases, authors have drawn attention to other dilemmas. When child labour is used, contrary to the ILO and other conventions, and contrary to company policies, or without a

corporation's knowledge, withdrawal of trade from the units who operate the practices can leave the children destitute.

It seems clear to us that the existence and awareness of standards and codes are not enough to *ensure compliance.* Even compliance itself can be problematic:

"Are awareness raising, management education and scholarly clarification of the issues enough to generate improvement? Are the issues mainly ethical, or mainly ones of enforcing known technical and prudential standards? Is enforcement (or lack of it) itself a thorny ethical issue? The OECD and the ILO with the support of many governments have issued and publicised standards since the early twentieth century. People are unlikely to change much in nature. There will always be those who will prefer to break the established rules, and prosper from it" (Donaldson, 2001, pp. 638-9).

In terms of applying the codes and regulatory practices from the older developed countries to transitional and developing economies, there seems to us to be a need for caution. If they are applied in the traditional, top-down ways, they are likely to suffer from the shortcomings that we have discussed, in addition to the dilemmas just mentioned. This seems to us to imply an even greater need for caution, but also for identifying and incorporating the "proper aspirations of stakeholders". These aspirations are likely to be modest enough in themselves.

There seems to us to be a parallel with the early industrial revolution in Britain. Robert Owen, founding figure of the Co-operative Movement, and Lord Shaftesbury's evidence in support of the Ten Hours Bill of 1844, demonstrated, in the early stages of industrialisation, that sweatshops and starvation wages are counter-productive.

It is even possible that the sub-culture and expectations of multinational corporations can impel managers to implement practices that few approve of individually.

4. Stakeholders

Freeman & Phillips (1996) divide stakeholder theory into three time periods:

In the first period, from the early 1960s, it was held that there are constituencies other than shareholders "who merit the consideration of managers in business decisions and actions" (p. 72).

The second period, from the mid-1980s, begins with Freeman's own work, operationalising the concepts "into a coherent set of ideas for the practising manager" (p. 73). Freeman and Phillips note a minor interest in some survey work on "how stakeholders think and feel towards the object firm" (p. 75).

The third period, according to Freeman and Phillips relates to the identification of a normative stream, exemplified by Donaldson (Tom) & Preston, (1995), drawing attention to the idea that normative thinking (how organizations ethically ought to act vis-à-vis stakeholders) is at the core of all business and economic thinking. By the mid-1990s, apart from prescriptive and survey research, there seemed to be few ways of involving stakeholders, or of deciding, in a particular context, although the practice in some European companies of having employee representatives on a supervisory board was sometimes noted.

Reviewing the literature on stakeholder theory, Maclagan (1998) accepts Goodpaster's (1991) distinction between a *strategic* and a *multi-fiduciary* model. The first of these uses stakeholder concepts "in the organisation's interest" (without commenting on how these are identified). The multi-fiduciary concept sees management as having duties to all stakeholders, with no special privileges to shareholders. Maclagan, however, identifies some key problems: Who are the stakeholders? How can the organisation's interest be recognised? Maclagan suggests that individual managers could be provided with the conceptual means to make individual moral choices, noting the variety of arrangements for representing interests, from British Health Service Boards to arrangements for employee participation.

Current practice seems to be a top-down mixture of prudential values and current *mores*. There are few, if any, mechanisms for identifying *proper* and *authentic* aspirations of stakeholders/ constituents. We return in a later section to the problem of how to tell what the "authentic" and "proper" aspirations are.

4.1.Consumer panels

Consumer panels are in use in the UK financial services regulation and there are active consumers' pressure groups. This sub-section examines the extent to which consumer panels can be regarded

as effective vehicles for representing the views/aspirations etc. of consumers. The possibility of *regulatory capture* has long been noted (Ethics Resource Center (USA, 1982); De George and Pichler (Eds.), 1978). There is a possibility that such panels could be subject to problems of isolation from their constituencies as they get close to the organisations that they are intended to monitor (akin to "regulatory capture"). A further possibility is that they could also develop "group norms" of their own, that are remote from their constituencies..

