Ethics Institute of South Africa

Building an ethical South Africa
Reg. No. 1999/020697/08

EthicSA Research Report No 3*

CORPORATE ETHICS INDICATOR

Report on the Business Ethics South Africa (BESA) Survey conducted by EthicSA in 2002

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***Full version of the Condensed Report first published on 27 November 2002**

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ACKNOWLEDGEMENTS

We wish to thank the following individuals and organisations for their assistance in making this research study possible:

- The Ethics Resource Center (ERC) in Washington, DC, USA, for its continual support, and, in particular, Joshua Joseph for contributing towards the design of the questionnaire, and Frank J Navran for reading the full text and recommending valuable improvements to the final draft;
- The staff at Consulta Management Consultants (Pty) Ltd for data preparation and transcriptions;
- Dezinamite Design Studio (Pty) Ltd for graphic design;
- Khanyisa Nevhutalu and Annelize Worst for their support in the EthicSA office; and
- Pieter Schoombee for final editing.

Nadia Genis scheduled and rescheduled all the interviews. Without her dedication and professionalism, this project would have been far more difficult.

We wish to thank the organisations that endorsed BESA 2002. Of course, their endorsements should in no way be construed as agreement with the substantive findings in this report.

We extend a special word of thanks to the 53 participating JSE-listed companies. Without their cooperation, this project would not have been possible. We trust our report will be of value to them, and that they will become champions for business ethics in South Africa. All stakeholders, internal and external, would benefit.

A generous grant from the Merck Company Foundation, based in New Jersey, USA, made the project financially possible.

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EXECUTIVE SUMMARY

1. BACKGROUND

What is the BESA 2002 survey?

The Business Ethics South Africa (BESA) 2002 research project was conceptualised and executed by the Ethics Institute of South Africa (EthicSA), an independent, not-for-profit company, operating on a grant from The Merck Company Foundation, based in New Jersey, USA.

Two significant sets of events prompted this benchmark study of top companies listed on the JSE Securities Exchange to assess the state of business ethics in South Africa.

First, catastrophic corporate collapses internationally and locally have caused harm and losses to thousands of stakeholders, most notably shareowners (shareholders) and employees. These were not collapses due to economic or political factors external to those organisations; they were caused by internal corporate greed and callous executive deception.

Second, the *King Report on Corporate Governance for South Africa – 2002 (King II)* was launched in March 2002. It is a standard-setting document, showing the way towards building an ethical corporate culture.

The BESA 2002 survey does not address the whole body of *King II*'s requirements for good corporate governance, such as directors' fiduciary duties, risk management, internal audit, and the like. The research focuses on *institutionalising* ethics in an organisation, or on key preconditions for managing and building an ethical organisational or corporate *culture*.

The value of BESA 2002

This BESA 2002 survey provides South Africa with a national organisational ethics benchmark. The criteria employed in BESA 2002 are those recommended by *King II*, together with the US Federal Sentencing Guidelines for Organisations (FSGO) (1991), which *King II* suggests as a model for good ethics management.

BESA 2002 portrays this national benchmark quantitatively as a Business Ethics Index, comprising two index scores, namely:

- Index 1: Effective Ethical Compliance Index, and
- Index 2: Perceived Ethical Conduct Index.

BESA 2002 allows EthicSA to develop a statistically reliable diagnostic instrument (or ethical risk assessment tool) for individual companies and other organisations, capable of measuring their business ethics performance against this national standard. EthicSA intends repeating the exercise every second or third year, with the next survey planned for 2004 or 2005.

Endorsements

BESA 2002 was endorsed by the Ethics Resource Center (ERC), Washington, DC, USA (EthicSA's sister company), the JSE Securities Exchange (JSE), the King Committee on Corporate Governance for South Africa, the South African Institute of Directors (IoD), the South African Institute of Chartered Accountants (SAICA), the South African Chamber of Business (SACOB), and the Centre for Business and Professional Ethics (CBPE), University of Pretoria.

We wish to express our appreciation for the professional input by the Afrikaanse Handelsinstituut (AHI) (Afrikaans business chamber).

BESA 2002 is unique

BESA 2002 measures the internal ethical performance of organisations by taking a unique look at ethical compliance. We focus not only on *formal* ethical compliance, but also probe *effective* ethical compliance. Our findings are expressed in Index 1: Effective Ethical Compliance Index.

In addition, BESA 2002 goes beyond effective ethical compliance into respondents' *experience* or *perceptions* of the ethical culture of their working environments. This yielded expectation/experience differentials, expressed in global terms in Index 2: Perceived Ethical Conduct Index.

From a methodological point of view, BESA is also unique since it comprises interviews across hierarchies from senior management to different employee levels.

Participating companies

Fifty-three top JSE-listed companies participated, representing 810 000 employees.

Statistical reliability and validity

Reliability refers to the extent to which a research instrument produces consistent results with repeated measurements. The international benchmark for reliability is 70.0%. The reliability of BESA 2002 is 90.1%.

Validity refers to the extent to which a research instrument measures what it intends to measure. The international benchmark for validity is 60.0%. The validity for BESA 2002 is 59.1%.

2. BUSINESS ETHICS INDEX

Index scores tend to be blunt numerical portrayals of characteristically complex environments and should, as such, be regarded with caution. It is therefore important to understand how we arrived at our two index scores statistically, what they express, and what their limitations are.

Index 1: Effective Ethical Compliance Index

The Effective Ethical Compliance Index (Index 1) was derived from a critical measurement of companies' performance against best practice standards as expressed in the FSGO. The FSGO are incorporated in *King II* as corporate ethics management recommendations and are increasingly used for international benchmarking.

The questionnaire allows for a maximum points score of 685 for top managers and 465 for middle managers and employees. For comparative purposes, the compliance score was standardised to a 100-point index.

According to our research, South Africa's Effective Ethical Compliance Index score is **57.0%**. Embedded in this score are the following:

- The best effective (as opposed to merely formal) ethical compliance score achieved by a single company is 86.9%.
- The worst effective ethical compliance score in a single company is 28.0%.

This index score gives reason for the following value judgments:

- Corporate South Africa has some hard work to do in respect of effective ethical compliance.
- To improve South Africa's effective ethical compliance score, a culture of responsibility should be developed, rather than settling for a system of corporate ethics management where it is sufficient to follow the rules or account for a series of tick boxes.

To summarise, an Effective Ethical Compliance Index score of 57.0% probably means that many organisations pay mere lip service to ethics management, and this constitutes a significant ethical risk.

Index 2: Perceived Ethical Conduct Index

The Perceived Ethical Conduct Index (Index 2) consists of 35 pairs of expectation-and-experience statements designed to register experienced or perceived ethical conduct in organisations.

This Index deals entirely with respondents' experience of ethics in their organisations. It is assumed that (formal and effective) ethical compliance initiatives, as expressed in Index 1, always take place in an environment either conducive or detrimental to their success.

According to our research, South Africa's Perceived Ethical Conduct Index score is **76.0%**. Embedded in this score are the following:

- The average ethical expectation score is 96.0, and the average gap score is 20.3.
- When scores are expressed as percentages, the highest perceived ethical conduct score achieved by a single company is 99.6%.
- By contrast, the lowest perceived ethical conduct score of a single company is 23.6%.

In our judgement, the implications are:

- 76.0% is not a score to be accepted with complacency. Since an ethical culture functions only 76.0% of the time, it indicates a failure rate of, on average, one in every four instances.
- The lowest scores of single companies are very low, indicating significant ethical risk.
- Since a sound ethical culture ultimately allows for effective ethical compliance, companies with such a culture should regard it as one of their most valuable assets.
- Companies lacking a sound ethical culture should take active measures to develop one. Recent history has shown that it takes only a few key individuals to spark a major collapse in corporate governance.

Index 3: Integrated Ethical Culture Index?

The statistical challenge is to determine the nature of the correlation between Effective Ethical Compliance and Perceived Ethical Conduct, thus arriving at a third index, indicating "total ethical health".

Analysis of the constituent data sets of the two indices was, however, not sufficiently reliable. Clearly, the relationship between effective ethical *compliance* and perceived ethical *conduct* in the establishment and maintenance of an integrated ethical corporate culture requires further research.

Corporate South Africa should strive for *values-driven* organisational cultures, while *formal compliance structures*, like rules and regulations, still remain significant components of good corporate ethics management.

3. RESEARCH FINDINGS

3.1 Effective ethical compliance

3.1.1 Codes of Ethics

Existence of Codes of Ethics

General comment: JSE listing requirements and King II insist that an ethics management programme should have a Code of Ethics as its first base. It is, therefore, significant that one out of four senior managers responded that their companies did not have a Code of Ethics, and that one out of three employees either had no knowledge of a Code of Ethics or claimed that it did not exist.

- 76.8% of senior managers responded that their companies had a Code of Ethics.
- 66.7% of employees said their companies had a Code of Ethics, which indicates poor communication.
- 24.7% of employees said that they did not know and 8.6% denied their companies had a Code of Ethics.

Developing Codes of Ethics

General comment: In companies with a Code of Ethics, considerable confusion exists about the process of developing a Code.

- 78.6% of CEOs believed that senior management were solely responsible for the development of their companies' Codes of Ethics.
- 62.5% of senior management actually entrusted with Code development believed that they (senior management) were solely responsible.

Distribution of Codes of Ethics

General comment: About 75% of employees indicated that the Code of Ethics had been made available to them. External distribution is poor — approximately 25% indicated they were aware that the Code had been distributed to shareowners, while fewer than 20% indicated that it had been distributed to suppliers.

