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I. INTRODUCTION

Well before the recent Wall Street scandals and the ensuing regulatory legislation, corporations were creating corporate codes of conduct and mission statements. Johnson & Johnson summarized its corporate identity before the company went public. Termed "Our Credo,"[1] this concise statement ensured that the values of Johnson & Johnson's family owners would continue even as the corporation became held by increasingly diverse shareholders.

For other institutions, codes of conduct resulted from legal pressure. In 1991 Congress amended the Federal Sentencing Guidelines, adding corporations to the list of criminal defendants to whom the Guidelines apply.[2] Since 1991, the vast majority of large U.S. companies have established corporate compliance systems, a significant feature of which is some kind of code of ethics. The 2002 Sarbanes-Oxley Act put further pressure on corporations in the securities industry to develop codes of conduct as a way to prevent future improprieties.[3] In addition, the 2004 Amendments to the Federal Sentencing Guidelines added the requirement

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1. *See* Johnson & Johnson, *Our Company*, *at* http://www.jnj.com/our_company/our_credo/index.htm.

2. *See* Sentencing Guidelines for the United States Courts, at 18 U.S.C. app. [hereinafter USSG] § 8A1.1 (2005).

3. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 746-810 (2002) (codified as amended in 15 U.S.C. §§ 7201-7266 (2005)).

that corporations develop ethical cultures beyond effective compliance programs.[4]

This paper addresses issues surrounding the design and implementation of an ethics program, first providing a snapshot of the six principles for building ethical cultures, followed by a more extensive discussion of each principle.

II. SIX PRINCIPLES FOR BUILDING ETHICAL CULTURES

1. THE VALUE OF CODES OF CONDUCT AND MISSION STATEMENTS

Standing alone, codes and mission statements can cause more problems than they solve. They can be very effective, however, when embedded within a program that creates and supports a culture of ethical behavior.

2. ETHICS AS THE RULES THAT SUSTAIN RELATIONSHIPS

An effective ethical code sustains relationships, and hence an effective ethics program does not ignore the interaction that occurs among relevant parties. Prior to the creation of a program, a company should engage all key parties that will be affected by the new program, and rules important to sustain the relationships should be clearly identified.

3. HARDWIRED CHARACTERISTICS IMPEDE ETHICS, AND HENCE REQUIRE CUSTOMIZED PROGRAMS

Certain hardwired dimensions of our human nature impede the capability of humans to make thoughtful, ethical decisions. Companies also suffer from this inability to naturally include ethics in business. To counter this, ethics programs must be customized. There is no one-size-fits-all program that solves institutional ethical problems.

4. LEGAL COMPLIANCE OR HARD TRUST

A clear set of rules, whether formal or informal, is imperative. Clear rules define acceptable behavior and specify when violations of that behavior are subject to punishment.

5. ORGANIZATIONAL JUSTICE OR REAL TRUST

Another essential element can be termed "Organizational Justice," or "Real Trust." Organizational Justice requires the alignment of institutional

4. *See* USSG § 8B2.1.

practices with the best thinking on ethical behavior. Further, those affected by the company must perceive the organization as being fair. There should be a mechanism to encourage periodic review of the ethics program by independent members of the board of directors and by regular surveys conducted throughout the organization.

6. GOOD FAITH OR GOOD TRUST

"Good Faith," or "Good Trust," refers to the encouragement of a sense of purpose to which people link their identities. It also means using the institutional framework to draw upon people's natural moral sentiments.

III. PRINCIPLE 1
THE VALUE OF CODES OF CONDUCT AND MISSION STATEMENTS

There is not a strong record of codes of conduct changing behavior. Linda Trevino has suggested that "paper programs," (ones that involve only the issuing of codes and mission statements for compliance purposes) are ineffective, and can create a more cynical culture where employees observe the gap between rhetoric and practice.[5] Participants in my executive education classes are asked two questions. First, do their companies have a code of conduct? Second, when was the last time they read it or know of any efforts to make the code part of the day-to-day dialogue occurring at work? Nearly everyone answers "yes" to the first question and are mute to the second.[6] If those taking executive education courses are representative of the workplace generally, it is unlikely that codes of conduct permeate the lives of employees.