4.2. Agency theory

One way of approaching the problem of how well people's aspirations can by represented by others on their behalf is through agency theory. Agency theory originated with some work by Jensen and Meckling (1976). Defending the approach in 1994, Jensen comments (Jensen, 1994, pp. 13-15):

> *"Agency theory postulates that because people are, in the end, self-interested, they will have conflicts of interests over at least some issues any time they attempt to engage in co-operative endeavours. ... because conflicts of interest cause problems and therefore losses to the parties involved, the parties themselves have strong motivation to minimise the agency costs (as we labeled them) of such co-operation. This conservation of value principle is the basic force that motivates both principal and agent, or partners, to minimise the sum of costs of writing and enforcing (implicit or explicit contracts) ... and the residual loss incurred because it will not pay to enforce all contracts perfectly. ... The central proposition of agency theory is that rational, self-interested people always have incentives to reduce and control conflicts of interest so as to reduce the losses these conflicts engender."*

Agency theory distinguishes between *principals* and *agents.* An example of the agency relationship in financial services, is provided by Goodhart *et al.*(1998, p. 46):

> *"Financial regulators - the principals - aim to establish a system that limits systematic risk by supervising the risk taking behaviour of single institutions ... regulators are entitled by law to interfere ... through directives and rules and, if necessary, direct intervention to ensure the stability of the financial system."*

Thus, the concepts of agency, principals and agents is concerned with indirect, mediated, adjustment of the relationships between interested parties. Consumer panels, "ombudsman systems"[10] and regulators are part of a system designed to move towards the parity of relationships between, for example, suppliers and consumers under conditions in which the consumers do not, or cannot have access to the knowledge that is vital to contractual relationships. We would add that the concepts involved in equitable contracts are highly normative. "Equitable" and "appropriate" are ethical as well as legal and economic concepts. We accept the need in many economic and financial relationships, for regulators and agents. We are in no doubt that consumer panels, arbitrators and others have an important role in helping to establish and maintain a degree of equity in commercial (and administrative) relationships. Their research programmes and reports, as well as their "missions" are illuminating, and we believe, effective to a degree.

Our point here is that the size, notoriety and frequency of business and financial scandals appears to have been increasing in many countries, despite changes in, and increasing sophistication of regulatory systems. In practical terms, it looks as though there could be at least one missing factor, and at least one doubtful assumption common to regulatory regimes.

One factor that is missing from most, if not all, regulatory regimes and company-wide or industry-wide codes, relates to provision for all the major interested parties to communicate with each other in the code processes. These processes include the production, operation, monitoring and revision of the codes. Most participation that does occur is almost entirely top-down. Such participation as does exist is almost invariably bi-partite, and firmly within the control of regulators or top management. These include, employee surveys, works councils and their equivalent, as well as consumer panels. This, of course, brings into question the *independence of the codes*. The dependence is partly, but only partly, mitigated by regulatory relationships. It seems to us that knowledge of each party's expectations is unduly limited by such arrangements. Clearly, millions of consumers, thousands of suppliers, and thousands of employees cannot all participate in all

[10] "Ombudsman" is a Swedish term, meaning "legal representative". "Ombudsman" systems have come to be used also in other countries, such as the UK. Essentially, Ombudsman systems provide for the appointment of officials to investigate complaints against public authorities, or against institutions (or businesses) regulated by the authorities.

code-related activities. Equally clearly, not all would wish to do so. Finally, even if the expectations of all interested parties were known, the question arises as to whether these expectations are well-informed or not, realistic or not, well-intentioned or greedy. In the next section of this paper, we seek to show that *responsive codes* can go some way towards meeting these problems.

5. Responsive Codes

We noted earlier that the size, notoriety and frequency of business and financial scandals appears to have been increasing in many countries, despite changes in, and increasing sophistication of regulatory systems. We suggest that major reasons for the increase include *increased opportunities and lack of certainty of exposure of malpractice, and uneven distribution of knowledge.* The evidence presented to, and reviewed by the (British) Treasury and Civil Service Committee on the working of the financial system provides much support for this view. It was summarised by the Chairman of the SIB (Securities and Investments Board) (Now the Financial Services Authority) identified for the UK Treasury and Civil Service Committee (1995) some specific criticisms made to him, in his Review of the working of the legislation:

a) The objectives of the act are unclear
b) There is suspicion that self-regulation equates with self interest
c) Cost effectiveness is not evident
d) Too much fraud goes unpunished
e) The system is too complex
f) The retail area is ineffectively regulated
g) The regulation of professionals is still not sufficiently distinguished from that of the retail market
h) The compensation scheme is unfair as to funding and inappropriately structured
i) The regulation of exchanges and markets is imprecisely defined.

