

# Business Ethics

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## What is meant by Ethics?

Ethics refers to 'doing the right thing, in the right way, for the right reason'. While what is right may differ from country to country and from company to company or even from a person to person, there are always certain norms or standards which are accepted by almost all the people around, or the society in immediate environment, as being representative of the right thing to do. Adhering to these norms and standards relating to what is deemed as good is often considered a first step towards ethics. The next step is doing it in the right way, not just the legal way, not the short-cut way, not the convenient way, but the most appropriate way for the purpose. For example, let us assume that spending 2% of your income on charity is the right thing to do for an individual in a particular society. That is the first step – i.e. determination of the portion of income that must be spent on social causes. The next step is how to spend that 2%. If you throw that amount of money on the street, someone needy is quite likely to pick it up and use it. But then it is equally likely that someone not so needy may pick it up and use it for non-social purposes. It is therefore important that careful thought be given to the manner in which donations are given. Giving them to street beggars may seem to be convenient, but is not ideal. Sending a cheque away to just any charitable body is a short-cut which may not prove to be the correct way. History has shown us that a number of these charitable bodies are not really efficient or honest. It is therefore necessary that some investigation be made as to how good or effective an organization is before sending them the cheque, or finding out how genuine the need of the individual being helped is before dishing out the money. That would be the right way to do the right thing. And now let us look at the third part, namely doing it for the right reason. If the donation is given solely for the purpose of getting a photograph published in the newspaper and getting some recognition in the social circles, the donation ceases to be ethical – it enters the realm of self promotion. The donation should be given out

of a genuine desire to help the deserving people, not to build a public image for one's own self.

### **The Concept of Business Ethics**

Just as individuals should follow ethical principles in their daily lives, so should the business firms. Companies are also members of a society: they draw their revenue from the society, they get their capital and human resources from the society and they depend on the society for their very existence in about the same manner as do the individuals.

Running or managing a business has four principal functions: planning, organizing, leading and control. Applying the three dimensions of ethics (namely, doing the right thing, in the right way, for the right reason) to all the four functions of management is what constitutes the basic scope of business, or corporate, ethics. Let us consider it in stages:

- a. Planning and leadership, that include policy formation and setting the general direction of the company, must be based on a strong sense of ethics so that the business aims at doing the right thing.
- b. Organizing, that includes making arrangements for the plans to be implemented, must be built around ethical principles so that whatever a company does (or however it conducts its affairs) is done in the right way.
- c. Control that ensures that company plans and policies are adhered to should again have a strong dose of ethics, so that whatever is done is done for the right reason, not just to tick the boxes.

Hence Business Ethics (or Corporate Ethics) refers to the application of ethical principles of doing the right thing, in the right way, for the right reason, to all aspects of running a company including planning, leadership, organizing and controlling.

### **Evolution of Corporate Ethics**

There are two elements of business ethics: the business and the ethics. Business has almost always had a negative image. A simple look through the literature of any language over the history will show that businessmen are generally portrayed as villains, greedy, devoid of human decency, uncaring. This image has not emerged accidentally; businessmen have contributed to this image over the centuries through their ruthless pursuit of profits. This image persists even today – more so in

developing countries like Pakistan than in the more developed countries where the companies have started realizing the benefits of being ethical – and accordingly began mending their ways. The second element is ethics. Ethics has roots essentially in religion. We all know the teachings of Islam which cover all aspects of human behavior including business. Holy Prophet, peace be upon him, was himself a businessman who set and followed very high ethical standards. Pakistan was carved out of India which had a large population of Hindus. Hindus have historically followed a caste system and businessmen were considered the third tier of humanity. They were placed below religious people (brahmins) and soldiers (khastris), and just above the untouchables (shudars) in terms of importance in the society. This arrangement did not provide much motivation to businessmen for honesty or social responsibility. It has taken a very long time for this mentality to soften. It is said that people in Pakistan are generally very honest as individuals due to the influence of their religion but when it comes to business, a desire for profit somehow overwhelms all social values.