Lynn Paine has demonstrated that companies opting for a "compliance model" of creating an ethical work culture typically do not inspire their employees to aspire to ethical conduct.[7] Employees may be relieved that they are not violating the law, but they are not likely to report this to their families at the end of the day with pride. Creating an environment where employees are required to stay out of trouble typically does not encourage them to change their mental orientations enough to actually do so.

5. Linda K. Trevino, et al., *Managing Ethics and Legal Compliance: What Works and What Hurts*, 41 CAL. MGMT. REV. 131, 138 (1999).

6. This conclusion is drawn from informal surveys of participants in author's executive education courses at the University of Michigan Business School from 1996 – 2005.

7. Lynn Sharp Paine, *Managing for Organizational Integrity*, HARV. BUS. REV., Mar.-Apr. 1994, at 106.

This difference, between a compliance-based corporate culture with its focus on prohibitory legal rules and an aspirational culture that aims to achieve positive good, has been cited by LaRue Hosmer as a key cultural differentiation between Exxon at the time of the Valdez oil spill and Johnson & Johnson at the time of the Tylenol poisonings.[8] In a culture taught to only avoid violating rules, Exxon took a legally defensible minimalist response whereas Johnson & Johnson, in following their aspirational corporate credo, responded actively, going beyond the requirements set by any law.

While clear rules implemented alone can be ineffective, they remain important. Clear rules provide three benefits. First, they provide some protection against litigation by demonstrating that the company took steps to comply with applicable laws. Second, clear rules work as an efficient mechanism to announce what is important and valued as opposed to what will not be tolerated. This is particularly important when organizations have highly mobile workforces, and new employees must learn the complexities of an organization's values quickly. Third, creating a code of conduct can serve as the launching pad for a more comprehensive ethics program.

IV. PRINCIPLE 2
ETHICS AS THE RULES THAT SUSTAIN RELATIONSHIPS

Although humans are social creatures, ethical codes are defined personally. Ethics reach into our very identities, but because they encompass a set of obligations to other people, ethical codes can never be private. It is our ethical obligations to ourselves and society that sustain our relationships.

The easiest way to understand why employees might resist ethical edicts from top management is to think of how un-inspiring it is to be told what to do, morally speaking, by someone else. Even if one agrees with the advice, most people do not like being lectured on moral issues. Corporations would take a large step toward employee buy-in if, for instance, they asked each employee, from CEO to janitor, to define seven principles, virtues, or values, by which the organization and its members would be governed. The results are not likely to be surprising since, contrary to popular belief, people consistently value similar things. The

8. LARUE T. HOSMER, THE ETHICS OF MANAGEMENT 149-152 (4th ed. 2003).

level of buy-in, however, will be much different if those affected by the company's rules have input during their development.

Surveying internal stakeholders as to what they think is important does not mean that companies can ignore other external constituents. The public, represented by regulatory agencies, is a critical stakeholder. The same buy-in theory that applies to employees also applies to members of the investing and non-investing public. Obviously, one cannot survey all possibly affected constituents: the point is that it is important to understand the variety of relationships the company has, and to take them into account when creating the rules of governance.

V. PRINCIPLE 3
HARDWIRED CHARACTERISTICS IMPEDE ETHICS AND HENCE REQUIRE CUSTOMIZED PROGRAMS

Psychological research demonstrates that individuals tend to believe that they themselves are ethical while others are not.[9] Further, people believe that they are relatively good at objectively analyzing ethical issues.[10] Unfortunately, this is frequently a factor of self-deception rather than a realistic characterization of human cognitive capabilities. David Messick and Max Bazerman note that people tend to have more confidence in their decisions than they should; they believe that they will not get caught when they take questionable steps; and they underestimate the reaction of those who are affected by their actions.[11] People also tend to divide the world into "us" and "them."[12]

The "us" versus "them" dichotomy is neither good nor bad; it is simply the way people perceive and categorize each other. Converting this dichotomy into something constructive requires exposing insular groups to outside voices. There is a tradition in moral philosophy that argues that humans develop their moral character in relatively small mediating institutions, such as family, neighborhood, and religious organizations.[13] In these mediating institutions, people experience the consequences of their actions and, accordingly, adapt their moral norms and character in order to

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9. David Messick & Max Bazerman, *Ethical Leadership and The Psychology of Decision Making,* 37 SLOAN MGMT. REV. 9, 9-10 (1996).