Many of these criticisms continued to be made to the Treasury and Civil Service Committee. The Committee's final Report was in October 1995. The main recommendation was for no major

change, and the Government agreed. Events from the publication of the ENRON bankruptcy suggest that the problem is still widespread.

Because values dominate business practice and the theories it is based on, there are several areas in which particular attention is needed with reference to the dominant values. *The first* is the proper management of conflicts of duty, to employer, client and code, for example. *The second* area concerns what sanctions are proper when codes and rules are broken. Rules and codes that seek to impose what is merely current practice or fashion have no moral right to expect compliance. That requires consent based on at least a belief that distributive justice has been genuinely attempted. Thus, the proper conduct of relationships and the process of rule-setting are at least as important as the substantive rules contained in the code.

The demand for codes of practice is part of the pressure for clearer standards in industry. In retail financial services, the demands and pressures seem insatiable. They provide overwhelming evidence that the industry has yet to provide a balance of the interests and expectations of those who contribute as suppliers, customers or shareholders. Public acceptance of codes, charters and self-regulation as more than public relations exercises remains problematic. Only *responsive codes*, with matching support systems - the essential requirements for earning public confidence and providing the balance - are absent.

5. 1. Features of responsive codes

Formal codes that are responsive have the following characteristics:

1) They develop methods of identifying the parties directly relevant to the business or organisation
2) The principles of the code are agreed by the relevant parties
3) Where the parties are *represented*, the representatives are chosen by them (consumer representatives by consumers etc.)
4) Revision and monitoring of the code is by an independent review group, and not by any one group (e.g. top management, consumers, employees): all parties have an equal status vis-à-vis the code

5) The custodians of the code are not empowered to apply sanctions, but can publish reports on the operation of the code
6) Problems of operation and problems of amendment are brought to the attention of the relevant parties by the custodians of the code
7) Amendments are by agreement
8) The influence of the code is determined by its ability to achieve agreement on the relevant principles and on the method of operation of the code

Some existing codes exhibit feature 1), 5) and, occasionally 6). In our view, progress will be achieved when codes achieve all eight characteristics listed above.

In all organisations with management-driven codes, the standards and values of the organisation rank higher than the perceived standards and values of the public which uses their services. The general public, made aware of its 'rights' through citizens' charters and the European Court of Human Rights, is now questioning the complaints procedures of organisations with management-driven codes. With the proliferation of Fair Trading Offices and Ombudsmen (more evidence of the popular clamour for fairness and justice) it has become easier for members of the public to challenge organisations that have traditionally been judged and jury in their own cause (a feature of management-driven codes). The clamour for higher standards in the labour market takes the form of searching for means of training to meet standards prescribed in the traditional way. As this usually includes the main points of contact with the public, the scope for meeting the standards announced remains problematic.

There are *four principles* underlying relationships between people jointly involved within a business which is in balance:

a) relationships in business of any type between individuals are based on mutual respect. This implies recognition of the significant role of individuals in contributing to the services offered by the business;

b) a state of openness should exist, by which is meant the free and honest exchange of information between individuals who are all committed to the success of business in their own interests;

c) a fair share or mutually accepted proportionate balance of effort and rewards, including recognition, between the individuals and within groups of people involved in the business;

d) individuals in the business are aware of the importance of maintaining balanced relationships with each other, not only from their own standpoint but from the standpoint of others with whom they work.

When one or more of the key principles is missing in a business, responsive codes, based on these principles, can provide guidance and support to individuals and groups in the business to redress the balance of relationships.

5.2. Responsive Codes and Motives for Compliance

The longest-standing codes have been devised and imposed by professional organisations to ensure that members have the appropriate skills and knowledge to practise competently. The common ground between professional organisations and commercial organisations with management-driven codes is the intention of the industry-elected oligarchy to convey to the public that "their" practitioners are competent and can be trusted.

Without representative and responsive codes, the more powerful always impose their values and interests on the less powerful.

5.3.Formal and Informal Codes

Formal codes of practice (Donaldson, 1992) are not the only practical codes operating in businesses and organisations. What is variously called "the informal system", "group dynamics", the "organisational culture" or "custom and practice" is a result of the interaction between official rules, deeply held values that can be in opposition to them and the expediencies necessary to "get the job done". A typical example is the commission basis of insurance sales people's pay, the training received and the pressure to achieve target. Here the pressure is to forget the precepts learned in training, and indeed, a salesperson who insists on them, is often likely to be accused of not making targets. As we pointed out earlier, a code, which tries to impose new rules against these pressures, stands little chance of being observed.