Businesses are now slowly recognizing the importance of being ethical. They are realizing that doing the right thing is a good business tactic and actually helps improve the profits. Doing the right thing in the right way is often easier and more efficient than doing it the wrong way which ultimately proves more expensive. And finally, doing the right thing for the right reason that is for ethical consideration itself rather than as a public relations exercise is what really makes a difference. A remarkable improvement in the ethical behavior of business firms has been witnessed over the last fifty or so years. Two factors have contributed to this improvement: firstly the scandals like Bhopal leakage in India, Enron in America and Mirror Group in UK, (all consequences of unethical behavior by companies) have led the regulators to come up with more strict laws and tougher codes and secondly the companies have themselves realized that doing business ethically is in their own interest from a long term perspective.

### **How to enforce what is right?**

There are essentially three ways in which business ethics may be enforced, namely through Law, Industrial Codes and Internal Codes.

#### **Law**

The Law plays a very important and effective part in ensuring that companies behave ethically, particularly in countries like Pakistan. In fact, it is often said that if you want any business to do a particular thing, make a law for it. For example, SECP had been advising the companies to have an Audit Committee and file their periodic returns on a timely basis. Companies paid scant attention to its advice. Then came

the Code of Corporate Governance and a change in listing regulations of Karachi Stock Exchange and SECP started fining errant companies. All of a sudden every listed company had a formal audit committee and most if not all companies started filing their return very promptly. Despite its power and good intentions, the problem with the Law is that unwilling people generally have the liberty to follow only the words of law, not its spirit. For example, even today the Audit Committees of most companies are seldom independent or effective. Law does not create honesty – it can only punish those who are caught doing a dishonest act. Again, Law cannot and does not cover everything. In fact, a very large part of ethics relates to area of behavior that can simply not be covered by Law. For example, we cannot make a law saying that everyone must donate money to charity, or give blood to a seriously injured patient. Nonetheless laws, rules and regulations made by a government and its agencies to regulate the various aspects of running a business remain a potent source of enforcing ethical practices.

### *Industrial and Professional Codes*

These codes have similar if somewhat lesser power than Laws to make companies behave in an ethical manner. Codes issued by professional bodies like Institute of Chartered Accountants, Engineering Council, Medical Association, etc all enforce a very strict code of conduct on their members, who in turn influence the companies (they work for or provide services to) to do the right thing. For example, an external auditor is required by his professional association (ICAP) to refuse to issue an audit report unless he is fully satisfied that the accounts are compliant with applicable accounting standards and laws. His refusal to sign an audit report, in turn, leads the companies to be more upright in maintaining their accounting books and preparing its financial statements. Similarly industrial and trade associations like chambers of commerce, APTMA, APCMA, etc also prescribe codes of conduct for their members relating to their specific areas.

### *Internal Codes*

A code of ethical conduct prepared and enforced by a company's board of directors is reflective of what a company truly wishes to achieve in the realm of business ethics. Code of Conduct, Statement of Values, Mission Statement, Credo, Procedure Manuals and other similar documents sincerely designed and earnestly implemented by the top management have a much greater likelihood of success in infusing ethics into the conduct of a company's employees than external factors like the law and industrial codes.

### **Need and importance**

Companies that follow good ethical practices can reap the following benefits:

- A significant improvement in company's public image and reputation. A company that follows good ethical practices earns a reputation that frequently translates into better public image and greater acceptability of its products by the society. It is believed by customers everywhere (and not unreasonably so) that products made by an honest company must be of good quality. Such products are often able to command a premium price, thereby adding to company's profitability.
- A company that follows ethics in its operations is able to infuse honesty in its employees. This in turn means that they do not cheat the company, do their work sincerely, and generally look after the company's assets. This leads to higher productivity and efficiency.
- A reputation of being ethical helps a company attract and retain better employees. This explains the overwhelming preference of fresh university graduates to work for multinational companies (that generally have a good reputation for ethical work environment) than accept appointments in local business organizations (that generally suffer from poor reputation in this regard).
- A company with good ethical image is able to attract capital more easily and at more competitive rates. A number of research studies conducted in USA and Europe have concluded that companies that have better corporate governance have a lower cost of capital. This simply means that investors (both shareholders and long term lenders) are happier to invest in ethically sound companies.
- An ethically run company plays its due role in society which results in betterment of the society as a whole. It pays its taxes promptly which helps the government, it participates in social welfare which contributes to general well being of people, and it looks after the environment which secures the future of our children.
- In short, ethical conduct of business keeps everyone happy including the investors, managers, employees, customers and society at large. And every one including the company wins.