10. *Id.*

11. *Id.*

12. *Id.* at 9.

13. TIMOTHY L. FORT, ETHICS & GOVERNANCE: BUSINESS AS MEDIATING INSTITUTION 21-39 (2001).

be a good citizen of that community. Moreover, there is anthropological and psychological data indicating that people tend to be more comfortable in small groups.[14] For example, group conversations tend to max out at between four to six individuals; the average size of hunter-gatherer societies was thirty; and the maximum size of a group in which one has face-to-face relationships tends to rest at about one-hundred and fifty.[15]

People generally understand that their actions affect those close to them. It is much harder, however, to understand the consequences of one's actions in a large structure, such as a corporation. In a global economy it may seem unfathomable that one has obligations to unobservable stakeholders. It is the law that serves to sustain relationships between individuals and their more distant peers. A trader for the New York Stock Exchange, for example, may be focused on how to get along with other traders rather than the impact his actions have on distant investors. Whatever the governing body -- federal, state, or municipal -- the law is a reminder of the obligations a corporate group has to the rest of society. As noted in the first principle, however, rules alone are not optimally effective.

Certain industries and corporate cultures tend to produce specific problems. For example, doctors and lawyers are familiar with malpractice issues, chemical plants understand the possibility of chemicals getting into local water sources and nuclear plants know the risk of radiation leaks occurring. Addressing these problems before they arise is a far more effective means of dealing with ethical responsibility. Thus, returning to the Exxon Valdez example, had Exxon discussed the possibility of an oil spill and their responsibilities to the public, the company would have been better prepared for the Valdez disaster. This is, in fact, a key difference between Exxon and the Johnson & Johnson Tylenol case. Because of the values expressed by Johnson & Johnson in their corporate credo, and the credo's permeation throughout the company culture, the employees knew what to do when an outside party corrupted the product. In short, Johnson & Johnson employees took to heart the values of service to their constituents and tailored a response specifically attuned to those values.

In addition to generalized notions of dialogue and preparedness, which focus attention on those issues likely to cause problems for a particular industry and company, the type of company makes a difference. Some

14. *Id.*
15. *Id.*

firms are organized primarily to materially satisfy consumer tastes. We expect Ford and GM to produce cars we like: their responsibilities run primarily to shareholders and customers. Although these companies occasionally add to those duties, they do so either out of a sense of "enlightened self-interest," where they anticipate potential regulation and attempt to head-off some of the law's heavy-handed and frequently overbroad solutions, or out of a sense of corporate leadership that builds economically valuable reputation and goodwill.

Other companies, however, have a more explicit public purpose. Society expects accounting firms to do more than satisfy shareholders, partners, and clients. In fact, we expect them *not* to satisfy client wants. That expectation was fulfilled by Mr. Arthur Andersen, the founder of the accounting firm that bears his name. Andersen is known to have refused doctoring the books of the powerful railroad companies of his time.[16] Accounting firms fulfill their public duty, when they provide reliable, accurate financial information. Recent commingling of accounting firm functions has severely undermined that public good, which should take priority over private gain. The same holds true for law firms. Lawyers have a duty to zealously represent their clients while acting as an officer of the court and working towards the administration of justice. Securities exchanges provide another example; while the opportunity for private gain brings people to an exchange, the institution exists to provide a public good, market liquidity.

The recent spotlight on corporate responsibility has focused on the establishment of basic principles that apply to all companies. Each company, however, must make an individual assessment of important public relationships and focus on those relationships when creating a code of conduct and ethics program.

VI. PRINCIPLE 4
LEGAL COMPLIANCE OR HARD TRUST

In an environment with little turnover in organizational membership and a relatively homogenous population, formal written rules are relatively unimportant. Through custom alone, people know the rules of the community. Such an environment may exist in some small, rural towns or city neighborhoods. It may also exist in long-standing businesses or

16. KENNETH E. GOODPASTER, ET AL., *The Corporate Scandals of 2002 (B): Arthur Andersen LLP, in* BUSINESS ETHICS: POLICIES AND PERSONS 71 (McGraw Hill 4th ed. 2005).

industries. The more diverse and mobile the population, however, the more important it is to have clear, formal rules that alert people to what is expected.