The actual motives or reasons for introducing codes can be just as mixed as those for complying with them:

> *"The main advantage of introducing a voluntary code of practice would be to avert regulatory action by the Government... particularly if the Treasury and the OFT were supportive of a voluntary code... a code might also add value in public relations terms, because non-members would not have the advantage of offering the protection of the code to clients"* (Miller,1984)

There are many reasons, apart from hoping for discounts on fines levied, why such codes have appeared on the scene, both in America and in Britain. Most weeks produce a crop of scandals, often in financial services. Not all are of the scale of the Bank of Credit, Commerce International BCCI collapse, Guinness or Maxwell affairs, but in their wake come inevitable criticisms by regulatory authorities, and mounting frustration by customers. Sometimes the regulatory bodies themselves are subject to scrutiny and criticism.

Many managers have reacted to pressures by changing their methods and procedures to comply with burgeoning legislation and regulators' guidelines. The cloak of anonymity has been taken off some company officials but, in general, traditional top-down business cultures persist.

5.4 Designing Responsive Codes: A step-by-step approach

According to the notion of responsive codes, rules governing practice, ethics and ethical codes are different, though related. For example, codes of practice may or may not be ethically defensible as well as meeting non-moral (e.g. technical and prudential) values. Ethical principles can operate without Codes, and Codes can be purely pragmatic, technical or prudential, with few serious ethical implications. In general, though, techniques logically exist to serve and apply stronger, moral and prudential values.

We propose, as a major principle, that "ethics" cannot be defensibly imposed by any adult person on any other but that rules etc., properly made, can and should be enforced in an ethically defensible way. This requires full regard at all times to the requirements of distributive justice and natural justice to which we have already made reference.

5.4.1. A Step-by Step Approach.

Commonly, codes of practice prescribe levels of knowledge and skills but beyond operating within legal parameters of the profession or trade they do not offer much on applying the more intangible values of fairness and natural justice. Industrialised societies are becoming more questioning, and demanding of higher standards of service that are demonstrably fair to the consumers. Responsive codes of practice take into account the expectations and values of the major stakeholders in any business organisation, but they have not yet become widely enough used, and there is usually little appreciation or understanding as to who are the stakeholders in the business or organisation.

We remarked earlier that in all organisations with conventional, management-driven codes, the standards and values of the organisation rank higher than the perceived standards and values of the public who use their services.

Responsive codes of practice can help to generate a framework for consensus and for legitimation. They are essential for providing a systematic basis from which rules may be derived and gain recognition for being normatively correct, and thus justifying procedures and sanctions for the purpose of enforcement. The disappointing record of one-sided, management-driven, codes of practice can be improved by designing or re-designing them to identify and become responsive to the proper aspirations of "stakeholders".

This, incidentally, also explains why the problems raised by "whistleblowers"[11] are so damaging to all concerned, and why they do not yield to whistleblowers hotlines, and to statements of professional support for standards. The way in which most codes are drafted, introduced and used is thus usually at odds with their stated intentions.

The **first** prerequisite for Responsive Codes is to avoid looking for success formulae or quick fixes, because success defined unilaterally can only "work" for those who have the power to demand it, and 'success' will be defined differently by other, such as customers, who have the ability to resist, complain or apply pressure.

[11] The term stands for an employee who reports unethical behaviour on the part of the organization or specific individuals to an outside entity such as the media, government bodies or interest groups. The case

An effective code of practice needs a proper and impeccable basis for ensuring natural and distributive justice. This enables client organisations and their members to get on with what they are skilled at and employed to do, unencumbered by the gamesmanship, bureaucratic and group rivalries that dominate most institutions, especially where there are conflicts of interest and perception and there is competition for scarce resources.

There are always, in formal organisations, a "mission statement" or its equivalent, "delivery" methods which translate the mission into practice, and a set of organisational myths and taboos, which prevent or help in the translation process.

In addition, there is always a gap between the (usually impeccable) aspirations of the mission statement and the organisational reality. Whether this gap is large or seriously problematic depends on whether the assumptions, practices, myths and taboos (what we call "intervening processes") are accepted as fair and just. There is always and inevitably already in existence in all organisations a code of practice (often unwritten) that is variously called the "organisational culture", "custom and practice", *etc.* This can support or undermine any formal code of practice.

