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Business Ethics

Ethics Pays

By Dr. Peter M. Hughes, CPA, CCEP, CIA, CITP, CFE

Who wants to see the profits of their company double or triple while building customer, investor and employee loyalty? This question has an easy and ready answer—everyone does! Yet, despite the universal and unanimous support for just such a bottom-line booster, most companies are oblivious to the fact that they currently have just such a product in their inventory. A product, mind you, that is easy to manufacture, non polluting, green as an evergreen, that has an inexhaustible supply and that has customers lining up around the block to buy.

The beauty of Ethical behavior is that it is understood in every culture, every language and by everyone, regardless of age, race, or income level.

So, tell me you say, what product are you talking about? What does it look like? Well, I'm talking about the most tangible and irreplaceable asset of any company. I'm talking about the very soul of an organization. I'm taking about the "Ethics" of a company.

Keeping Ethics Simple

"A lot of long words missy, we're but humble pirates, what is it you want?" to quote the famous pirate Captain Barbosa from the Disney movie, *Pirates of the Caribbean: In Search of the Black Pearl.* What is it we want from ourselves, our employees, our suppliers and from our corporations? The word Ethics is derived from the Greek word "ethikos" and means "character" that is the distinctive, noteworthy quality of an individual or organization.

Ethics. It has a universal appeal, it underscores an expectation of goodness and it inspires and uplifts everyone who witnesses it and everyone who demonstrates it. Ethical behavior is the bedrock of every successful society, individual, company and organization. The beauty

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of Ethical behavior is that it is understood in every culture, every language and by everyone regardless of age, race, or income level. It readily resonates with everyone, everywhere.

The claim that Ethics doesn't pay is a mistaken notion that is easily refuted with readily available data.

Common Myths about Ethics

Ah, you say, a nice sentiment but not one that pays for itself. A "feel good" notion that can't hurt but sure doesn't help the bottom line. At best, many companies feel Ethics is an intangible idea that needs to be promoted in the Annual Report to the stockholders, but nothing that a financial analyst or CPA can calculate a Rate of Return ("ROR") on. Ethics, after all, is a Cost Center not a Profit Center, right? It's part of the overhead, isn't it?

Myth Busters or Ethics Equal Profits

The claim that Ethics doesn't pay is a mistaken notion that is easily refuted with readily available data. Ethics does help the bottom-line. Studies show that companies that are well-governed and exhibit a climate of corporate integrity outperform the S&P 500. The fact that good corporate governance yields tangible, monetary returns is more than a "feel good" endeavor. Studies show that Corporate Ethics is a contributor to the profitability of a company with those companies that have the best governance structures beating the S&P 500 by an average of 11% for the year ending February 28, 2005.[1]

Ethics are Appealing to Consumers

On the positive side of the consumer equation, the market research organization GfK NOP surveyed 5,000 consumers in the United Kingdom, the United States, France, Spain and Germany and found that about a third of those polled said they would pay a 5% to 10% premium for the products and services from an Ethical company over its competitors.[2]

This phenomenon is quite widespread. Additional studies have shown that consumers will "put their money where their mouths are" to support Ethical companies over their not so ethical counterparts. According to a 2003 survey, 80% of U.S. and European consumers are willing to pay more for goods and services from a company with a well-regarded labor and environmental record.[3]

Now on the negative side of consumer sentiment, a side no CEO would want to find him or herself on, the 2007 Edelman Trust Barometer has found that "Canadian consumers are growing more likely to boycott and speak negatively about companies that they feel are untrustworthy. Ac-

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cording to the annual survey of global opinion leaders, which are defined as college-educated people between the ages of 35 and 64 who are engaged in media, economic and policy affairs, and who have a household income in the top quartile, 86% of Canadians refused to purchase products or services from brands they do not trust. The survey also found that 77% of Canadian consumers have refused to invest in such companies and 85% of the survey's respondents said they have spoken critically of untrustworthy companies to acquaintances."[4]

Worldwide, 60% of investors surveyed stated that they would sell shares in a company they believed was behaving in a socially irresponsible way, even in spite of high earnings.

Clearly, this demographic group is one that no company would want to lose as its customers. Yet, most companies' lack of commitment to fostering Ethics in its products, placement and its manufacturing suggests either ignorance on this issue or a self-destructive tendency. These studies make it apparent that "Ethics" is an important component of a company's product, pricing and desirability. And the advertisers thought "celebrity" endorsements alone sold a product! These studies and polls strongly suggest that for this consumer generation, companies better start building into their product "ethics appeal" and fast, if they want to capture the attention and loyalty of their consumers.

Ethics are Valid Differentials to Investors

Investors just like consumers, also like Ethics in the workplace. A Global Scan survey found that 70% of Americans reported that a company's commitment to social issues is important when deciding which stocks or mutual funds to invest in.[5]

This means that investors do look for the Corporate Social Responsibility seal of approval. They do care and a good track record of Corporate Ethics does influence investors' stock buying decisions

On the other hand, investors also look to unload stocks of unethical companies. Worldwide, 60% of investors surveyed stated that they would sell shares in a company they believed was behaving in a socially irresponsible way, even in spite of high earnings.[6]

In layman's devastating language, the investors would "dump" the stock in light of foul play, corporate shenanigans and environmental and safety lapses. And they would do so, based on what they believed to be the case not what some fancy, high profile public relations firm puts out as damage control after the front page headlines have done the initial damage.