### **Characteristics of an ethical organization**

Typically an ethical organization would have the following characteristics:

- It has a formal code of ethics, or Integrity Policy, that it rigorously enforces on all its managers and employees.
- It maintains a regular interaction with all its stakeholders. It does not hide things; it is transparent in its conduct and does keep all concerned informed.

- It is obsessively fair in its dealings with every one: the investors, the employees, the suppliers, the customers, and the society. Fairness is a key ingredient of ethics.
- Its managers take responsibility individually – they do not hide behind collective responsibility charade.
- Its employees see their activities in terms of purpose, not just the outcome. They attach importance to not only what they are doing but also to why they are doing it. In other words whatever they do, they do it for the right reason.
- Its procedures and operations are not bureaucratic. Purpose is not sacrificed at the altar of systems. Its control processes are sound, i.e. they demand a high degree of efficiency but not at the expense of ethics.

### **Roots of unethical behavior at individual level**

A company comprises of people. People own and run the company. People work in and around the company. Hence the individual character of persons working in or around a company has a direct influence on the operational practices of a company. Let us briefly discuss the roots of unethical behavior at individual level to understand what the management of a company has to contend with when formulating and implementing ethical policies at the work place.

The following factors are said to contribute to employees being unethical:

- a. Pressure to balance work and family life;
- b. Poor communication between the company and its employees;
- c. Poor leadership in the company that fails to motivate the employees;
- d. Heavy work load, disproportionate to an employee's capacity to handle;
- e. Long working hours that interfere with family life;
- f. Undue pressure to meet sales or profit targets;
- g. Lack of recognition of effort or honesty;
- h. Politics at work place, favoritism by managers;
- i. Personal circumstances, home worries, sickness in family, etc.

If we study the above factors, it is not difficult to realize that most, if not all, of them can be handled by an efficient and ethical management through use of basic human resource management techniques. Employees need to be attended to, they need to be listened to and they need to be looked after. If managers pay adequate attention to each employee, giving him opportunity to discuss his or her personal issues with immediate supervisor, a number of the problems can be resolved before they lead to dishonest behavior.

## **Aspects of Unethical Behavior at Corporate Level**

Companies, much like their employees or other persons, also have issues and factors that lead to unethical behavior. Some of these issues are:

### ***Bribery***

This is the biggest curse facing the companies anywhere in the world; more so in the developing countries. Paying a bribe to a greedy governmental official, or purchasing manager of a client company, is often seen as the most efficient way of getting a job done. If company condones bribery to get a legitimate right, it soon reaches the stage where it starts using bribery to get what is not legitimately due to it. For example, if a company fails to grease the palm of a sales tax auditor, it may find that even though its sales tax records are in well in order, it cannot get a clean audit report. Now if it agrees to offer a bribe to the auditor to get a clean audit report, it may lose motivation to keep its sales tax records in order in the future. Next year, it may get a clean audit report without having satisfactory sales tax records. What starts as a payment for convenience, pretty soon turns into a source of dishonesty.

Companies need to draw strong codes of conduct to tackle issues like bribery. General Electric (GE) a major USA corporation has a very strong statement which should serve as a guideline to all companies. It says "No matter how high the stakes are, no matter how great the stretch is, GE will do business only by lawful and ethical means. When working with customers and suppliers in every aspect of our business, we will not compromise our commitment to integrity".

