CLIFFORD CHANCE

THOUGHT LEADERSHIP

INSTILLING VALUES IN BUSINESS

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Business ethics – or the lack of them – was the subject of discussion at a working dinner jointly organised by Clifford Chance and the Legatum Institute's Centre for Character and Values and attended by senior people from the law, business, academia and the Church. Here Lord Griffiths of Fforestfach, Vice-Chairman of Goldman Sachs International, explores why ethics matter.

I am a great admirer of Alasdair MacIntyre. He is one of the world's greatest living philosophers, invariably provocative and controversial but never without interest or depth of thought. A few years ago he gave a lecture with the arresting title "The Irrelevance of Business Ethics". He set out to argue that the financial crisis of 2008 was not the result of a lapse in ethics by bankers but that the very nature of dealing in financial markets was to offload risk on to a counterparty or client with no ethical consideration whatever, "the better the trader the more morally despicable". The result is that trying to teach ethics to traders was like reading Aristotle to a dog.

From the evidence of opinion polls the very expression 'business ethics' in an oxymoron. The fact that since the financial crisis banks have been fined over $300 billion, Volkswagen has admitted cheating on emission tests on potentially 11 million cars, Mitsubishi has acknowledged that it intentionally mislead regulators, shareholders of blue chip companies have revolted over executive pay and the House of Commons Select Committee has investigated the sale of BHS for £1 which was subsequently put into Administration with a huge pensions deficit the following year, all suggest that 'business ethics is for the general public a contradiction in terms.

Why ethics matter for business

Ethical behaviour by business is important for a number of reasons.

One is that the public expect business to be ethical. They expect business to be conducted in an honest, fair and transparent manner, which serves the greater good of society and not just the interests of management and shareholders. They expect the senior managers of business firms and the entrepreneurs who set up private companies to have a moral compass which respects the dignity of those who work in the organisation and those they serve as customers. They expect that businesses will have standards which do not seek to mislead or misinform customers regarding the true price and the quality of the products and services which they provide.

The fact that the public hold such views is important because through their elected representatives who pass legislation in parliaments it is the public ultimately who grant business

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a license to operate. Without such a license for example, limited liability companies would not exist. That license can be changed at the will of Parliament. What has become increasingly clear is that the public will not put up with unethical business. Without ethical business regulation will increase. Just look at what's happened in banking following the financial crisis. Regulation is at best a blunt instrument in that it cannot easily be tailored to meet the needs of individual companies. Not only that but regulation is a form of taxation and like most taxes it has a deadweight cost to society.

A second reason why ethics in business matters is that it underpins the legitimacy and attractiveness of a market economy. From the latter half of the eighteenth century and Adam Smith's great work on the causes of the growth in the wealth of nations, a market economy which fosters enterprise and freedom and allows markets to work and is by far the best driver of prosperity that we know not only that but a market economy entails a degree of economic freedom which is a key element of political freedom. Business without ethics and values therefore undermines the appeal of a market economy and a free society.

A third reason why ethics in business matters is a personal observation. Working in a company with ethical business principles and a culture built around strong values is far more fulfilling than working in a company which turns a blind eye to ethical standards and in which the culture is based principally on success and money. I have sat on the boards of fifteen companies in the private sector since working for the first 25 years of my career in the public sector. These companies were varied. Some were main boards with shares traded on the NYSE, NASDAQ or LSE; others were wholly owned subsidiary boards; some were large, others medium, some small in terms of size; two were joint ventures. The products and services covered were extensive: banking, broking, rail freight, care homes, music, cable communications, television, cleaning, killing bugs.

For me and I suspect for most of those who worked for the companies the most distinguishing factor in terms of a company being 'a great place to work' was the respect shown to fellow employees, the pride the firm took in its products and services, the sense of community which existed in the organisation, management's commitment to help people develop to their full potential and the fact that it served a greater purpose than just focussing on maximising the bottom line. It is because of these qualities that such a company is trusted by its customers and the community in which it operates. It is also the reason it is able to build up a culture of trust within the organisation so that management can be trusted to make the right decisions.

Three questions business leaders must ask

If businesses are to act ethically there are three questions business leaders must ask themselves:

First, who are we? Put differently, what do we stand for? What is our purpose?

