

The impact of codes of conduct on corporate culture

Measuring the immeasurable

Companies have been writing codes of business conduct for decades, but the role they play in shaping corporate culture is changing dramatically. The focus is shifting from writing a comprehensive code of rules to regulate conduct to leveraging a values-based code that inspires principled performance among employees, management and executives.

This shift is propelled by both internal and external sources. Investors, customers and other stakeholders increasingly want to do business with organizations that have high ethical standards and, as a result, top management and boards of directors are becoming more attuned to the ethical climate of their corporate culture. Additionally, there is increased pressure from regulators, including the U.S. Sentencing Commission's amended Federal Sentencing Guidelines for Organizations (FSGO) – generally regarded as the criterion for an effective ethics and compliance program – that now require organizations to focus on promoting an ethical culture and evaluating the effectiveness of their programs.

This paper assesses the impact of codes of conduct and code education on corporate cultures. It also suggests ways that organizations can improve the effectiveness of their code programs.

The evolution of codes

Codes of conduct extend back to before World War II. One of the earliest company codes was Johnson & Johnson's Credo, published in 1943 after General Robert Wood Johnson urged his fellow industrialists to embrace corporate responsibility to customers, employees, the community and stockholders.¹

Worldwide interest in business ethics and codes of conduct took off in the 1980s. Among the first large corporations to adopt codes of conduct were General Electric, General Dynamics, Martin Marietta (now Lockheed Martin) and several other defense contractors who saw business ethics programs as a way to self-regulate rather than submitting themselves to government regulation.²

In 1991, the U.S. Sentencing Commission issued the Federal Sentencing Guidelines for Organizations (FSGO), outlining the elements of an effective ethics and compliance program. As one component of this, the FSGO recognized that simply having a code was not enough. In this view, the "3P" approach – in which you "Print a code of conduct, Post it on the wall and Pray people actually read it"³ – simply did not form the basis for an effective program. As a result, the FSGO required code education for employees and other mechanisms for communicating and reinforcing organizational values.

In 2002, the Sarbanes-Oxley Act further bolstered the importance of codes of conduct by requiring public companies to have a code of conduct for top executives (and, if they didn't have one, to explain why). Then in 2003, both the New York Stock Exchange and the Nasdaq required listed companies to adopt and disclose a "code of business conduct and ethics" that applies to all employees and directors. Together with these regulatory developments, having a code became practically a mandate for public companies.

The most recent step in the evolution of codes of conduct occurred in 2004 with the Revised Federal Sentencing Guidelines, which stipulated that companies must promote an organizational culture that encourages ethical conduct and commitment to compliance with the law. The impact of this change in the FSGO is that it effectively elevates a company's code of conduct into becoming an integral part of its culture, not just a side note to employee education and communication.

Signs of code effectiveness and success

While complying with the Federal Guidelines, NYSE and Nasdaq and minimizing exposure to criminal liability are strong motivations for establishing an ethics and compliance program, progressive organizations are discovering that an ethical workplace also offers many performance benefits. Although evaluating their impact on performance is sometimes viewed as “measuring the immeasurable,”⁴ increasing evidence, both quantitative and qualitative, now show that corporate codes of conduct along with education improve employee morale and job satisfaction, aid the company’s recruiting efforts and help strengthen relationships with business partners.⁵

Many corporate leaders agree that “doing the right thing” is its own reward, but they are also finding that a strong ethical culture benefits the bottom line. Studies by LRN, and other organizations, for example, show a direct relationship between good corporate governance, ethics and compliance practices and the strength of numerous business success indicators, such as a corporation’s stock price⁶, customer purchasing patterns, and employee retention.

In several noteworthy cases, the impact of a code has been dramatic. For instance, in the late 1990s, Lockheed Martin’s ethics program prompted a virtual 180-degree turnaround in employee behavior and attitudes over a four-year period. Johnson & Johnson credits its *Credo* with helping it preserve its reputation and regain public trust after the Tylenol crises of the mid-1980s. During that period, “company managers and employees made countless decisions that were inspired by the philosophy embodied in the *Credo*.”⁷

In most organizations, the effects of having an inspiring code have been subtle but equally meaningful. Codes of conduct and code education are slowly permeating many corporate cultures, both helping employee understanding of their organization’s values as well as improving employee attitudes toward management. For example, in a recent LRN Ethics Study,⁸ eight out of ten employees say their organization has a written code of conduct or code of ethics, and of those, the vast majority (83 percent) believe that their management genuinely wants to promote ethics and integrity in the organization.