So you tell me, are "Ethics" bottom-line worthy? Should CEOs and the Board of Directors view Ethics as a critical component of their product? Is it enough to just build quality into a product while acting in a way seen as socially irresponsible? Do consumers weigh whether or not a company uses "sweat shops" to manufacture their product? You bet they do. Just ask NIKE about the devastating impact of being the former Poster-Child for sweatshop abuses. They will tell you of the negative effect of such lapses in Corporate Ethics and they will just as quickly tell you of the very positive bottom-line impact of being regarded now as the Poster-Child of Corporate Social Responsibility.[7]

The Recruitment Advantage of Ethics

So, in an economy of full employment and keen competition for the best and the brightest employees in light of the biggest wave of retirements ever recorded, what factors will make your company stand out to the workforce? Did you guess Ethics? Well, you're right. Ethics matter to the consumer,

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the investor and to the employees, future and present. A 2004 survey conducted by the Stanford Graduate School of Business, titled *Survey on CSR Reputation Effects and MBA Job Choice*, revealed that 94% of American students would choose to work for a company—you guessed it—with the better Corporate Social Responsibility rating than a competitor even if it meant less pay or benefits.[8]

Ethics has the potential to generate a tremendous rate of return on its investment, if given the proper resources and if viewed in the right light.

Given the high cost of recruitment and retention of valued employees, the fact that Ethics may help both attract and retain a company's most valuable asset, its workforce, strongly suggests Ethics should be seen as an indispensable and invaluable asset of any company's balance sheet.

Good Morale/Morals is Good for the Company

The adage, "a fair day's wage for a fair day's labor" still pertains to the average worker, so says Millie Kresevich, author of "Using Culture to Cure Theft."[9]

It appears that companies that do not treat their employees well or that fail to establish a culture of high ethical/moral standards for everyone, executive and staff alike, produce disgruntled employees with low morale/morals who are more likely to steal than happy employees

So what, some may say? So some employees may steal a few pencils, big deal. Well, it so happens that theft by employees is a big deal, and an issue that every CEO should care about due to its impact on the bottom-line. Studies by the Association of Certified Fraud Examiners revealed that fraud is a growing problem costing entities an average of 6% of their revenues a year. An additional 6% of revenues a year? That's the difference of doubling the bottom line for many companies. The 2007 listing of the largest 25 Fortune 1000 companies reveals that they have an average profitability of 7.88% and these companies are among the most successful ones in the world.[10]

Think of what that income booster would do to the stock price and how it would enable you to more competitively issue stock to fund expansions and acquisitions. Think of how this amount of money could enhance your product research and development efforts and the competitive advantage you would enjoy through such expenditures. "So, low morale/morals have a cost you say?" Yes, it does.

Ethics as a Productivity Enhancer

In addition to reducing employee theft, low morale/morals can cost a company in terms of productivity. The Gallup News Service noted that its Annual Work and Education poll found that employees surveyed admitted to wasting about an hour a day in the workplace.[11]

One hour a day. This unproductive time adds up to one wasted month a year for each and every employee. This is a major bottom-line theft that is directly related to low employee morale/morals. The loss of 12% of an entity's productivity is twice the annual profit for many companies. Given this fact, it should come as no surprise that a recent study by Sirota Consulting revealed that high morale/morals lead to higher stock prices.[12]

In fact the stock prices of the 14 high morale companies identified increased an average of 16% in 2004 while those other companies in the same industries increased by an average of just 6%, for a difference of 2 and a half to one.

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Ethics Give a Company a Bottom Line Advantage

You do the math and let the numbers sell themselves. What company doesn't want to increase its bottom line two to three times its current earnings without having to slash pricing? Answer: every company imaginable, and that includes yours. Just think about it. An inspired Ethics program can eliminate employee theft of up to 6% and increase productivity upwards of 12% of the gross revenues.

How hard does your company work to earn an additional 1% in income? If your company is like many companies, it works very hard to achieve this result.[13]

How much easier would it be to infuse "Ethics" into the product and into the process? How much easier would it be to encourage and promote a value that is already embraced by your employees, customers and investors than to create a new product line or product or to find new ways to cut manufacturing costs or to stream line business processes?

Think of the windfall of tapping into the Ethics of your organization and the benefits of a 300% increase in profits.

Conclusion

Ethics has the potential to generate a tremendous rate of return on its investment, if given the proper resources and if viewed in the right light. For the size of an Ethics Office and the budget requirements, it could quite possibly be the single most profitable center in any organization. Studies show that Ethics influences the buying decisions of consumers, the employment decisions of the labor force and the investment decisions of investors to such an extent as to give an Ethical company an advantage and an unethical company a disadvantage in the market place.

The studies suggest that Ethics is a way to tap into the loyalty of consumers and investors. Investors will pick the stock of a company that acts socially responsible over a competitor and consumers will pay an "Ethics" premium for the product and services. In addition, employees will choose to work for an Ethical company over its competitors while working harder and behaving more honestly for less when doing so. In simple terms, the "Ethics Factor" provides a competitive advantage which can be calculated in hard currency that has a real bottom-line impact. That is to say, Ethics Pays.

Endnotes

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Dr. Hughes's career has included serving as an Assistant Professor of Accounting at the California State Polytechnic University at San Luis Obispo, as the Director of Finance and Accounting for CBS Inc. and as the Director of Internal Audit and Compliance for NASA Jet Propulsion Lab, California Institute of Technology, and the Oregon University System.

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