This I believe is the most fundamental and difficult question for any business leader to ask. To explore the purpose of a business is to go beyond profit. Without profit – which is the financial return to those who provide equity capital – a business will not survive. However asking about purpose raises broader issues than the bottom line. Does the company take pride in the product or service it provides? Is being part of the firm a source of human flourishing? How does the company contribute to the common good by what it does?

The reason it is difficult to ask these questions is that they in turn ask each of us to turn inward and ask ourselves a far more searching set of questions, Who am I? What am I doing with my life? What is the purpose of my existence? Most of us most of the time want to park such questions and get on with the day to day challenges of running the business. Far better and more productive to log on and check what the markets have been doing overnight. Then respond to e-mails. After that a look at today's calendar with slots filled in from early morning to late at night.I served for 21 years on the Board of a US company, Herman Miller, which designed and manufactured office furniture. It was in the twentieth century a world leader in its field both in terms of design (it attracted great designers such as Eames, Ngouchi, Nelson, Gehry, Stumpf) and environmental stewardship well before that became an important item on corporate agendas. The Chairman who invited me to join the board was Max de Pree. It was only many years later that I came across an essay written by Nicholas Wolterstorff, a distinguished Yale professor of philosophy, that I became aware of the importance of the purpose of a business. This is what he said:

"About ten years ago now I served – quite amazingly – as a philosophical consultant to the Herman Miller Furniture Company in New Zeeland, Michigan. Max de Pree, the executive officer of the company, had invited an architect, a physician, a journalist, a furniture designer, a theologian, and me to an all-day session with him and about five of the top officers in his company. At the beginning of the day he posed ten questions that he wanted us to discuss, in whatever order we wished. He asked us not to concern ourselves with trying to say things that we thought would be useful to the company; he wanted the discussion to take whatever shape it wanted to take. I remember three of the questions. "What is the purpose of business?" he asked. Some of his younger executives were saying that the purpose of business was to make money. He himself didn't believe that; but he wanted to talk about it. Second, he wondered whether there was "a moral imperative", as he called it, for companies to produce products of good design. And third, he wanted to discuss whether it was possible to preserve what he called "intimacy" in a large company. It became clear, in the course of the discussion what de Pree himself regarded as the purpose of business. The purpose, as he saw it, was twofold: to produce products that serve a genuine need and are aesthetically good, and to provide meaningful work in pleasant surroundings for those employed in the company. He added that these purposes had for a long time shaped his operation of the company."

Now it seems to me that these two purposes are, or can be, an expression of charity – that is, in the course of the discussion that it was de Pree's religious commitment – specifically, his Christian commitment – that had led him to embrace these goals. He saw his operation of the company as an exercise of charity – though he didn't use the word. His own case, at least as he presented it, was a case of "transcendental faith" shaping economic activity. Was he prevaricating? Or deluded?"

Second, is the question What are our values? Have they been set out explicitly? Are they so general as to be vacuous? Who in the firm owns the values?

It is easy to write down a set of values for a business. Indeed nearly all large companies have similar sets of values: respect for the individual, honesty and integrity, social responsibility to the community, environmental stewardship and so on. Far more difficult is to assess their effectiveness. How do the values shape the way I work and the decisions I make? How do I behave differently because these values are set down and I am a member of that firm? What responsibilities do I now have because of these values? Do I treat colleagues differently? Do I treat clients differently?

I have found that the key to effective values in business is that they must be lived by the leadership of the company. The leadership must walk the talk. Without that the values are empty and the leaders guilty of hypocrisy. Preaching one thing but practising another. The leaders of a business cannot rely on regulation. Leadership cannot outsource the values of a business to regulators.

One test is what the leaders of a business think their values really are? Would that be shared by the average employee? Would it also be the perspective of clients and suppliers?

I was reminded of this recently in an article which appeared in Forbes magazine by Professor James Heskett, professor emeritus at Harvard Business School, on the subject of servant leadership which is a more used term in the US than in Europe. The concept of servant leadership places great emphasis on the role of a business leader serving employees. Heskett recalls an incident at a ServiceMaster board meeting at which I was present and remember distinctly when the Chairman and CEO, William Pollard spilled a cup of coffee prior to the board meeting. "Instead of summoning someone to clean it up, he asked a colleague to get him a cleaning compound and a cloth, things easily found in a company that provided cleaning services. Whereupon he proceeded to get down on his hands and knees to clean the spill up himself. The remarkable thing was that board member and employees alike hardly noticed as he did it. It was as if it was expected in a company with self-proclaimed servant leadership".