- In companies with a Code of Ethics, 75.8% of employees indicated that the Code had been made available to them.
- Of all respondents, 8.9% indicated that the Code of Ethics had been explicitly made available to job applicants.
- 61.7% of all respondents indicated that they considered the Code of Ethics to be a public document to be made available to anyone who asks for it.
- 46.7% of all respondents indicated that Codes of Ethics had been made available to newly appointed employees at induction.

- 25.4% of all respondents indicated they were aware that the Code of Ethics had been communicated to shareowners, 18.8% to suppliers.
- 17.8% of all respondents indicated that the Code of Ethics was made available on a public forum, such as a website.
- More CEOs than employees (a difference of 17.4 percentage points) indicated that employees had received a Code of Ethics at induction.

Content of Codes of Ethics

General comment: Considerable confusion exists across employment hierarchies as to whether companies' Codes of Ethics are predominantly values/principles-based (a values statement), predominantly compliance/rules-based (a code of conduct), or a balanced mix of the two. This may indicate a generally low level of familiarity with the contents of companies' Codes.

- 47.2% of all respondents said they considered their Code of Ethics to be a balance between general principles and values, on the one hand, and behavioural compliance guidelines, rules and regulations on the other.
- 10.6% of all respondents indicated that the main emphasis of their Code of Ethics was rules and regulations, while 28.1% indicated that the main emphasis was general principles and values.
- A significant 14.1% of all respondents indicated that they were uncertain about the content of their company's Code of Ethics.

Enforcement of Codes of Ethics (discipline)

General comment: A very high percentage of respondents indicated that their companies' Codes of Ethics were being enforced.

- 89.0% of all respondents indicated that their Codes of Ethics were enforced by disciplinary measures.

3.1.2 Leadership

Individual responsible for ethics management

General comment: Uncertainty and confusion were evident about the existence of an ethics function, whether a designated person (e.g. Ethics Officer) was responsible for ethics management, and where such a function might be located.

- In organisations with a person responsible for ethics management, 48.0% of employees and 55.0% of middle management were aware of such an office.
- Surprisingly, 25.0% of respondents with designated organisational responsibility for ethics management were not aware that they had been assigned this responsibility.
- Of all respondents, 37.3% indicated that an ethics management function was located in human resources, 24.0% risk management and 15.1% the company secretariat.

- Only 5.9% indicated that their organisation had a dedicated ethics and/or compliance department.
- 10.9% of CEOs believed they had a separate ethics management department, whereas only 2.0% of individuals responsible for this function indicated this to be the case.

Full-time or part-time person entrusted with ethics management

General comment: South African companies are in the early stages of assigning a dedicated person to manage, oversee or coordinate effective ethical compliance. Whether such a function will turn out to be part-time or full-time is currently far from settled.

- 23.0% of individuals responsible for ethics management indicated this to be a full-time function, at least while the function was being set up; once established, it would in all likelihood become a part-time function.

Due care in delegating discretionary authority

General comment: Questions under this heading were only addressed to senior management.

- Fewer than half of respondents (46.5%) indicated that companies utilise some form of integrity testing before promoting people to discretionary positions.

3.1.3 Communication

Frequency of communication on ethical issues in various media

General comment: Only two of the frequency scores for communication across different media exceed 50 points (on a frequency scale of 0-100, with 0 indicating "never communicated", and 100 "always communicated"). Existing ethics communication tends to be reactive.

- All respondents indicated the following frequency of communication on ethical issues (on a 0-100 frequency scale):
  - Dedicated ethics pamphlets – 54.7;
  - Board communications – 54.5;
  - Interim company reports – 47.8;
  - Internet/website – 37.5;
  - E-mail – 35.9;
  - Column in company newsletter – 33.4; and
  - Other (specified) – 56.3.

Ethics communication among senior management and from senior management to Investors

General comment: Questions under this heading were addressed to senior management only. Top-level communication on ethics ranges from good (audit committees) to poor (annual performance reports).

- Given recent accounting and auditing scandals, it is encouraging to note that on a 0-100 frequency scale, audit committees communicate on ethics at a frequency rate of 80.6.
- By contrast, respondents reported a low frequency (47.7) in respect of internal (individual or collective) performance reports. This appears to indicate that ethics is not considered a core component of overall company performance.

3.1.4 Education and training

Content of ethics education and training

General comment: The content of ethics education and training in organisations calls for careful review, in respect of both company Codes of Ethics and more generally.

- Only 40.5% of all respondents indicated that they had received education and training on their Code of Ethics.
- While 54.0% of CEOs believed their employees had received basic familiarisation with their Codes of Ethics or ethics generally, only 33.0% of employees themselves indicated this to be the case.
- Only 16.8% of respondents reported training in ethical decision-making skills, and only 21.2% reported case-study training.
- A relatively high percentage (32.8%) of all respondents indicated attendance of seminars, conferences or short courses.

Who receives ethics education and training?

General comment: Questions under this heading were addressed to senior management only. Clearly, ethics education and training are at unacceptably low levels in all categories.

- A very low percentage of chief executives (CEOs, CFOs, COOs) (19.6%) and ethics managers (17.3%) indicated that they had received ethics education or training in or through their companies.
- Of senior management, only 27.4% indicated that newly appointed employees received ethics education or training.
- Of senior management, a mere 17.3% indicated that established employees had received ethics education or training.

3.1.5 Enforcement, monitoring, reporting and guidance

Proactive ethics enforcement and channels for seeking ethics guidance

General comment: Enforcement is predominantly reactive rather than proactive, and junior staff members have less scope for seeking guidance or advice on ethical issues than senior management.

- Enforcement of ethical standards has a strong reactive and disincentive bias.
- In response to the question whether respondents were aware of avenues for seeking ethical guidance, 25.0% of employees and 10.0% of CEOs answered in the negative.

Confidential and anonymous mechanisms for reporting internal misconduct

General comment: Fewer than half the surveyed companies appear to have external hotlines, while respondents indicated that only a quarter of companies have internal hotlines. Reporting to line managers appears to involve considerable confidentiality risks, and employees are less convinced than senior management that at least some reporting mechanisms allow for anonymity.

- Whereas 43.6% of senior management indicated that their companies had an externally operated hotline, only 19.3% of employee respondents confirmed this.
- 22.7% of employees indicated that their superiors did not maintain confidentiality. Considering that 97.5% of all respondents indicated that their superiors were the primary avenue for reporting misconduct, this could be a significant ethical risk area.
- Of senior management, 69.5% believed that their reporting mechanisms allowed for anonymity, while only 45.0% of employees agreed.

3.1.6 Corporate social responsibility

General comment: Many senior executives are unfamiliar with the notion of a "triple bottom line". Apart from environmental issues, reporting on sustainability ("non-financial") issues is at a high level.

- In the light of *King II*, it is encouraging to note a high level of reporting on good governance issues (94.1%), social responsibility issues (92.1%), and black economic empowerment and transformation (85.1%).
- Environmental practices were reported in only two-thirds of responses (66.3%).
- HIV/AIDS reporting was indicated by 73.3% of respondents.

After interviewing 106 senior executives, we believe we are in a reasonably good position to make the following observations:

- The majority of South African companies do not yet meet international CSR standards.
- Many South African companies regard CSR initiatives not as issues of leadership and reputation management, but as marketing opportunities and exercises.
- Despite significant exceptions, lip service is still prevalent with regard to CSR.

- Special care should be exercised to ensure that evolving legislation and regulatory requirements do not induce strategic shortsightedness or window-dressing.

Community upliftment

- In general, South African companies do not yet define good CSR in a context of adding value. Good CSR is underpinned by good ethics, and ethics is not a commodity.

HIV/AIDS

- The fact that HIV/AIDS is not a notifiable or reportable disease makes the determination and management of its impact very difficult.
- A very small discrepancy exists between employee expectations and their actual experiences of company efforts to accommodate rather than discriminate against HIV-positive individuals.

The natural environment

- Environmental reporting is still mostly confined to companies with a direct impact on the natural environment, such as those in mining and industry.
- South African employees have shown a low sensitivity to environmental concerns.
- Very few companies have internal recycling policies regarding waste products not directly associated with manufacturing processes, such as paper or redundant computer equipment.
- Few companies scrutinise the environmental practices of their clients or suppliers.

Black economic empowerment

- Generally, South African companies have shown a high commitment to black economic empowerment (BEE).
- According to respondents, the dearth of suitably qualified candidates is a major source of frustration in meeting BEE targets.
- Many respondents indicated the need for better BEE communication and cooperation between business and government.
- Certain global companies based in South Africa face the problem of meeting government expectations while attempting to create a preferred employer status on a global level.
- Instances of racism still occur, but, according to respondents, conditions have shown a marked improvement in recent years.

3.2 Organisational culture

We determined organisational culture by asking respondents to indicate their *realistic expectations* of their companies, and then to report their *actual experiences* or *perceptions.* We then measured the differential or fall-out in each case. The average national differential was 20.3 (on a 100-point scale), with experience falling short of expectations. Anything above 15 indicates a significant differential. The three most significant expectation/experience differentials, and therefore ethical risk factors, were:

- The effectiveness of senior management's communication on ethics and compliance (34.7);
- Maintaining an environment free of theft (31.6); and
- Employees' lack of belief in their companies' stated values (30.5).