The **second** prerequisite is a diagnostic method for identifying the nature and significance to the company or institution of the "aspirations gap". This involves identifying the informal codes, operational practices and beliefs, and discovering whether the intervening processes support the official aspirations, (prevent them from being put into practice, or are in tune with reality).

The **third** prerequisite is the design of jointly-owned and jointly-monitored methods of ensuring natural and distributive justice, which may be summarised as "Management in Balance". A major component of this is whether or not the goods or services are delivered to standards that are acceptable to all relevant persons.

Many of these ideas have been around for a long time. American experience of many institutions and firms confirms to the hilt the need to get intervening processes in balance with the official aspirations. Without this, the resulting downward spiral is clear to see in very many institutions and firms including some in financial services.

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of the Mitsubishi is an example; for more info on the case, see Fear and loathing at Mitsubishi, Business

6. Ways forward: a positive strategy

The principles underlying our positive strategy are:

a) The "normal" values in financial service provision are usually impeccable from an ethical point of view.

b) There is an inevitable gap between these values as statements of intent, and what actually happens.

c) This gap is not mainly due to greed or cunning or to morally weak individuals, even if some cases of the type have been found to exist in financial services. The prime causes arise from intervening processes that can only be understood by careful analysis by the systematic procedures for identifying and reconciling as well as encouraging and enforcing values. This requires us to understand the ways that ethical values interact with the operating procedures in financial services.

d) Improvements also depend on understanding this link between values and operating systems. That so little has yet been done in this area explains the continuing search for elusive control procedures and for structures that are effective.

We hold that the expertise of market leaders in financial services (and for a most, if not all business), though essential for improved procedures, is not sufficient. The challenge is to identify and rectify the "real" operating procedures and values that interact to generate the malfunctions that are noted with such regularity in the media and the courts.

Truly free markets require dissemination of "good' information. They demand clear rules for business, and inevitably they demand a regulatory system that commands the support of the majority of those subject to them. These provide the ultimate justification for anti-monopoly and anti-trust laws, fair trading regulation, and industry self-regulation. Thus, free markets are highly structured and not, for example, anarchic.

The systems need also to be research based. Too many regulatory efforts proceed from perceived problem to code of practice or code of ethics without doing the necessary research, or

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Week, May 6, 1996.

having the concepts and tools with which to do it. They are usually strong in intention but weak in rationale, validation and monitoring.

More important still, the opportunity for abuse and manipulation will always threaten their credibility without the involvement of all the parties and the safeguard of independent review.

- Privileged knowledge will always imply a need for agents who can act on behalf of constituents. The rise in corporate scandals indicates that there is room for more public education, even though members of the public may not always be entitled to be protected from their own mistakes. A balance is needed, and has not yet been universally achieved.
- All groups, employees, consumers, managers, professional advisors, for example, can and do have sub-groups. All have interests and aspirations in opposition as well as in common. An implication of this is that to expect a single group (such as a consumer panel, or professional body or trade union) to be fully aware of constituents' needs and aspirations is to expect too much. Even when the main issues are resolved, events and aspirations change. For this reason, the creation and operation of all codes seems to us to require a constant monitoring, and a procedure for matching the particular obligations of managers and professionals with the aspirations of constituents under the code

Responsive codes are capable of providing the basis for this constant monitoring and revision at the level of individual firms and organisations. They could not replace the developed regulatory systems, but they could supply the acceptance that appears to be lacking, or at least only partial. The production and monitoring of specific codes at the micro level is a design matter. Attention will need to be paid to a variety of key elements.

The detailed design strategies are beyond the scope of this paper.

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Figure 1: Formation of Codes

	approx. per cent
Founder members and/or their family	8
Board of directors	22
Top management	80
Legal department	42
Consultants	2

Source: The Conference Board (1988) *Corporate Ethics*: Research Report No 900, Page 15

Figure 2: Constituencies Addressed

Constituency relationships addressed in codes were: (%)

	approx %
Employees	90
Employees' families	42
Local communities	44
Customers/consumers	85
Suppliers	85
Shareholders	40
Home country government	58
Foreign governments	43

Source: The Conference Board (1988) *Corporate Ethics*: Research Report No 900, Page 15