The LRN Ethics Survey also showed that roughly three out of four people who work at an organization with a written code of conduct or code of ethics affirm that their code helps them understand the conduct that the organization values. Nearly three-quarters (73 percent) say it makes the organization a

better place to work and that it alters behavior and helps direct decisions. More than eight out of 10 employees apply their understanding of the code frequently on the job. In contrast, other studies have shown a direct correlation between job dissatisfaction and unethical conduct.

Such survey findings are persuasive about the impact that a compelling code of conduct can have on an organization. Indeed, The Ethics Resource Center’s (ERC) National Business Ethics Survey shows that an organization’s ethical culture greatly influences employee conduct. Key “ethics-related actions” (ERAs) observed in organizations with strong ethical cultures include (1) management communicating ethics as a priority, (2) management setting a good example of ethical conduct, (3) coworkers considering ethics when making decisions, and (4) coworkers talking about ethics in the work they do.

Code endorsements from ethics officers

In addition to the various survey results such as the LRN Ethics Study, first-hand experience from ethics officers coincides with the conclusion that codes of conduct are strengthening ethical cultures.

Melanie Lawrence, Adecco International’s global vice president for compliance, says that employees have become more comfortable discussing ethics and asking ethics-related questions since the company rolled out its code and online code education in late 2005 and early 2006. In one case, employees reported that a high-level executive had been making sexist and ageist “jokes” during business-related conference calls. Lawrence is convinced that they would have remained silent before the company implemented its education program. In addition, the executive, who worked outside the U.S., was unaware that his remarks were offensive and potentially discriminatory (arguably, they were acceptable in his home country), and he appreciated the feedback. This example illustrates the importance of uniform standards of conduct for global companies that operate in countries with contrasting business cultures.

For Anthony Shore, vice president and assistant general counsel of the PMI Group, one sign of his program’s success is the number of times the word “Electric” – the brand the company created for its code of business conduct and ethics – crops up in workplace conversations. This tells Shore that employees are thinking about the code when making business decisions and considering its impact on their behavior.

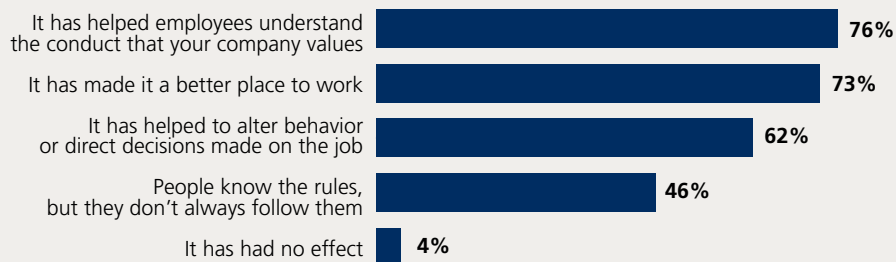
Highlights of LRN ethics study: How codes of conduct are making a difference

Current research by LRN⁹ shows that codes of conduct are having a positive impact on employee behavior and perceptions. Among the findings:

- Seventy-nine percent of employees say their organization has a written code of conduct or ethics.
- Of those, 83 percent believe that management genuinely wants to promote ethics and integrity in the organization, 70 percent think management is trying to comply with the law, and 61 percent believe their organization has a code of conduct or ethics so management can protect itself.
- Seventy-three percent of employees whose organizations have a written code of conduct or ethics say it makes the organization a better place to work.
- Sixty-two percent think the code has helped alter behavior or direct decisions.
- Eighty-two percent say they often apply their understanding of the code on the job.
- Forty-six percent of respondents say that employees know the rules, but that they don't always follow them.
- Only 4 percent of employees said the code had no effect.