The third question is 'What is going on in our business?

As a non-executive director of a company whose board meets four or six times a year, one of the most frustrating challenges is obtaining sufficient information to really find out what is happening in the business. I believe it is very important that non-executives meet not only senior but middle management and even junior staff. Only once have I ever found senior management reluctant to allow non-execs talking directly to management. Frequently the binding constraint is the time non-exec's are able to devote to meeting employees. However it is only then that they find out what is really happening in the business.

In small companies finding out what is really going on in the business is not really a problem. In large multi-nationals however the issue is a major challenge. In the money laundering activities carried on by certain banks the sheer size, organisational structure and large number of countries in which the bank operated have proved a major obstacle to effective control.

A number of steps are necessary in making values effective in business.

First, it is important to set out explicitly the purpose of the business. For this a one-time mission statement is typically far too general and vague and begs the question of what the purpose of a business really is when spelt out in practical terms.

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Second, it is important to set out in some detail the ethics, values and business principles of the firm. The temptation is to frame these in general terms. Management must accept that the actions of today will be judged by the standards of tomorrow, which means being ahead of the curve.

Third, on the basis of its purpose and values, it must build a culture with implications for all employees, affecting every aspect of the business; reporting, firing, promotion, human resources, selling, buying, accounting, auditing and so on.

Fourth, senior leadership must show through 'the tone from the top' that they live the values and they are committed to ensuring that the same values permeate the middle and lower echelons, the 'permafrost' of the firm.

Fifth, the leadership must be able to constantly appraise the effectiveness which its values, code of ethics, business principles have on conduct. They must trust but verify. This will include keeping a close eye on disciplinary matters and terminations, with regular surveys of staff and clients. Such information is important in compensation discussions and promotion recommendations.

Sixth, in all of this non-executive directors have a key role to play in that on behalf of the shareholders and stakeholders they are the guardians of the purpose, values and ethics of the company.

Size, Ownership, Competition

The challenge of implementing values in a business can be made easier or more difficult by certain factors, namely size, ownership and the extent of competition in the markets in which the firm operates.

The size of a business matters. Implementing values in a small firm is easier than in a large firm. In a small firm it is much easier for senior management to know what is going on. A large firm needs systems of control and trust in those responsible for them. It may also be easier in a firm delivering a single product or service rather than in a conglomerate in which there are different kinds of businesses with different business cultures, something which becomes even more challenging when the company has operations in different countries.

Different forms of ownership will face different challenges. A private firm and especially a family business may find it easier to develop an effective culture than a publically traded company. A partnership may have built in checks and balances to maintain high standards. That any concept of intimacy has disappeared.

The competitiveness of the markets in which a firm operates is a further factor to be taken into account. Competition is beneficial. It drives down costs and will lead to lower prices for consumers. It allows new firms to enter the business. It encourages innovation. However, in a highly competitive market when margins are under pressure, hiring staff is difficult and expensive; if competitors begin to use questionable methods ("tolerated practice") ethical standards will be under pressure. This raises an important issue for public policy. What is the optimal degree of competition? Reducing barriers to entry and opening markets to foreign companies is beneficial but is there a point at which competition becomes excessive and undermines ethical behaviour? Will the market itself be self-correcting? Should it be left to regulation? And if it will, at what social cost?

I believe that the subject of maintaining ethical standards in business, of creating business cultures in firms which make them "great places to work" and of punishing wrongdoers for illegal activity is fundamental to a market economy and a free society.

Brian Griffiths, Baron of Fforestfatch

Lord Griffiths serves as Vice-Chairman of Goldman Sachs International and as an international advisor to Goldman Sachs on issues relating to privatisation, private equity and governance. He chairs the Centre for Enterprise, Markets and Ethics. He was a Director of the Bank of England and head of the Policy Unit at No 10 from 1985 to 1990. He was a special advisor to Margaret Thatcher on the government's privatisation and deregulation programmes.

The Legatum Institute

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