One interpretation of these three differentials is cause and effect. It is possible that poor communication leads to insufficient belief in a company's stated values, which, in turn, contributes to unethical conduct, such as theft.

4. CONCLUDING REMARKS

King II recommends that organisations develop Codes of Ethics. The JSE Securities Exchange listing requirements likewise require companies to have Codes of Ethics.

Developing an organisational Code of Ethics is not a superficial or minimal task of simply adopting a generic document and then informing standard-setting and regulatory bodies that the organisation is in compliance. A truly responsible commitment to developing a Code of Ethics, one that testifies to integrity, credibility and trust, is an ongoing process that permeates all organisational functions and activities. Such a process involves a delicate balancing act between:

- Creating an ethical organisational *culture*; and
- *Complying* with formal requirements.

The development of a Code of Ethics involves an encompassing process whereby ethics is *institutionalised*. This process requires adopting a "Total Ethics Management" *programme*, aimed at establishing an ethical organisational culture that reflects a balance between a commitment to core values and compliance, with values informing and driving compliance. This process of institutionalising ethics in organisations has five stages:

- Securing senior management leadership and commitment;
- Performing an ethical diagnosis or risk assessment;
- Codifying values, policies, procedures and rules;
- Doing ethics education and training; and

- Setting up sustainability structures for ethics management (communication, enforcement, monitoring, reporting, guidance and external auditing).

We believe this BESA 2002 study shows that corporate South Africa has taken significant steps towards responsible ethics management, in respect of both effective compliance and building an ethical organisational culture.

All South African organisations, big or small, in civil or political society, should aspire to:

- Put into place the constituents of ***formal*** ethical compliance (by developing a Code of Ethics and establishing compliance policies and procedures);
- Convert formal ethical compliance into ***effective*** ethical compliance (promoting the Code of Ethics and institutionalising ethics through an ethics management programme); and
- Establish an ethical ***culture*** (by integrating ethics into all organisational structures, functions and activities, in such a way that they promote individual ethical conduct and collective ethical practices).

The importance of building a responsible ethical culture lies in the growing evidence that medium-term to long-term financial sustainability is crucially dependent on ethical risk management and, therefore, leadership and reputation management. In short, we should build an ethical organisational culture because:

- It is the right thing to do;
- Regulations require it;
- Society demands it;
- Our stakeholders deserve it;
- Our strategic partners expect it; and
- Special interests and the media are watching us.

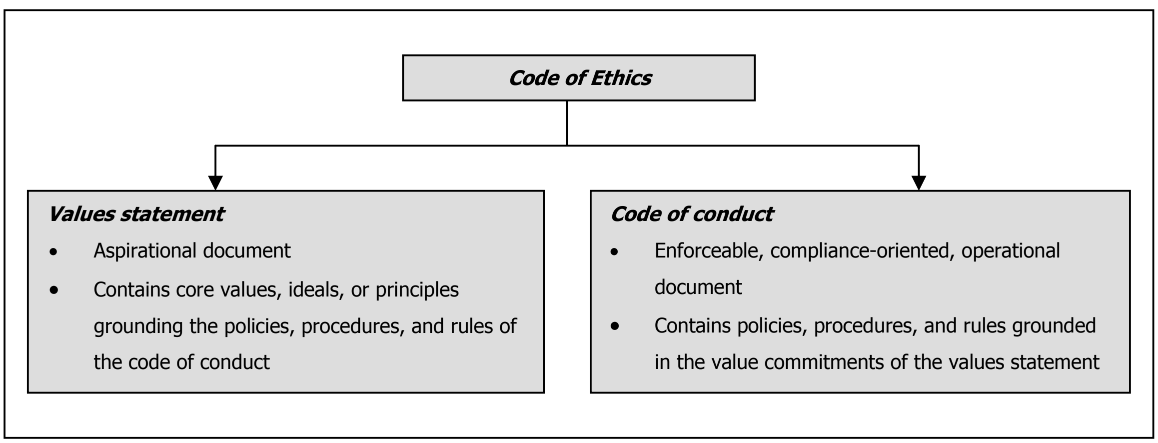
GLOSSARY OF KEY TERMS

Code of conduct: See "Code of Ethics"

Code of Ethics: A company's Code of Ethics contains the ethical standards to which it commits itself, both as an *organisation* and in respect of *individual conduct* by members of the organisation. It has two components (see Diagram 1) — in the form of two documents or combined in one document — namely:

- **Values statement** — a short, *aspirational* document or credo listing and defining a company's *core ethical, operational and other values, ideals, or principles*; and
- **Code of conduct** — a longer, *enforceable*, *compliance-oriented*, *operational* document setting out *policies*, *procedures*, and *rules* regarding best practices for guiding behaviours that address ethical issues relating to, for example, personal information and privacy; using company resources; use of information technology; travel, entertainment, and gifts; conflicts of interest; and outside activities. A code of conduct provides illustrations of how values (contained in the values statement) translate into concrete decisions and actions, rather than a full or comprehensive catalogue of rules or prescriptions. Nor is it a comprehensive manual of applicable laws and legal regulations, but, where appropriate, it refers to such more technical or comprehensive documents for guidance.

Diagram 1: Code of Ethics



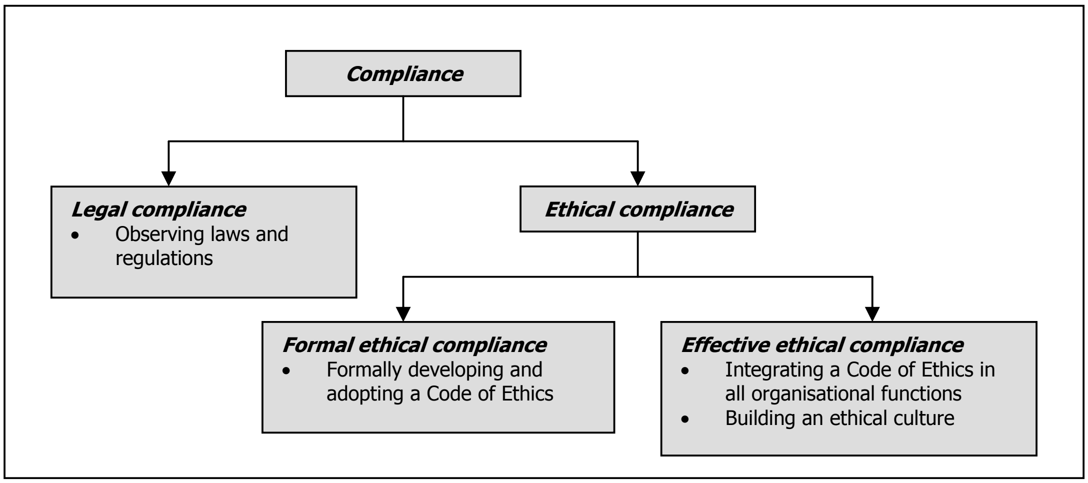
Compliance:

"Being compliant" may have a legal, ethical, or both legal and ethical meaning (see Diagram 2):

- **Legal compliance** – following laws, regulations, and rules for a profession, an organisation or an industry sector (e.g. *"Does your company comply with the Basic Conditions of Employment Act?"*)

- **Ethical compliance**
    - **Formal ethical compliance** – formally or technically satisfying minimum standards for organisational ethics management, such as developing and adopting a Code of Ethics as recommended by *King II* or required for listing on the JSE Securities Exchange (e.g. "*Does your company have a Code of Ethics?*")
    - **Effective ethical compliance** – institutionalising ethics through an ethics management programme, which includes adopting and following policies, procedures, and rules (e.g. "*Do employees receive training on your company's Code of Ethics?*")

Diagram 2: Compliance



Ethical reasoning: A rational process of deliberation and weighing of both factual (relevant findings, data) and moral considerations (values, standards, obligations, and the like) in order to arrive at a considered conclusion about what one ought to do, or what is right, good or fair, from a moral point of view, in a specific situation or as a rule.

Ethical values: Core aspirational notions embedded in the standards of right, good and fair human conduct; for example, the value of honesty generates the principle (and obligation) of honesty, which is a standard of good (ethical) conduct.

Ethics: The discipline of critical reflection on the nature of morality; a systematic endeavour to understand the values and principles informing right, good and fair individual human actions (conduct) and collective human actions in institutions (practices), as well as the good society. Conduct and practices conforming to these standards are judged to be ethical; conversely, those that do not are judged to be unethical.

Ethics management programme: *King II* requires that companies and other organisations institutionalise their internal ethics initiatives in the form of a specific programme with clear constitutive components, such as (i) senior management buy-in, (ii) ethical diagnosis or risk assessment, (iii) codification of values, policies, procedures, and rules (iv) ethics education and training, and (v) establishing structures for sustainable ethics management (communication, enforcement, monitoring, reporting, guidance and external audit). Such an ethics management programme should be designed to establish an ethical organisational culture, reflecting a balance between a commitment to core values and compliance, with values informing and driving compliance.

External ethics audit: In regard to institutionalising ethics in an organisation, *King II* recommends that companies and other organisations commission an "independent verification" of their ethics and compliance programmes, which, presumably, may be performed by non-governmental organisations (NGOs), private concerns or academia.

JSE Securities Exchange listing requirements: As part of its listing requirements, the JSE Securities Exchange requires listed companies to develop and adopt a Code of Ethics. These are primarily regulatory rather than aspirational requirements.