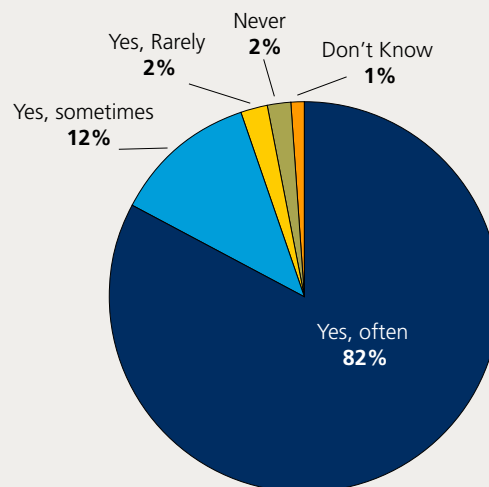
Company code of conduct/ethics

Which, if any, of the following describe how the code of conduct or ethics at your company has influenced your company's workplace?



Applying code of conduct/ethics on the job

Do you apply your understanding of the code of conduct or ethics on the job?



The success of codes and ethics and compliance programs is also apparent when analyzing hotline or helpline calls. At Temple-Inland, for example, Director of Compliance Paul Liebman tracks calls to the company's ethics helpline. Since the company started its ethics and compliance program, Liebman has seen a sharp decline in the number of anonymous calls, an increase in the number of callers who first tried to resolve the issue locally, and a significant improvement in the percentage of calls that deal with substantive ethical and legal issues rather than HR-related complaints. To Liebman, these results reflect a positive change in the company's ethical culture. Employees are developing a better understanding of ethical issues and are becoming more comfortable reporting misconduct and asking questions.

Employee surveys are one of the most effective tools for taking an organization's "ethical pulse." Most ethics officers are just beginning to conduct formal employee surveys that focus on ethics, but some have tested the waters with informal surveys. For example, Joseph Sepesy, Dow Chemical Company's deputy director of global ethics and compliance, has been posting ethics-related questions on the company's intranet site, receiving thousands of responses. Seventy-six percent of the respondents said that Dow's Code of Business Conduct influenced their behavior on the job. And a similar percentage said they had consulted or used the code within the preceding year. Almost half of the respondents consulted the code within the preceding month.

Building a strong ethical culture

Culture has emerged as the key factor driving the development of effective ethics and compliance programs.¹⁰ According to "Culture Matters: Lessons from the National Business Ethics Survey (NBES), formal ethics and compliance programs are critical to developing and maintaining a strong ethical culture.¹¹ The results of the NBES particularly underscore the importance of how organizations design their ethics and compliance programs. In leading organizations, programs are increasingly designed around a written code of conduct combined with one or more education courses.

However, the differentiating factor in the success of a program is not just what's in the code, but that the organization leverages it to shape its ethical culture. For this reason, many ethics and compliance officers now emphasize the importance of communication using multiple channels to raise employee awareness and disseminate organizational values. For example, in addition to courses, they utilize numerous other methods to engage employees.

Ensuring the effectiveness of a code

Although written codes of conduct and code education are core elements of an effective ethics and compliance program, simply adopting and distributing a code and offering education is not enough. Whether a program will have a positive impact on an organization's culture depends on how an organization uses these tools. "[A] world-class code is no guarantee of world-class conduct," cautions a Harvard Business School study.¹²

"A code is only a tool, and like any tool, it can be used well or poorly – or left on the shelf to be admired or to rust."¹³

Each organization is different, with unique goals, strategies and risk profiles. In addition, organizations are at different stages in the evolution of their codes of conduct and their ethics and compliance programs. To have a positive impact on its culture, an organization must tailor its code to meet its particular needs and to align with its overall business strategy as well as the goals of its ethics and compliance program.

Dow Chemical's Sepesy, for example, finds online education to be a powerful tool for educating employees about a company's values and standards, but "there comes a time," he says, "when you just need to have a real person walking around and talking about the code."

Temple-Inland's Liebman agrees. The company makes its Standards of Business Conduct and Ethics available electronically and provides online education for employees. But Liebman also takes the show on the road (literally) to get people talking about the code. His well-received "Afternoon at the Movies" events at Temple-Inland's facilities provide employees with an entertaining venue for discussing ethics. Liebman creates a movie-theater atmosphere, complete with popcorn and candy, and shows clips from *A Few Good Men* to get the conversation rolling.

Several officers likened implementing ethics education to running a marketing campaign. They recognize that their "market" is made up of many different types of employees who respond differently to different forms of communication. Some have created a "brand" around their programs in an effort to raise awareness and send a consistent message.