### ***Coercion***

Coercion refers to forcing a person to act in a manner that is against the person's personal beliefs. It can take various forms like blackmailing, arm-twisting, threat of blocking an approval or loss of a license, etc. In fact coercion is another side of the bribery coin. Companies face coercion from many quarters, political as well as social. And sadly, companies too use this tactic to achieve their objectives. Employees are frequently forced to fudge records for not so legitimate reasons. Unless a company demonstrates a strong will to withstand external coercion and disband internal coercion, it cannot succeed in pursuing an ethical conduct of its affairs.

### ***Conflict of interest***

There are times when even the most loyal employees may find that their personal interests collide with that of the organization. Likewise, there are situations where the interest of a company may clash with that of the society, or a particular group of

stakeholders. Companies need to devise policies and procedures to combat both aspects of conflict of interest. Its code of conduct should be so designed, and its human resources policies should be so realistic that they should leave no room for an employee to justify placing his personal interest above those of the company. Similarly, no argument should be accepted by a board of directors to allow the company to sacrifice the interest of the society only to further its own cause.

### ***Tax evasion***

This may be viewed as an aspect of conflict of interest. Companies often find it difficult to accept payment of taxes as a legitimate duty. The general argument is that companies seldom receive anything in return of these payments. The affliction applies not only to direct taxes like income tax, but also extends to indirect taxes as well like sales taxes and custom duties. The level of resistance being experienced by the Pakistani government in implementing its Value Added Tax (VAT) system is a clear proof of businessmen's attitude towards taxes. Payment of all due taxes is a fundamental part of a company's responsibility towards the society in which it operates. And the company's board of directors must ensure this when drawing up its code of ethical conduct.

### ***Insider trading***

As explained in an earlier chapter, insider trading refers to use of privileged price sensitive information (which becomes available to a senior manager or director by virtue of his position) that is not known to the general market for the purpose of personal gain. For example, if the company is going to announce very high profits or dividends, the finance director may know this well before anyone else does. Now the announcement of such results is likely to increase the market price of company's share. The finance director can go to the market and using some front-man to buy up a large number of company's shares before the company actually announces the results. As soon as the results are announced and the market responds favorably, the finance director can off-load the shares at a hefty profit. This is both unethical and illegal, despite the common plea taken by offenders that they did not hurt anybody or the company. Companies must make very strong rules about maintaining confidentiality and avoidance of insider trading.

### ***Lack of Regard for the Society at large***

This includes pollution of rivers, emission of harmful gases into the atmosphere, indiscriminate use of non-renewable natural resources, marketing of unethical products (like pornographic material or cigarettes), use of unsafe material in manufacture of consumable products, etc. All these things are controllable, at a

price. Every company should make it a policy to bear that price in the larger interest of the society.

### **How to enforce Ethical Conduct in a Company**

The first step towards building an ethical environment in a company is for the board to promulgate a formal Code of Ethical Conduct which clearly and categorically lays down the company's policy on ethics and declares its total commitment to adherence to ethical principles in all spheres of its activities. In particular, the following should be included in the Code:

#### *Ethical Decision-making*

The company must clearly state its intention to make sure that all its policy and operational decision-making processes are governed by ethical considerations. This means the company shall in all circumstances endeavor to do the right thing, in the right way and for the right reasons.

#### *Avoidance of conflict of interest, at all levels*

The company shall avoid conflict of interest at all levels. In the first stage, it shall ensure that it will not place the interest of any particular stakeholder above the interest of another stakeholder. Secondly, it shall not allow company's interest to prevail upon that of the society in which it operates. Thirdly, it shall create a work environment that motivates the employees that they do not act contrary to the interest of the company in order to serve their personal interest.

#### *Honesty and Integrity*

The company must assert that it shall conduct its business honestly and with integrity. It shall not sacrifice these principles for the sake of convenience or profits. It shall not engage in activities like bribery or coercion to meet its objectives.