King II: *The King Report on Corporate Governance for South Africa – 2002*, developed by the King Committee on Corporate Governance and released on 26 March 2002; Section 4 of *King II* deals with, among others, institutionalising ethics in an organisation. For more information, visit www.iodsa.co.za, or e-mail iodsa@iodsa.co.za

Morality: A form of human behaviour (together with religion, labour, sociability, and the like); the practice of aligning individual and collective human conduct, social structures, institutions or practices, according to universalisable standards of right, good and fair conduct.

US Federal Sentencing Guidelines for Organisations (FSGO): In 1991, the FSGO were developed in the United States in order to standardise penalties for corporate crimes across the fifty states of the union. These guidelines set seven criteria "… to prevent and detect [ethical] violations…", the rationale or intent being that if they are followed, company or individual liability for misconduct will be diminished. *King II* recommends that South African organisations implement these seven steps in order to put in place proactive ethics management practices — see Section 2, Box 1. However, in South Africa the FSGO are aspirational corporate governance guidelines and not legal or regulatory requirements.

Values statement: See "Code of Ethics"

SECTION 1: BACKGROUND

1.1 What is the BESA 2002 survey?

- The Business Ethics South Africa (BESA) 2002 research project was conceptualised and executed by the Ethics Institute of South Africa (EthicSA), an independent, not-for-profit company, operating on a grant from The Merck Company Foundation, based in New Jersey, USA.
- Two significant sets of events prompted this benchmark study of top companies listed on the JSE Securities Exchange to assess the state of business ethics in South Africa.
  - First, catastrophic corporate collapses internationally and locally have caused harm and losses to thousands of stakeholders, most notably shareowners (shareholders) and employees. These were not collapses due to economic or political factors external to the relevant organisations; they were caused by internal corporate greed and callous executive deception.
  - Second, the *King Report on Corporate Governance for South Africa – 2002 (King II)* was launched in March 2002. It is a standard-setting document, showing the way towards building an ethical corporate culture. *King II* is a kind of blueprint of the preconditions for building an ethical organisation, ethics being the *context* within which the whole of *King II* is located.
- The BESA 2002 survey does not address the whole body of *King II*'s requirements for good corporate governance, such as directors' fiduciary duties, risk management, internal audit and the like. The research focuses on *institutionalising* ethics in an organisation, or on key preconditions for managing and building an ethical organisational *culture*. In the language of *King II*, BESA 2002 explores how corporate South Africa is doing in respect of key "integrated sustainability" concerns of corporate governance – such as ethics management structures, policies and procedures, the environment, and social and transformation issues (including Black Economic Empowerment).

1.2 The value of BESA 2002

- This BESA 2002 survey provides South Africa with a national benchmark — the corporate ethics management initiatives of a representative sample of JSE-listed companies. The standards employed by BESA 2002 for measuring these initiatives are those recommended by *King II* and the US Federal Sentencing Guidelines for Organisations (FSGO) (1991), which *King II* suggests as a model for good ethics management.

- BESA 2002 portrays this national benchmark quantitatively as a Business Ethics Index, comprising two index scores (see 2 below), namely
  - Index 1: Effective Ethical Compliance Index, and
  - Index 2: Perceived Ethical Conduct Index.
- BESA 2002 allows EthicSA to develop a statistically reliable diagnostic instrument (or ethical risk assessment tool) for individual companies and other organisations, capable of measuring their business ethics performance against this national standard. This is in line with the *King II* recommendation for "independent verification of conformity to established principles and standards of ethical behaviour" (*King II,* page 110), that is, an external ethics audit.
- EthicSA intends repeating the exercise every second or third year, with the next survey planned for 2004 or 2005.

1.3 Endorsements

- BESA 2002 was endorsed by the Ethics Resource Center (ERC), Washington, DC, USA (EthicSA's sister company), the JSE Securities Exchange (JSE), the King Committee on Corporate Governance for South Africa, the South African Institute of Directors (IoD), the South African Institute of Chartered Accountants (SAICA), the South African Chamber of Business (SACOB), and the Centre for Business and Professional Ethics (CBPE), University of Pretoria.
- A special word of thanks goes to the Afrikaanse Handelsinstituut (AHI) (Afrikaans business chamber) for its support and continued belief in the value of this project.

1.4 BESA 2002 is unique

- BESA 2002 measures the internal ethical performance of organisations by taking a unique look at ethical compliance. We focus not only on *formal* ethical compliance (e.g. *Does your organisation have a Code of Ethics?*), but also probe *effective* ethical compliance (e.g. *Is your Code of Ethics communicated to your employees at induction and periodically during employment?*). In other words, since formal ethical compliance runs the risk of being empty window-dressing, we investigated whether it was supported by effective (actual) ethical compliance. Our findings are expressed in Index 1: Effective Ethical Compliance Index. (Results are based on 25 275 data bits.)
- In addition, BESA 2002 goes beyond effective ethical compliance into respondents' *experience* or *perceptions* of the ethical culture of their working environments. We put 35 pairs of questions to respondents, in each case asking them (a) what their *expectations* were for their organisation, and (b) what their *experiences* or *perceptions* were in their organisation. This yielded expectation/experience differentials, expressed in global terms in Index 2: Perceived Ethical Conduct Index. (Results are based on 29 470 data bits.)

- We surveyed senior management (two from each company) and middle management (two from each company), while employees constituted 50% of the total survey sample (four from each company), for a total of 54 745 data bits.

1.5 Participating companies

- Fifty-three top JSE-listed companies participated, representing 810 000 employees. Thirty of these participating companies are listed in the *Sunday Times Business Times Top 100 Companies* (10 November 2002).
- Generally, we received good cooperation from companies. All the sectors of the South African economy are represented in the survey, with the exception of the media sector.
- The manner in which companies responded to our invitation to participate in the survey, as well as the manner in which they actually managed and communicated their participation to their participating employees, often correlated with our findings on the quality of ethics management in those companies, with some significant exceptions.
- In a number of companies, the absence of proper internal communication channels caused delays and logistical difficulties in commencing and completing fieldwork.
- Significantly, despite their size and complex structures, many of the larger companies, most often multi-nationals, managed to communicate very effectively with the BESA management team as well as with their employees.
- Medium-sized to smaller companies were most prone to communication lapses.
- We should mention that, in one company, interviews could not be completed due to very poor internal communication and a lack of commitment to the survey from mainly middle management.

1.6 Confidentiality and anonymity

- Information regarding company names, individual respondent identities and industry sectors are kept confidential according to the South African Market Research Association (SAMRA) Code of Conduct for Survey Research.
- Our findings relate to corporate South Africa as an entity, not individual companies or sectors of the economy.

1.7 Communicating the BESA 2002 findings

- Some participating companies expressed concerns about the manner in which EthicSA would report on the results. Would this research not reflect negatively on corporate South Africa, thus causing unnecessary harm? We believe such concerns are appropriate.
- Our approach, however, has been one of partnership with corporate South Africa; we have focused on establishing the truth and reporting constructively. BESA 2002 was designed to

assist business in corporate ethics governance and management initiatives. We believe more damage would be caused in the long run if identified ethical risks were to be swept under a carpet of non-disclosure.

- The everyday practical considerations of running a successful business present potentially compromising ethical situations requiring ethical choices. This report highlights ethical risk areas that should be addressed creatively and proactively.

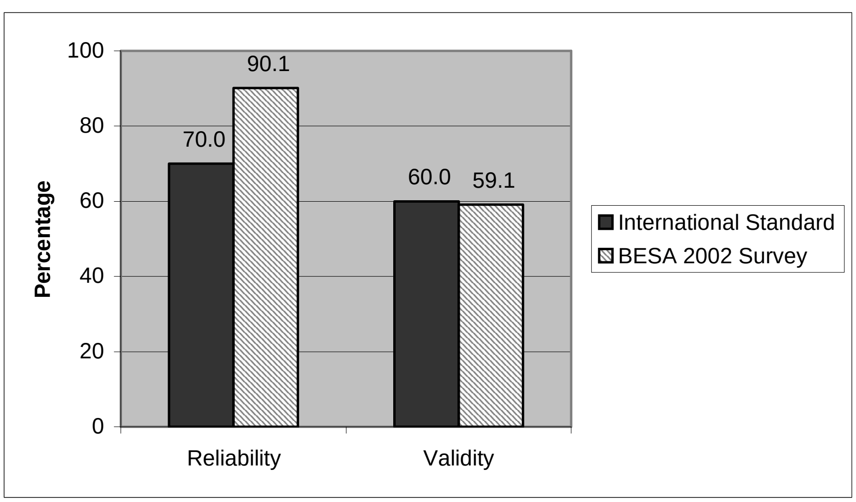
1.8 Design and methodology

- Instrument (questionnaire) design involved wide participation and several pilot studies.
- Fieldwork consisted of 421 telephone interviews, lasting 30 minutes on average.
- In order to standardise the fieldwork, one individual (Willem Punt), with a background in both business and ethics, conducted all telephone interviews.
- Reputable statisticians supervised research design and methodology.

1.9 Statistical reliability and validity

- *Reliability* refers to the extent to which a research instrument produces consistent results with repeated measurements. It is calculated by means of statistical analysis, of which the Cronbach Alpha is the most widely used. The international benchmark for reliability is 70.0%. Measuring the Cronbach Alpha for BESA 2002 produced a reliability of 90.1%.
- *Validity* refers to the extent to which a research instrument measures what it intends to measure. The international benchmark for validity is 60.0%. At 59.1%, the validity for BESA 2002 is in line with this standard.
- Reputable statisticians checked and approved the reliability and validity of the study. See Figure 1.