The PMI Group's Shore, for example, created the brand "Electric" for the company's program. And Temple-Inland's Liebman developed a brand around the company's ethics helpline number and logo that appears on all compliance-related materials. At PPL Corporation, Chief Compliance Officer Kathleen Matthews developed the slogan "Be a L.E.A.D.E.R." (Let Ethical Awareness Determine Every Response") to communicate the company's core values.

Measuring program effectiveness

The evidence to date suggests that codes of conduct, code education and other tools are working – and will increasingly work. So the next question is, how does an organization measure the effectiveness of its program?

Organizations actually have many tools to measure ethical performance. Before reviewing them, it's important to state that analyzing these measurement tools must be done in context. Each organization is different, with unique organizational cultural factors and risks. Whether an ethics and compliance program is successful depends on the objectives it was designed to achieve. A manufacturing company subject to strict environmental regulation, for example, is likely to have different objectives than those of a professional services firm. And a domestic company may emphasize different things than a multinational corporation does.

Scott Mitchell, president of the Open Compliance & Ethics Group (OCEG) advises organizations to measure the impact of their programs in the context of their cultures. Some organizations, for example, have "report first" cultures, in which employees are urged to report observed misconduct to a compliance and ethics officer immediately. "Report second" organizations, on the other hand, encourage employees to discuss ethical concerns

Entertainment value: Creative ways to get employees talking about ethics

One of the best ways to build an ethical culture involves getting employees to actively talk about the code of conduct and ethical issues. Many organizations are coming up with creative approaches to turn what may seem like a dull, dry subject into an engaging and entertaining experience.

Temple-Inland uses the movie *A Few Good Men* as a basis for discussion. After showing clips from the movie, the discussion leader asks the group questions like "Why didn't the two marines have the courage to come forward and disobey an order they knew was ethically wrong?" It's a powerful technique for getting employees to speak freely, according to compliance director Paul Liebman. "Employees think they're talking about the movie," Liebman says, "but they're not." He then can follow up the discussion with the far more direct questions, such as "Do we live or work in this kind of environment?" "Do we have a 'marine mentality' that compels us to adhere to a strict code of silence?"

Another company uses the movie *Jaws* as the backdrop for ethical discussions. In one scene, after the first shark attack, local leaders debate whether they should close the beach on one of the busiest holiday weekends of the year, missing out on significant tourist dollars. It's a great way to get employees talking about the merits of sacrificing safety for profits.

Movies aren't the only way to get employees to open up. In the late 1990s, Lockheed Martin launched a board game called *The Ethics Challenge*, featuring characters from the Dilbert comic strip. Employee teams competed to find the best answers to real-life ethical dilemmas. The game inspired employees to think about ethics while also having fun in the process.

with a supervisor or peer before taking the next step. Other organizations blend the two approaches, asking employees to report first for certain issues and second for others. As a result, a meaningful analysis of survey responses, helpline data and other measures is impossible without first understanding how an organization obtains its reports and how such reports contribute to depicting its culture accurately.

Dave Heller, chief ethics and compliance officer at Qwest Communications, agrees that program success must be measured on an organization-by-organization basis. Qwest recently engaged an outside company to conduct an in-depth ethics survey of its employees. Heller was pleased with the results and found it even more useful to compare Qwest's results to data gathered from other companies. But for Heller, the real value of this initial survey is in establishing a baseline that allows the company to measure its progress in future years.

Measurement tools

Just as it's important to use multiple channels to communicate organizational values to employees, it's also important to use multiple feedback channels to gather data about an ethics and compliance program's impact. Here are some of the tools organizations can use to measure the effectiveness of their programs:

Employee surveys. Comprehensive employee surveys are one of the most powerful tools for taking an organization's ethical pulse. Surveys measure a combination of actual behavior – such as whether respondents observed misconduct or how respondents acted under certain circumstances – as well as employees' perceptions of the organization's ethical climate – such as whether they feel pressure to compromise their ethical standards or fear retaliation if they report misconduct.

Surveys about compliance issues provide valuable feedback on program outcomes as well as the presence of ERAs that measure the strength of an organization's ethical culture. But questions should not be limited to ethical issues. Research conducted for the Lockheed-Martin Corporation in the late 1990s¹⁴ revealed three statistically significant predictors of unethical conduct:

1. pressure to perform – that is, to meet productivity goals;
2. observed misconduct; and
3. job dissatisfaction.

Thus, to provide an accurate reading of an organization's ethical climate, it is useful to expand survey questions to include information about working conditions and overall job satisfaction.