#### *Fairness in dealing with every one*

The company must be fair to all the persons that it deals with, both internally and externally. This means it should be fair to its investors (shareholders as well as lenders), its employees, its suppliers, its customers and the society at large. It shall refrain from undesirable practices like nepotism, favoritism and discrimination on grounds of religion, language, color, origin or gender. The same set of rules should be applied to everyone so that no one is placed at a disadvantage in relation to another.

### *Transparency: accurate, complete, objective communication*

The company must maintain regular communication with all stakeholders. All decisions should be made in a transparent manner and information should be conveyed to all concerned, fully and objectively. No behind-the-back, or under-hand deals should be entered into, nor any officer allowed to with-hold information from a person who is entitled to such information.

### *Acting in good faith*

The company must act in good faith based on whatever information it has in any particular situation. While mistakes may occur, the underlying consideration in all of company's policies and actions should be good faith. This principle is consistent with being fair, honest and transparent in all its dealings.

### *Compliance with Law*

Compliance with all applicable laws should be the paramount responsibility of a company. Its code of ethical conduct must clearly instruct all managers and employees to never run afoul of the law, regardless of the size of stakes. There are laws at different levels, e.g. municipal, district, provincial or central government. All of them should be religiously followed to the extent that they relate to company's affairs. All returns and reports must be filed as required by the law, in time and with all honesty. This point also extends to a need for complying with different professional codes and standards relevant to the nature of the business a company is engaged in.

### *Confidentiality and respect for confidential data received*

The code must state company's desire to maintain confidentiality of the issues deserving of confidentiality. At the same time, the company must respect the confidentiality of the information it receives from its business associates, not allowing it to be misused or abused.

### *Proper use of position, power or property*

The company must exhort its officers to use their position in the company, their powers and the company property at their disposal properly and only for the purpose intended, namely the company's benefit.

### *Encouraging ethical reporting: whistleblowing*

The code of conduct must encourage ethical reporting, both within and to the outside authorities. It should specify the route for non-formal reports, preferably laying down a procedure for handling internal whistleblowing. Employees and where relevant outsiders should be provided due opportunity to air their views, and share their observation of any untoward incidents in the company.

## The Pakistani Context

In Pakistan, it is common for business managers and businessmen to complain that conditions prevailing in the country are simply not conducive to being completely ethical. Thousands of underhand deals are struck everyday and go unreported. There is hardly a company which has not been at some time or another directly or indirectly involved in some foul play. Even those companies that started off with an intention to do business in an ethical manner have had to compromise along the line due to highly politicized and bureaucratic business environment. Growing corruption, increasing disparity between people, rising inflation and shrinking profits add to the woes of companies that wish to remain ethical.

Some thirty years ago, companies used to bribe government officials to get what was not rightfully due to them, e.g. winning contracts by unfair means. Now the situation has reached a stage where a company has to bribe governmental officials even to get what is rightfully due to them, e.g. renewal of a license. A survey conducted among managers in India (where the business environment is not much different from Pakistan) in 2007 showed that business executives consider the following three factors to be prime obstacles to ethical behavior by the companies:

- Company policies,
- Unethical industrial climate, and
- Rampant corruption in the government.

If we look at the above list, the first item clearly relates to governance. If the Board of Directors clearly spells out a formal code of conduct for the company, this point can be addressed. If all the companies, or at least all the major ones, start following this line, the second item on the list can also be gradually resolved. This leaves us with corruption in the government which exists primarily because there are businessmen who are too keen to feed the dishonest government officials. Once there is a general atmosphere of ethical behavior among big businesses, government officials will find it difficult to persist in their nefarious ways for long. Even today, there are some companies that enjoy such good reputation for uprightness that government officials are quite reluctant to seek any undue favors from them. The list includes both local and international firms operating in Pakistan.

There is a need for change in mind set. Ethics is not yet a priority in the minds of businessmen or even law-makers. The politicians (who carry the primary responsibility for bringing about that change in mind-set) are themselves mired in accusations of unethical practices. Recent spate of allegations about fake degrees held by many assembly members is a clear sign of how political parties stand on ethics.