Figure 1: Statistical reliability and validity



SECTION 2: BUSINESS ETHICS INDEX

Index scores tend to be blunt numerical portrayals of characteristically complex environments and should, as such, be regarded with caution. It is therefore important to understand how we arrived at our two index scores statistically, what they express, and what their limitations are.

2.1 Index 1: Effective Ethical Compliance Index

The Effective Ethical Compliance Index was derived from a critical measurement of companies' performance against local and international best-practice standards as expressed in the US Federal Sentencing Guidelines for Organisations (FSGO) of 1991. See Box 1. The FSGO are incorporated in *King II* as corporate ethics management recommendations and are increasingly used for international benchmarking.

Index 1 expresses responses to a variety of factual questions testing compliance knowledge at different levels of the organisation. The questionnaire allows for a maximum points score of 685 for top managers and 465 for middle managers and employees. For comparative purposes, the compliance score was standardised to a 100-point index.

Box 1: US Federal Sentencing Guidelines for Organisations (FSGO) (1991)

1. Compliance standards and procedures reasonably capable of reducing the prospect of criminal activity;
2. Oversight by high-level personnel;
3. Due care in delegating substantial discretionary authority;
4. Effective communication to all levels of employees;
5. Reasonable steps to achieve compliance, which include systems for monitoring, auditing and reporting suspected wrongdoing without fear of reprisal;
6. Consistent enforcement of compliance standards, including disciplinary mechanisms; and
7. Reasonable steps to respond to and prevent further similar offences upon detection of a violation

Source: *An Overview of the Organizational Guidelines*, Paula Desio, Deputy General Counsel, United States Sentencing Commission, http://www.ussc.gov

According to our research, South Africa's Effective Ethical Compliance Index score is **57.0%**.

Embedded in this score are the following:

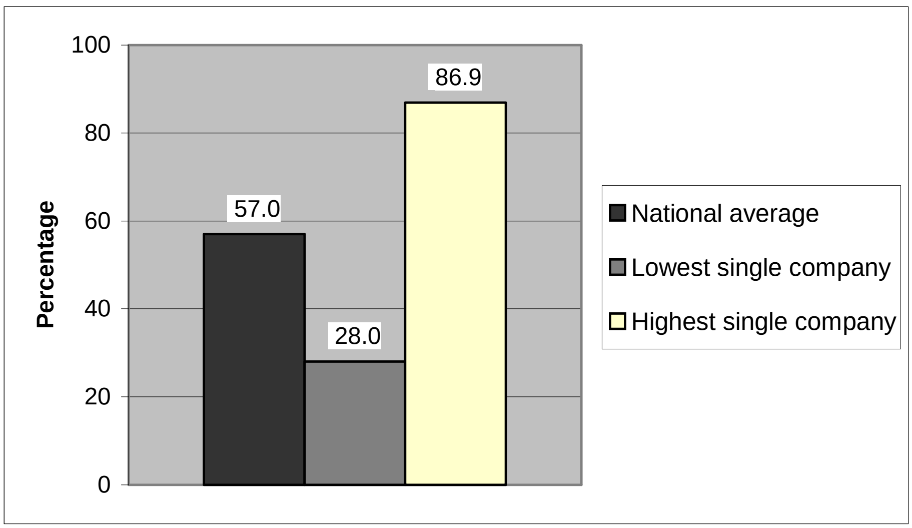
- The best effective (as opposed to merely formal) ethical compliance score achieved by a single company is 86.9%.
- The worst effective ethical compliance score of a single company is 28.0%.

This index score gives reason for the following value judgments:

- Corporate South Africa has some hard work to do in respect of effective ethical compliance.
- To improve South Africa's effective ethical compliance score, a culture of responsibility should be developed, rather than settling for a system of corporate ethics management where it is sufficient to follow the rules or account for a series of tick boxes.

To summarise, an Effective Ethical Compliance score of 57.0% probably means that many organisations pay mere lip service to ethics management, and this constitutes a significant ethical risk. See Figure 2.

Figure 2: Effective Ethical Compliance Index scores



2.2 Index 2: Perceived Ethical Conduct Index

Index 2 consists of 35 pairs of expectation-and-experience (perception) statements designed to register experienced or perceived ethical conduct in organisations.

Whereas Index 1 is based on knowledge of factual compliance, Index 2 deals entirely with respondents' *experience* of ethics in their organisations. This approach assumes that (formal and effective) ethical compliance initiatives, as expressed in Index 1, always take place in an environment either conducive or detrimental to their success.

Using a statistically derived factor analysis, discrepancies between each individual's 35 expectation-and-experience response pairs were weighted and calculated into an index score, consistent with international scientific research best practice.

According to our research, South Africa's Perceived Ethical Conduct Index score is **76.0%**.

Embedded in this score are the following:

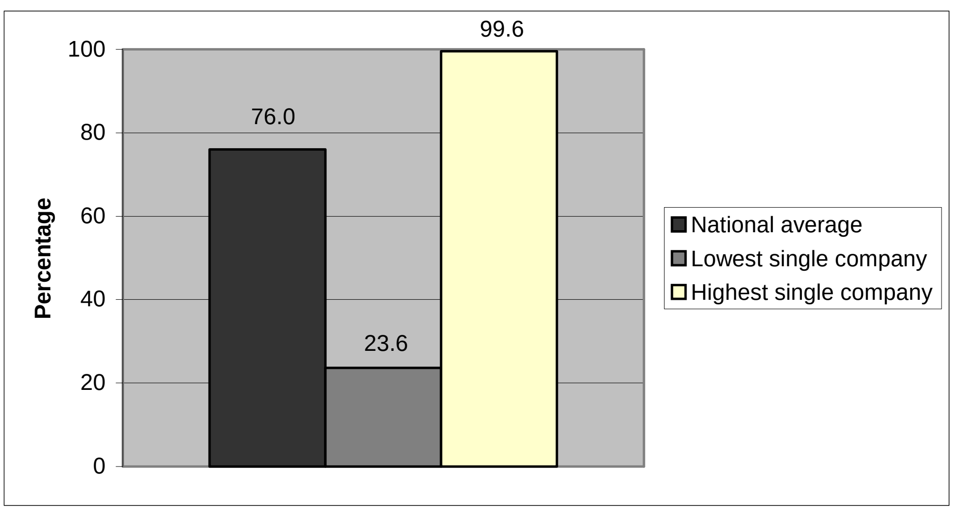
- On a 100-point scale, the average ethical expectation score is 96.0, and the average gap score is 20.3.
- Expressed as percentages, the highest perceived ethical conduct score achieved by a single company is 99.6%.
- By contrast, the lowest perceived ethical conduct score of a single company is 23.6%.

This index score gives reason for the following value judgments:

- Compared with effective ethical compliance (Index 1), corporate South Africa does much better by creating an ethical culture only 24.0% below individual respondents' expectations.
- Nevertheless, 76.0% is not a score to be accepted with complacency. Since an ethical culture functions only 76.0% of the time, this indicates a failure rate of, on average, one in every four instances.
- The lowest scores of single companies are very low, indicating significant ethical risk.
- Since a sound ethical culture ultimately allows for effective ethical compliance, companies with such a culture should regard it as one of their most valuable assets.
- Companies lacking a sound ethical culture should take active measures to develop one. Recent history has shown that it takes only a few key individuals to spark a major collapse in corporate governance.

To summarise, a Perceived Ethical Conduct score of 76.0% constitutes a significant ethical risk, with some organisations doing considerably better than others. Scores indicating higher risk call for urgent ethics management intervention in those companies. See Figure 3.

Figure 3: Perceived Ethical Conduct Index scores



2.3 Index 3: Integrated Ethical Culture Index?

The statistical challenge is to determine the nature of the correlation between Index 1 (Effective Ethical Compliance) and Index 2 (Perceived Ethical Conduct), thus arriving at an Integrated Ethical Culture score (Index 3) indicating the "total ethical health" or "integrated ethical culture" of corporate South Africa.

In a correlation analysis of the constituent data sets of the two indices, we found an unreliably low 12.0% statistical certainty that effective ethical compliance (Index 1) will contribute 35.7% to actual ethical conduct in the workplace, with perceived ethical conduct (Index 2) contributing 64.3%.

On the basis of this *inconclusive statistical evidence* an Integrated Ethical Culture score (Index 3) would be **69.0%**. Clearly, the relationship between effective ethical compliance and perceived ethical conduct in the establishment and maintenance of an integrated ethical corporate culture requires further research.

Further research should be done against the background that *values*, as expressed in an organisational culture, are far more useful than effective *compliance* in securing an ethical working environment. The reason for this may be that morally responsible individuals tend to behave ethically. There is, however, no statistical evidence to indicate that effective ethical compliance alone will yield the same result.

Formal compliance structures, like policies, procedures and rules, still remain significant components of good corporate ethics management, but in themselves they are not sufficient for institutionalising an ethical corporate culture. Corporate South Africa should strive for a *values-driven* ethical organisational culture.

SECTION 3: RESEARCH FINDINGS

We present our findings in both qualitative and quantitative form.

- *Qualitative* findings are presented in quotation *boxes* with sample comments recorded during interviews in response to open-ended questions in the questionnaire.
- *Quantitative* findings are reported in *seven clusters*. Before reporting findings for each cluster, we suggest *best-practice* standards, influenced by *King II* and other standards. This provides a frame of reference for understanding and interpreting quantitative findings.