Interviews and reviews. To interpret organization-wide survey findings better, measurement should also include individual interviews, group interviews or focus groups, and reviews of relevant internal documents (such as policies, annual reports, executive speeches, new employee orientation materials and leadership education materials).

Independent audits. Many organizations engage independent third parties to audit their ethics and compliance programs. Auditors evaluate program components against world-class standards as well as the organization's specific risk profile and assess the program's effectiveness through document reviews, employee surveys, interviews and focus groups.

Helpline analysis. Analyzing helpline calls is an effective way to evaluate the impact of ethics and compliance programs. But the key to gleaning useful information from helpline data is to look beyond the raw data such as the number of calls to the actual content of the calls. Important indicators include:

- the number of anonymous calls,
- the number of callers who attempted to resolve the issue locally first, and
- the substantive nature of the call (in other words, whether calls were about ethical or legal issues as opposed to HR-related complaints).

It's important to recognize that the number of helpline calls can send an unclear message about a program's effectiveness. After an organization unveils its code of conduct and code education, for example, one might expect reports of misconduct to decline because employees have a better idea of what is expected of them. On the other hand, reported misconduct may initially rise because employees are now better equipped to recognize misconduct. For this reason, helpline call volume analysis may be most meaningful when it's tracked over time or when combined with call content information.

In addition, "after-action" research can be extremely useful in interpreting helpline data and improving the process. Some organizations, for example, routinely conduct "customer satisfaction" surveys before closing a case file. The survey might ask the caller questions such as:

- Were you aware of the company's code of conduct?
- Did you consult the code of conduct before you called the helpline?
- Did the code help you determine whether the conduct in question raised ethical or legal issues?
- How difficult was it for you to make the decision to call the helpline?

- Did your first conversation with us raise or lower your level of concern regarding the safety and effectiveness of the process?
- Was our explanation of the limits on confidentiality clear and understandable?
- Were you aware that you had the option to remain anonymous?
- Have you experienced any negative consequences as a result of using the helpline?
- Would you recommend the helpline to a colleague facing a similar situation as yours? If not, why not?
- How might we improve this service?

Targeted feedback. End-of-course surveys or feedback captured as the education is delivered is another important way to evaluate the effectiveness of the education itself as well as to gather additional information about the organization’s culture. Some organizations, for example, include questions at the end of a course on a particular rule asking participants whether they have observed violations of that rule.

General feedback. Job satisfaction surveys, exit surveys and other general feedback tools can also provide valuable insight into an organization’s culture. Incorporating ethics-related questions into general surveys provides yet another channel for employee feedback and may elicit more candid responses. If questions are crafted properly, employees may reveal a lot about the organization’s ethical culture without necessarily realizing they’re talking about ethics. The survey might ask, for example, whether management and supervisors provide information and keep commitments.

Also, as noted elsewhere in this paper, job dissatisfaction can be a predictor of unethical conduct. So, general feedback on the level of job satisfaction among employees has significant ethical implications.

Informal mechanisms. For many ethics and compliance officers, one of the best ways to measure the impact of a code of conduct and code education is simply to listen to what employees are saying about the code and to encourage feedback. Some CEOs have gone so far as to invite all employees to e-mail them with feedback or questions on ethics or other business issues.¹⁵ Not only can this approach generate valuable information, but it also sends a powerful message to employees about the importance of an open discussion about ethics.

Benchmarking ethics

Some compliance officers are hungry for that elusive metric that will enable them to measure their ethical performance against their peers, but benchmarking ethics and compliance programs remains a developing science.

Part of the challenge in developing quantitative benchmarks is the need to analyze results in the context of an organization’s culture. As researchers gather additional data from individual organizations and develop more sophisticated analytical techniques, it’s likely that we’ll see the development of benchmarks and metrics that account for differences in ethical culture.

Summary of how to measure the impact

Organizations are using a variety of tools to assess the impact of their programs:

- Employee surveys about ethics, working conditions and overall job satisfaction.
- Independent audits that assess an organization’s risks; examine how its code, code education and other program elements stack up against world-class standards; and rate its performance based on employee surveys, interviews and focus groups.
- Helpline analysis that looks beyond the number of calls at the content of those calls.
- Targeted feedback solicited as education is delivered.
- General feedback through job satisfaction surveys, exit interviews and other mechanisms.
- Informal feedback through discussions or e-mails with employees.

