Ethics Management – not as easy as I, II, III

The importance of corporate governance and the ethical values that underpin it was summarized very well a few years ago by the CEO of a well-known South African company, quoted in the 2006 edition of “South Africa’s Leading Managers”: “The company believes that adherence to the principles of corporate governance… as set out in the King I and King II reports … is an essential building block in the search for success. We fully underwrite and support the King values from a legal, business and moral point of view”. Soon afterwards the company picked up quite a few legal, business and moral problems, and Fidentia’s CEO – Mr J. Arthur W. Brown – protested his innocence from Pollsmoor Prison.

Fidentia did not survive long enough to contemplate compliance with King III, but the latest (draft) version of the South African benchmark of corporate governance takes ethics management, and its key role as part of good governance, to a new level. It is interesting to note the changes between the three King reports, and it is useful to contemplate the significance of these changes in a world that seems to offer more examples of unethical behaviour than ever before.

King I (1994) merely stated that a company needed a code of ethics, and – in case it did not have one – offered a “cut and paste” code as an appendix that any company could adopt. The less said about this approach, the better. Not only is the practice of adopting a code that was written by someone else bad practice, but even this generic code was not a shining example of what a good code should look like.

King II (2002) introduced the far more useful concept of “demonstrating a commitment to organizational integrity”. Borrowing heavily from the Federal Sentencing Guidelines in the United States, King II still required companies to have a code, but focused on ethics management processes that should support such a code: measuring the ethical climate, development and implementation of a code, providing support mechanisms (e.g. a hotline and an ethics champion), and involving the board in measuring and reporting on ethical performance.

King III (2009) goes even further – a whole chapter is devoted to leadership, integrity and corporate responsibility issues, and principle 2.4 states that the “board should actively manage the company’s ethics performance”. According to King III, the board should take responsibility for creating and sustaining an ethical corporate culture, which requires effective governance of ethics. Governance of ethics is explained as ensuring proper ethics management, which comprises ethics risk management, development of a code of ethics, integration of ethics into the company’s strategies and operations, and reporting and disclosure of ethics performance. Integration is the key word in King III – it incorporates the King II requirement of “demonstrating commitment”, but emphasizes integration as opposed to a standalone activity.
A comparison between King I, II and III clearly illustrates a move from form to substance, from merely proving the existence of a code to demonstrating a commitment and integrating it into strategy and operations. The irony is that companies could pay lip service to any of these activities. Ticking many boxes seems far more impressive than ticking only one. This is also the challenge for measurement and reporting – reporting on a commitment is not the same as demonstrating a commitment.

“Setting the tone at the top” is sometimes used as the differentiating factor. But again, failure to set the tone at the top can mostly be proven only in retrospect, since few senior executives will openly and actively encourage unethical behaviour. Even J. Arthur W. Brown or Ken Lay from Enron said the right things. Less than a year before the collapse of Enron Ken Lay personally signed off the new Enron Code of Ethics and implored all employees to fully comply with its contents. He clearly stated that “Enron’s reputation finally depends on its people, on you and me. Let’s keep that reputation high”.

When companies start thinking about how to apply King III requirements with reference to ethics management, integration should be the guiding concept. Perhaps it is semantics, but the role of the board should not be to “actively manage the company’s ethics performance”, as proposed in principle 2.4, but rather to supervise and monitor effective – and integrated – ethics management.

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