3.1 Effective ethical compliance

3.1.1 Codes of Ethics

BEST PRACTICE

- *Organisations should codify their core organisational and ethical values, policies, procedures and rules in a Code of Ethics (values statement and code of conduct).*
- *A Code of Ethics should be customised for the organisation, not generic. It should be tailored to the organisation's needs and the specific ethical challenges it faces. Variables like the size of the organisation and industry, and professional codes applying to its employees, should be taken into account.*
- *Code development should be a participatory process involving employees at all levels. It follows that developing a Code of Ethics should neither be an exclusively senior management exercise, nor top-down.*
- *A Code of Ethics should consist of a clear and relevant set of guiding values (values statement), operationalised by key policies, procedures, and rules (code of conduct).*
    - *A Code of Ethics containing only values, without illustrations of how those values translate into specific conduct, tends to be "empty" – formalistic, devoid of content, or "remote" from everyday choices and activities.*
    - *By contrast, a Code of Ethics containing only rules and regulations, without an explicitly understood anchor in underlying values, tends to be "blind" – directionless, devoid of context, or "external" to an integrated organisational culture. Moreover, a rules-driven (as opposed to values-driven) Code may create the perception that actions not explicitly addressed by a rule or regulation are ethically acceptable.*
- *All employees should have a copy of the organisation's Code of Ethics. Should there be significant discrepancies between the educational levels of management and employees, a simplified version should be made available.*
- *A Code of Ethics should be distributed to internal and external stakeholders.*

- *Organisations should distribute their Codes of Ethics to external consultants and suppliers as part of contract agreements, especially since procurement, tenders, contracts and sales are ethically high-risk areas.*
- *Organisations should comply with the Promotion of Access to Information Act (No 2 of 2000) and make their Codes of Ethics available on a public forum such as an external website.*
- *A Code of Ethics should form the basis of disciplinary action.*
- *All employees should participate in a formal process familiarising them with the Code of Ethics, preferably at induction, with a formal follow-up at least once every two years.*
- *Employees should receive education and training on how to apply the values and guidelines of the Code of Ethics to specific job-related or task-related ethical challenges (see 3.1.4 below).*
- *Organisations should consider putting an (e.g. annual) "expiry date" on their Codes of Ethics, thus necessitating periodic and explicit re-adoption of and re-dedication to their Codes.*

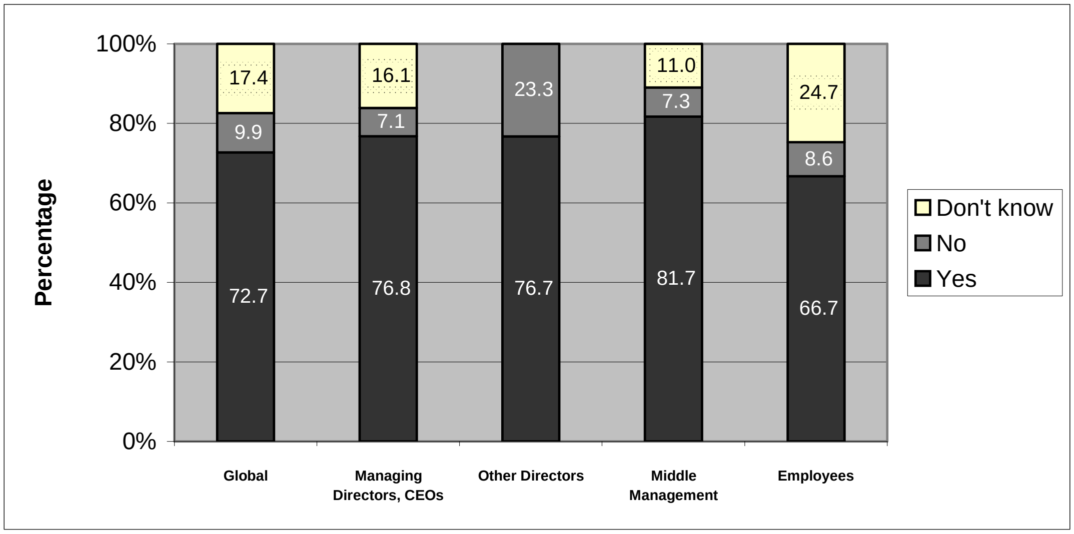
FINDINGS

Existence of Codes of Ethics

General comment: JSE listing requirements and King II insist that an ethics management programme should have a Code of Ethics as its first base. It is, therefore, significant that one out of four senior managers responded that their companies did not have a Code, and that one out of three employees either had no knowledge of a Code or claimed that it did not exist. Considering that participants in BESA 2002 represent the cream of the South African private sector, this leaves considerable scope for improvement. See Figure 4.

- 76.8% of senior management responded that their companies had a Code of Ethics.
- The discrepancy between employee knowledge of a Code of Ethics and that of senior management is significant – only 66.7% of employees knew their company had a Code. This indicates poor communication.
- Significantly, 24.7% of employees said they did not know whether their companies had a Code of Ethics, while 8.6% denied that their companies had a Code.
- The fact that 81.7% of middle management indicated the existence of a Code of Ethics, in contrast to 76.7% of other directors (mostly persons designated to manage such Codes), seems to indicate some confusion about the nature of a Code of Ethics.

Figure 4: Existence of Codes of Ethics



Developing Codes of Ethics

General comment: In companies with a Code of Ethics, considerable confusion exists about the process of developing a Code.

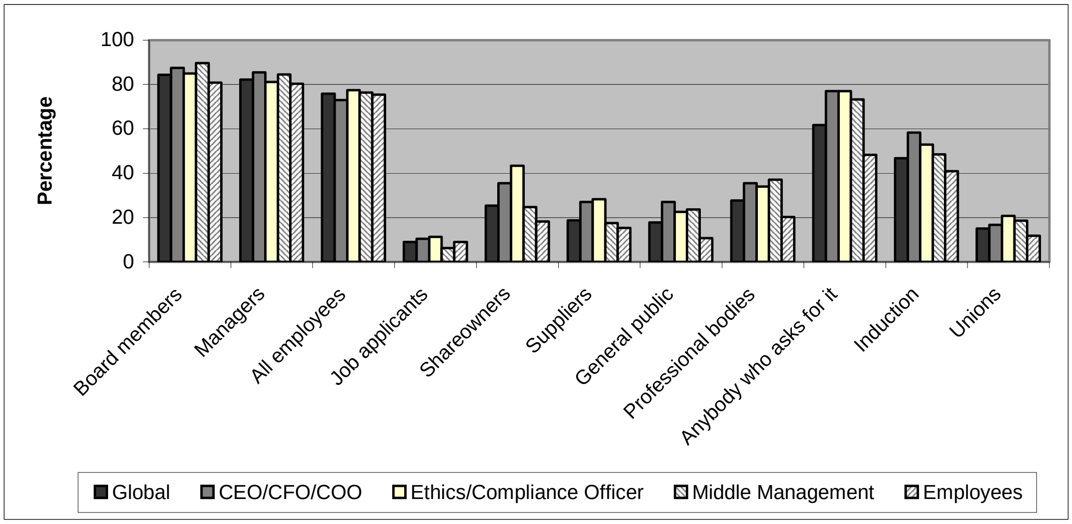
- Significantly, whereas 78.6% of CEOs believed that senior management were solely responsible for the development of their companies' Codes of Ethics, only 62.5% of the senior management actually entrusted with Code development believed that they (senior management) were solely responsible. This differential of 16.1 percentage points probably indicates considerable confusion in companies about the process of developing a Code.

Distribution of Codes of Ethics

General comment: About 75% of employees indicated that the Code of Ethics had been made available to them. External distribution is poor — approximately 25% indicated they were aware that the Code had been distributed to shareowners, while fewer than 20% indicated that it had been distributed to suppliers. See Figure 5.

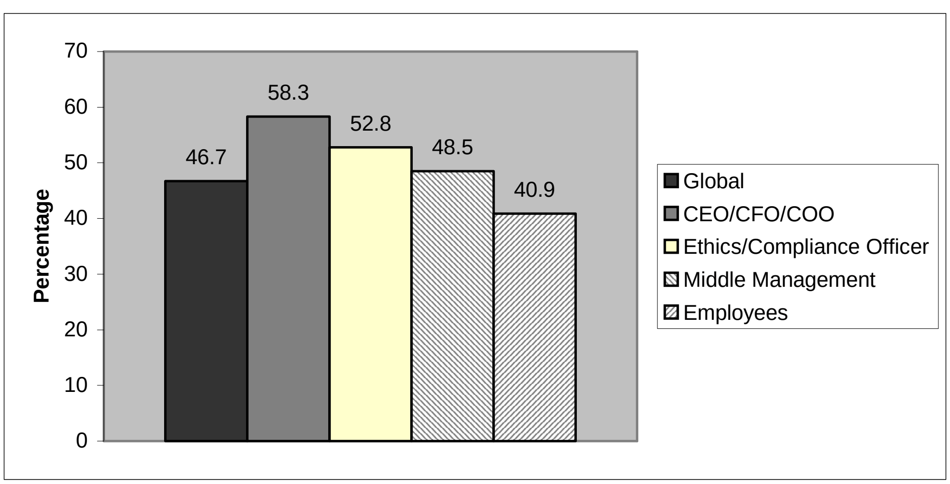
- In companies with a Code of Ethics, 75.8% of employees indicated that the Code had been made available to them.
- Of all respondents, only 8.9% indicated that the Code of Ethics had been explicitly made available to job applicants.
- Only 61.7% of all respondents indicated that they considered the Code of Ethics a public document to be provided to anyone who asks for it. This response appears to be corroborated by anecdotal evidence that tertiary educational institutions struggle to obtain Codes of Ethics for research and resource retention purposes.
- On average, fewer than half of all respondents (46.7%) indicated that Codes of Ethics had been made available to newly appointed employees at induction.