Closing the gap

For many organizations, the biggest obstacle to a successful ethics program is the gap between the values they articulate in their codes of conduct and their “operational values” – in other words, “how things really work around here.”¹⁶ The key to closing the gap lies in *how* organizations are using education and any other tools at their disposal to shape their ethical cultures and translate written values into operational values.

The most successful ethics and compliance programs are the ones that align the code of conduct and other program elements with the organization’s strategies, values and overall program objectives. As organizations refine and adapt their programs, it will become increasingly important for them to develop measurement techniques – both qualitative and quantitative – that rate their progress toward that goal.

End notes

- ¹ For a history of Johnson & Johnson's code, see www.jnj.com/our_company/our_credos_history/index.htm.
- ² See International Labour Organization, "Corporate Codes of Conduct," at www.itcilo.it/english/actrav/telearn/global/ilo/code/main.htm.
- ³ Randy Myers, "Ensuring Ethical Effectiveness," *Journal of Accountancy*, Feb. 2003.
- ⁴ Kathryn Tyler, "Do the Right Thing: Ethics Education Programs Help Employees Deal with Ethical Dilemmas," *HR Magazine* 50, no. 2 (Feb. 2005).
- ⁵ See "Emphasis on Strong Compliance & Ethics Reduces Enterprise and Investment Risk, Says OCEG; Cites Study Linking Strong Compliance and Ethics Programs to Stronger Stock Prices," *Business Wire*, Feb. 5, 2004.
- ⁶ George Donnelly, "Beyond the Code: Benchmarking Ethics, Compliance Programs," *Compliance Week*, June 14, 2005.
- ⁷ See www.jnj.com/our_company/our_credos_history/index.htm.
- ⁸ LRN Research on Code of Ethics (July 5, 2006).
- ⁹ See note 6, *supra*.
- ¹⁰ The U.S. Sentencing Commission recognized this in its 2004 amendments to the FSGO. Among other things, the amendments: (1) expand the purpose of an effective program to include promoting "an organizational culture that encourages ethical conduct and a commitment to compliance with the law," (2) require organizations to assess ethics and compliance risk areas, and (3) require organizations to periodically measure the effectiveness of their programs.
- ¹¹ According to the 2005 NBES, "where cultures are strong, it is in part because a formal program is in place. Even further, formal programs are likely to be an essential element in the maintenance of a strong culture."
- ¹² Lynn Paine, Rohit Deshpande, Joshua D. Margolis, Kim Eric Bettcher, "Up to Code: Does Your Company's Conduct Meet World-Class Standards?" *Harvard Business Review* (Dec. 2005).
- ¹³ *Ibid.*
- ¹⁴ Need citation.
- ¹⁵ See Joann S. Lublin, "The Open Inbox," *The Wall Street Journal*, Oct. 10, 2005, p. B1.
- ¹⁶ See Edward L. Pittman and Frank J. Navran, "Directors' Guide to Assessing an Ethical Culture," *Wall Street Lawyer*, July 2003, p. 12.

About LRN

LRN is a global provider of governance, ethics and compliance management applications and services, including its flagship education offering. Its complementary solutions for a company's workforce, management and leadership helps them fulfill their respective roles in promoting lawful and ethical conduct and making responsible behavior an integral part of everyday company practice. LRN's integrated solutions include ethics and compliance education, certification, helpline, incident management, dashboard, advisory, legal research and assessment. The online education solution offers more than 200 courses, covering more than 3,600 topics, and has helped millions of employees around the world act more responsibly, work more productively and become better informed about the laws and values that govern their day-to-day decision-making.

LRN has developed more than 100 web-based code of conduct education courses for Fortune 500 companies and other organizations. Its teams of content authors, designers and code of conduct experts work with customers to design a customized code education program that completely reflects the company's values and culture, and its service organization helps ensure that the company implements and manages the program effectively. LRN also provides online code of conduct courses based on universal best practices and helps clients create, revise and advance their codes of conduct for greater impact.

LRN works with more than 250 organizations, including The Dow Chemical Company, DuPont, Johnson & Johnson, Pfizer, Procter & Gamble and Raytheon. LRN operates in more than 120 countries, with headquarters in Los Angeles, CA and additional locations in New York and London. More information about LRN is available at www.LRN.com.



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