For this reason, it is important that corporations have stated conduct policies that are more than paper statements. People need to be educated as to the specifics of the policy in order to clearly understand its dictates. Further, the policies need to be enforced to emphasize their importance.

One element of an effective policy is attention to legal requirements. The necessity of compliance is well understood in business these days, as demonstrated by the proliferation of corporate codes of conduct in response to the Federal Sentencing Guidelines and Sarbanes-Oxley. This is representative of "Hard Trust" because legal accountabilities are backed by set, enforceable penalties for violation of the stated rules.

VII. PRINCIPLE 5
ORGANIZATIONAL JUSTICE OR REAL TRUST

Much academic work at business schools focuses on theories of justice.[17] While the terminology changes, the normative approach of business ethicists suggests how classic notions of philosophy, such as attention to rights, distributive justice, and utilitarianism, apply to the corporation. The descriptive approach concentrates on whether key stakeholder groups perceive organizations to be fair. Methodologically, these takes are very different, but the significant connection between the approaches is one of building trust. What makes individuals perceive that their organization is trustworthy is the integration of management and business practices with considerations of the ethical treatment of stakeholders.[18]

A quality analogy ties the two approaches. Quality management theorists argue that a quality control process that waits for an inspection at the end of a production cycle is ineffective.[19] If one waits to review quality

17. *See, e.g.*, THOMAS DONALDSON & THOMAS W. DUNFEE, TIES THAT BIND (1999) (approaching justice from a social contract perspective); *see also*, ROBERT C. SOLOMON, ETHICS & EXCELLENCE (1993) (approaching justice from an Aristotelian perspective).

18. LaRue T. Hosmer, *Why Be Moral: A Different Rationale for Managers*, 4 BUS. ETHICS Q. 191, 202 (1994).

19. *See* Timothy L. Fort, *The Spirituality of Solidarity and Total Quality Management*, 14 BUS. & PROF. ETHICS J. 3, 11 (1995).

until just before shipping, it is often too late. If the product is sub-par, one has a dilemma: absorb costs of remanufacturing or sell a defective product. Neither is a good choice. A better approach is to build in quality checks throughout manufacturing process. Doing so would ensure that there are no surprises in the end.

So it is with ethics programs. If one puts off considering ethical dilemmas until, for example, oil is floating in the Prince William Sound, it is too late. The way to approach the problem is to be prepared for such contingencies. This requires ongoing consideration of ethical issues rather than waiting to consider them when a problem arises.

The normative school of business ethics advises that questions of stakeholder rights, distributive justice, and utilitarianism be consistently raised.[20] Corporations can affect stakeholder rights, for instance, through unsafe working practices or ecological degradation. In considering distributive justice, corporations should consider how their actions affect their most vulnerable stakeholders. If a glue product contains certain chemicals that adversely impact children's health, the glue-manufacturer should take steps to protect children. The manufacturer's duty to prevent such injury is particularly great when a child's family or the government fails to provide adequate safeguards. Ecologically, corporations should increasingly consider the greatest good for the greatest number in terms of integrating non-polluting practices with profitability. At the extreme, such considerations might transform businesses into institutions that lose sight of their profit making function. Many commentators and business leaders, however, argue that a well-run company does all of these things. It is simply good management to build in such considerations.

The descriptive approach to organizational justice looks to how programs are perceived. As Trevino and her colleagues have shown, a code of conduct that is simply a paper program is ineffective and can breed cynicism.[21] Similarly, if people in the company believe that an ethics program imposes rules on the lower-ranked individuals to the exclusion of higher-ranked ones, it will undermine the credibility of the program. Organizations that follow-through on complaints will garner more trust and be perceived as fairer than those that do not. All of these dimensions feed into perceptions that a company takes ethical issues to heart.

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20. *See* Fort, *supra* note 12, at 131 (following the work of WILLIAM C. FREDERICK, VALUES, NATURE & CULTURE IN THE AMERICAN CORPORATION (1995) in reducing contemporary business ethics to a formula of rights, justice, and utilitarianism).