Figure 5: Distribution of Codes of Ethics



- External distribution of Codes of Ethics is generally poor. Only 25.4% of all respondents indicated they were aware that the Code had been communicated to shareowners, which may be a partial explanation of the low level of shareowner activism in South Africa. Only 18.8% of respondents reported that the Code had been distributed to suppliers. Procurement clearly constitutes a significant ethical risk area, and failing to communicate an organisation's ethical standards to suppliers exacerbates this risk.
- Only 17.8% of respondents indicated that the Code of Ethics was made available on a public forum, such as a website. Given the *Promotion of Access to Information Act (No 2 of 2000)*, this indicates a problem area.
- More CEOs than employees (a difference is 17.4 percentage points) indicated that employees had received a Code of Ethics at induction. See Figure 6.

Figure 6: Codes of Ethics distribution at induction



Content of Codes of Ethics

General comment: Considerable confusion exists across employment hierarchies as to whether companies' Codes of Ethics are predominantly values/principles-based (a values statement), predominantly compliance/rules-based (a code of conduct), or a balanced mix of the two. This may indicate a generally low level of familiarity with the contents of companies' Codes.

- 47.2% of all respondents said they considered their Code of Ethics to be a balance between general principles and values, on the one hand, and behavioural compliance guidelines, rules and regulations on the other.
- 10.6% of all respondents indicated that the main emphasis of their Code of Ethics was rules and regulations, while 28.1% indicated that the main emphasis was general principles and values.
- A significant 14.1% of all respondents indicated that they were uncertain about the content of their company's Code of Ethics, which further corroborates our impression of insufficient familiarity with Code content.

Enforcement of Codes of Ethics (discipline)

General comment: A very high percentage of respondents indicated that their companies' Codes of Ethics were being enforced, which is encouraging. While we are in favour of linking the Code of Ethics to disciplinary procedures, this form of compliance should be supported by proper communication of the Code to all employees and by commitment to underlying values.

- An average of 89.0% of all respondents indicated that their Codes of Ethics were enforced by disciplinary measures.

Box 2: Codes of Ethics

Middle Manager: "*Communication of the code of conduct and a requirement of an explicit commitment to it, in other words, people sign and accept the code of conduct…"*

Employee: "*Niemand het geweet van hierdie 'Code of Ethics' nie. Nou weet meeste, okay, meeste van die ambagsmanne en so aan. Soos die 'labourers', hulle 'worry' nie daaroor nie. Hulle kom maar net werk toe, en gaan maar net huis toe. Die heel laagste vlak gee nie om daarvoor nie. Maar ek dink die middelvlak, hulle is baie meer bewus gemaak daarvan."*

Employee: *"Basically, to have the whole organisation understand each and every Code of Ethics that there is. So, basically, if they can have a – I don't want to say – a workshop, if they could have a sort of hotline or something for people to explain what this whole Code of Ethics is... You might read what is on there, but you might not understand what they say."*

Designated Ethics Officer/Compliance Officer: *"…We used to have our staff sign an ethics statement. They had to sign a document that said that they supported the policy, etc. They had to make an annual declaration. We should do it again."*

Codes of Ethics *(continued)*

Middle Manager: "*Well, I think that the type of thing that we are experiencing at this point in time – is that people at the bottom of the organisation are starting to put some pressure higher up into the organisation by saying that, listen, you know, you are not really acting towards or in line with the code of conduct. You have agreed, you are one of the senior managers in the organisation, you have agreed to the… process, but you are not practising what you are preaching. And that is the type of pressure that people higher up in the organisation are starting to feel.*"

Chief Financial Officer: *"I think the senior director sets a Code of Ethics himself and we lead by example. There's nothing in writing, but it's verbally communicated in the organisation to indicate what is acceptable and what isn't. I think leading by example is the most important aspect of it."*

Designated Ethics Officer/Compliance Officer: *"Some of the areas that we need to work on, areas for development, are the implementation of a code of conduct and basically communicating and escalating that throughout the group."*

Middle Manager: *"Our greatest challenge is the communication of the code of conduct and a requirement of an explicit commitment to it, in other words, that people sign and accept the code of conduct… an explicit commitment to it."*

3.1.2 Leadership

BEST PRACTICE

- *Organisations should designate a person or persons – an Ethics Officer, or ethics committee – to take control of corporate ethics management initiatives.*
  - *Organisations should stress that Ethics Officers are not in the business of policing the ethics of employees' behaviour. They manage initiatives designed to cultivate and strengthen an ethical culture. All stakeholders should be made aware that responsibility for ethical behaviour rests squarely on their own shoulders.*
  - *An Ethics Officer's tasks include:*
    - *Facilitating the process of identifying organisational values;*
    - *Reinforcing values and standards via codification and policy development;*
    - *Aligning the organisation's ethical values with its vision, mission and strategy;*
    - *Integrating ethics into functional areas;*
    - *Promoting leadership, ownership and accountability;*
    - *Coaching, guiding and mediating;*
    - *Assisting with investigations of misconduct;*
    - *Assembling data relating to ethics management; and*
    - *Regular reporting to the CEO and Board.*
  - *Functionally, organisations should distinguish between Compliance Officers as overseers of legal and technical compliance with various laws and regulations, and Ethics Officers as custodians of organisational and individual commitment to the values and principles underpinning legal and technical compliance.*

- o *The functions of Ethics Officer and Compliance Officer should be the minimum norm, and given the complexity of some organisational environments, should ideally not be managed by one individual.*
- *An Ethics Officer must be a senior manager.*
- *Due care should be exercised to ensure that the individuals designated to manage an organisation's corporate ethics initiatives have sufficient time and resources to fulfill their mandate effectively.*
- *Given that ethics management duties require a wide range of skills and competencies, due care should be exercised to ensure that such a person is competent at ethics management and oversight. It does not necessarily follow that an individual who is a good Company Secretary or Financial Officer would be a good Ethics Officer. Ethics training and capacity, as well as personality considerations, should be the deciding factors.*
- *Senior management should take special cognisance of possible distrust and fear of reprisal among employees that might undermine or jeopardise ethics management initiatives.*

FINDINGS

Individual responsible for ethics management

General comment: Uncertainty and confusion were evident in companies about the existence of an ethics function, whether a designated person (e.g. Ethics Officer) was responsible for ethics management, and where such a function might be located. See Figure 7.

- In organisations with a person responsible for ethics management, less than half (48.0%) of employees were aware of such an office, increasing to 55.0% among middle management.
- Surprisingly, 25.0% of respondents with designated organisational responsibility for ethics management were not aware that they had been assigned that responsibility, or did not know of someone else in the organisation with those assigned duties.
- Of all respondents, 37.3% indicated that an ethics management function was located in human resources, 24.0% risk management and 15.1% the company secretariat.
- Only 5.9% indicated that their organisation had a separate (dedicated) ethics and/or compliance department. This suggests that companies are not yet convinced of the necessity to assign specific resources to ethics management.
- Many companies argue that ethics management should not be the sole responsibility of one manager, but that it should be the responsibility of all managers. This is of course quite true, and it is important to include representatives from various functional areas in an ethics task team. However, one senior manager must take responsibility for the integration, coordination and facilitation of the ethics management process. Even though all managers have responsibilities regarding financial management, one would surely not conclude that a company does not need a CFO.

- 10.9% of CEOs believed their companies had a separate ethics management department, whereas only 2.0% of individuals responsible for this function indicated this to be the case.

Figure 7: Departmental distribution of an ethics function

Department	% of Mentions Global	% of Mentions Managing Directors, CEOs	% of Mentions Other Directors	% of Mentions Middle Management	% of Mentions Employees
Legal Department	3.7%	2.2%	0.0%	6.2%	4.7%
Marketing Department	0.7%	0.0%	0.0%	0.0%	1.9%
Forensic Department	1.8%	2.2%	2.0%	3.1%	0.9%
Internal Audit Department	5.5%	8.7%	6.1%	4.6%	4.7%
Company Secretary	15.1%	21.7%	32.7%	9.2%	8.4%
Separate Ethics or Compliance Department	5.9%	10.9%	2.0%	4.6%	5.6%
Human Resources	37.3%	23.9%	20.4%	47.7%	44.9%
Finance	5.5%	4.3%	10.2%	3.1%	5.6%
Risk	24.0%	26.1%	26.5%	21.5%	22.4%