21. Trevino, *supra* note 5.

The extent to which an organization aligns its management practices with its stated beliefs, and the extent to which ethical considerations are allowed to be part of the regular work life of participants, complement these notions. Performance incentives need to be integrated with rhetoric. If the company wants to sell quality food products but has financial incentives for selling tainted food surreptitiously in order to improve a manager's bonus, there is a detrimental mismatch. Recognizing the alignment of the incentive structure with stated values transforms business ethics from something that is merely a question of personal integrity to one of management practice.

In addition, companies that are successful in fostering ethical corporate cultures find ways to make ethical considerations a topic of conversation without heavy-handed lecturing. Thus, allowing employees to convey stories about admirable behavior, running modules that test and teach ethical thinking and establishing employee mentor programs are all ways to improve ethical practices.

In management literature the term "organizational justice" refers to the stakeholders' perception of an institution's fairness. Surveying techniques have been developed so that such perceptions can be captured on a regular basis. Rather than relying solely on a top-down evaluation of the company's attempts to instill ethical values, an organization could develop surveying mechanisms designed to regularly elucidate how the daily affairs of the organization are perceived, and how well they follow the goals of the program. The board of directors, advised by special consultants, should regularly evaluate the effectiveness of their program. Surveys should be developed and administered in a web or e-mail based format, which would allow those regularly working with the company to evaluate how well the goals of the program are being achieved. This will serve to help determine whether the organization is acting fairly and justly in the eyes of the stakeholders, and provide an early warning system for potential slippage. Further, it will emphasize the ongoing importance of ethical behavior.

VIII. PRINCIPLE 6
GOOD FAITH OR GOOD TRUST

Although staying out of trouble is an important goal, such a limited objective tends to obscure the most important dimension of ethical behavior. It is one thing for a person to be honest because otherwise they may get in trouble or harm their reputation. It is another for a person to be honest simply because that is the person they want to be. A person who finds it inspiring to be ethical is more likely to be sincere and passionate and, therefore, more trustworthy.

The individual quest for moral identity does not mean that people's relationships with others, including their business communities, are unimportant. Organizations can nurture or destroy moral virtue. Recent studies in anthropology suggest that humans are hardwired to be most cognizant of the importance of relationships in relatively small groups.[22] Extrapolating from the ratio of the sizes of neocortices of primates, Robin Dunbar predicts that the number of people one can feel they are connected with is as small as one-hundred and fifty.[23] That number correlates with survey evidence showing that it is the average number of names in an address book, as well as the average size of a military company.[24] This also connects with the strand of natural law that argues that human beings develop their moral character in relatively small "mediating institutions" where individuals must face the consequences of their actions.[25] In large organizations, corporate or governmental, an individual employee can feel that his or her actions do not make a difference. Ethical conduct is bound to be undermined in such institutions. Hence, if ethical conduct is to be encouraged, individuals should be connected in small groupings within the business in which one develops citizen-like awareness.[26]

The danger, however, of such small groupings is a potential for an "us" verses "them" mentality to develop. To counteract this risk, it is important to make sure that in any small group, there are outside voices to counteract insularity and identify goals that open individuals to positive good. Outside voices include independent members of the board of directors and members of the local community.

With such a system in place, corporations can have a positive impact on the local community, promoting economic development[27] and fostering a sense of citizenship.

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22. *See* Fort, *supra* note 12, at 49-52.

23. *See* ROBIN T. DUNBAR, GROOMING, GOSSIP, AND THE EVOLUTION OF LANGUAGE 63 (1996).

24. *Id.* at 74-76.

25. *Id.*

26. Fort, *supra* note 12.

27. *See* TIMOTHY L. FORT & CINDY A. SCHIPANI, THE ROLE OF BUSINESS IN FOSTERING PEACEFUL SOCIETIES (2004).

IX. CONCLUSION

All too frequently, the implementation of an ethics program consists of the publication of a code of conduct calling for employees to obey applicable laws while paying homage to the importance of adhering to high standards of integrity. Employees sign a statement that they have received a copy of the code and press releases tout the company's actions. These steps, along with the appointment of officials with good titles to oversee the plan and some other processes mandated by the Federal Sentencing Guidelines or Sarbanes-Oxley, make for *prima facie* evidence that is helpful in litigation. They do little, however, to change corporate culture.

To create ethical cultures, companies need to take into account the foundational issues that make for better ethical decision-making and those that tend to undermine it. These foundational underpinnings go to the heart of human nature and require a comprehensive and ongoing effort.