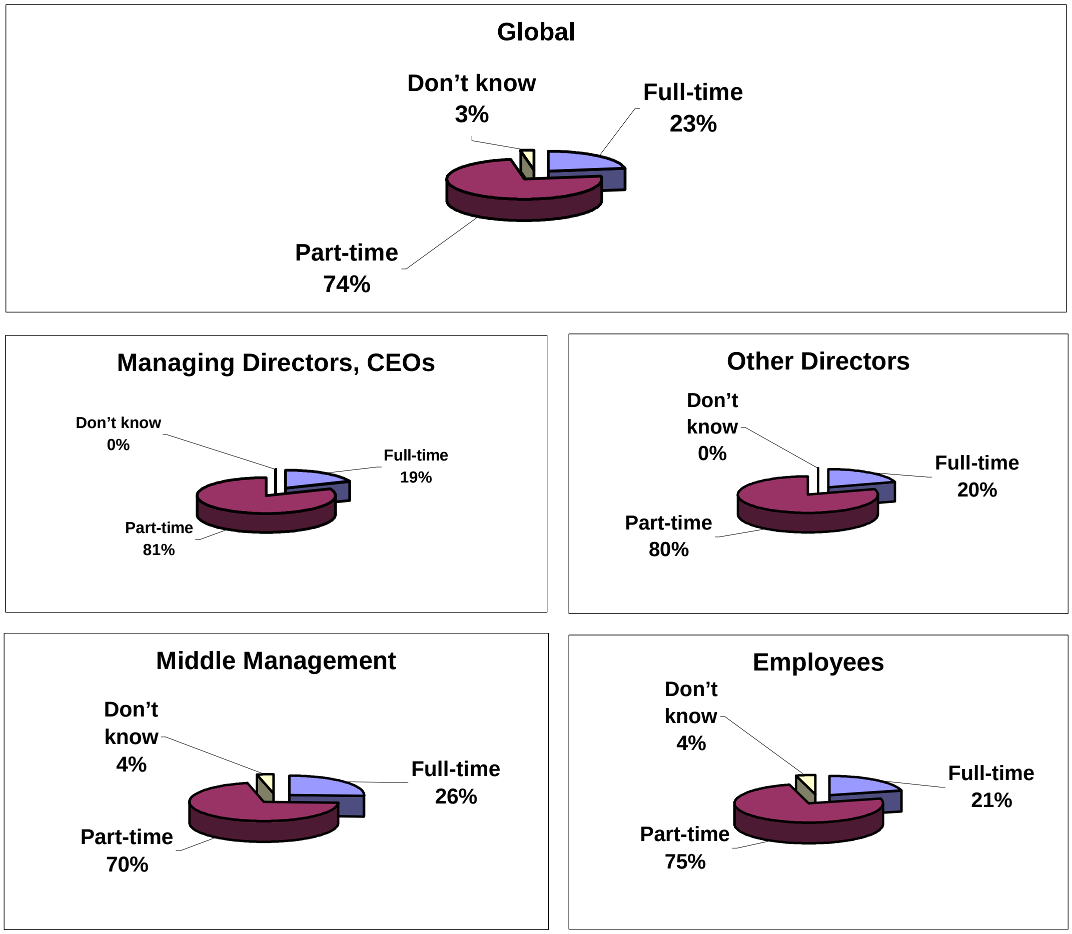
Maximum
Minimum

Full-time or part-time person entrusted with ethics management

General comment: South African companies are in the early stages of assigning a dedicated person to manage, oversee or coordinate effective ethical compliance. Whether such a function will be part-time or full-time is therefore far from settled. See Figure 8.

- 23.0% of all respondents indicated that ethics management was a full-time function. However, most of these respondents indicated that it would be a full-time function only while being set up. Once established, it would in all likelihood become a part-time function. This might fuel a perception of a lukewarm commitment to ethics, undermining the effectiveness of the function.

Figure 8: Full-time or part-time person entrusted with ethics management



Due care in delegating discretionary authority

General comment: Questions under this heading were only addressed to senior management. Integrity testing of persons occupying discretionary positions, an important requirement of King II, falls considerably short of the ideal.

- Fewer than half of respondents (46.5%) indicated that companies utilise some form of integrity testing prior to promoting people to discretionary positions.
- All respondents (100%) affirmed that CV checks as well as interviews were used as part of integrity testing.

Box 3: Leadership

Chief Executive Officer: *"Ons het nie 'n afdeling net vir etiek nie. Ons het 'n totale geïntegreerde benadering tot etiek. Eerlikheid is een van die mikpunte, so daar is 'n bewusmakingsprogram wat baie formeel en baie intens is. Soos ek sê, veral die personeel is ingelig oor wat ons wil doen en hoekom ons dit doen – wat ons waardes is."*

Designated Ethics Officer/Compliance Officer: *"I think, generally speaking... King II drive... the development and understanding of the director's duties and responsibilities, open avenues for ethics and understanding of the development of ethical behaviour, as well as what kind of ethics is required. This impacts [upon] our ongoing relationship with the various suppliers and service agents where we also take a strong line on their ethical conduct and not only our own. I think it's an awareness that we do utilise proper ethical channels. As for junior management, we follow an ongoing repetitive approach in enforcing ethical behaviour and good business ethics, be it from a trading perspective, or just being on the general side. Our ethics initiatives are ongoing; it's a culture in our company. As for compliance issues, we have a very strong internal audit department and we continually train and develop individuals from all levels of management and all staffing levels on compliance issues with regard to our systems and our policies on good ethics. So, from that side I believe it's more training, development and awareness of the programmes that are going on, on a day-to-day development basis. And also externally, the guys on a more senior level have the opportunities to attend various conferences and seminars on ethics and compliance issues. I mean, King II has created a major drive with all senior management for awareness. We have also gone to the directors and it is done on director level as well. I believe on that side a major inroad has been made and keeps being made on a continual basis. It's a cultural thing to us; it's not something we think about overnight. It's something we live and breathe."*

Chief Executive Officer: *"With the release of King II, our group Board decided some months back, prior to the release of those findings, that, once they came out, we would review them and we would then adopt them as a policy in the company and wherever practically possible would seek to meet those recommendations as a JSE-listed company. The appointment of some of our more recent Compliance Officers has followed that."*

Employee: *"Topbestuur is te slap – 'n baie wyd uitgespreide topbestuur wat nie diepte het nie. Jy het een persoon wat in beheer is van sake. Dit is amper, kan ek sê, outokraties – as mens dit so kan noem. Ja, ek sal sê dit is 70% outokraties. Daar is nie eintlik 'n konsulterende proses nie. Jy word maar vertel wat jy moet doen, en klaar."*

Middle Manager: *"I think we've got serious communication and commitment problems from senior management here. I mean, I don't think there is anything wrong with our ethics and whatever, but I think we have a problem with communicating that needs to be addressed. When senior management do not communicate it, their buy-in is not apparent to all."*

Employee: *"The person who runs the company [is my greatest concern regarding ethics]. Well, that is as honest as I can put it. If it doesn't come from top down, nothing is going to change in the company and, unfortunately, the person who is the head of the company, is the person who is doing all the things that he shouldn't be doing. So it isn't going to change, unfortunately."*

Employee: *"Dit is 'n outokratiese bestuurstyl. Deur die volgende vlak bestuur word daar glad nie besluite geneem nie, so, met ander woorde, alles word van bo af afgedwing ondertoe. Dit is outokraties en dit word nogal onredelik afgedwing sodat jy nie die gevoel het om deel te neem aan maatskappy-inisiatiewe nie, want jy weet klaar dat dit gaan afgeskiet word en op 'n latere geleentheid weer opgebring word en moontlik teen jou gebruik word, of die krediet gaan na iemand anders toe."*

3.1.3 Communication

BEST PRACTICE

- *Organisations should utilise the widest feasible range of vehicles for ethics communication.*
- *Senior management should communicate frequently on the importance of ethics.*
- *Organisations should avoid communicating only reactively about ethics, that is, after the occurrence of an unethical incident, or the discovery of an unethical practice.*
- *Explicit, proactive communication on ethics should be the norm, since it indicates a high commitment to ethics and is more likely to inculcate an ethical culture in the workplace.*
- *Proactive ethics communication tends to reduce fear of reprisal among employees, while encouraging a culture of individual and collective assumption of responsibility.*
- *Organisations should communicate on ethical conduct in a transparent manner within the bounds of privacy considerations. In cases where privacy is deemed an issue, the emphasis should be on the nature of the unethical conduct and not the identity of the person.*
- *Ethics communication should not only be via written or electronic media, but also in training, leadership and motivational speeches.*
- *Such active ethics communication will assist in avoiding situations where employees are unaware of the existence of written ethics communication, or not encouraged to take an active interest in such communication.*
- *Employees often do not understand the contents of written ethics communication, and require active and face-to-face explanations.*
- *For ethics communication, organisations should take care not to employ media to which employees do not have easy access, such as the intranet for workers who do not have computers. Moreover, expecting workers to read a long notice on a notice board during tea break is not realistic.*

FINDINGS

Frequency of communication on ethical issues in various media

General comment: Only two of the frequency scores for communication across different media exceed 50 points (on a frequency scale of 0-100, with 0 indicating "never communicated", and 100 "always communicated"). This indicates considerable scope for improving ethics communication, an ethical risk area. Moreover, it indicates that existing ethics communication tends to be reactive. These findings corroborate earlier observations that internal corporate communication on ethics requires considerable improvement.

- All respondents indicated the following frequency of communication on ethical issues (on a 0-100 frequency scale):
  - Dedicated ethics pamphlets – 54.7;
  - Board communications – 54.5;
  - Interim company reports – 47.8;
  - Internet/website – 37.5;
  - E-mail – 35.9;
  - Column in company newsletter – 33.4; and
  - Other (specified) – 56.3.

Ethics communication among senior management and from senior management to investors

General comment: Questions under this heading were addressed to senior management only. Top-level communication on ethics ranges from good (audit committees) to poor (annual performance reports). "Annual performance reports" are defined as internal documentation comprising performance appraisals of individuals or collectives.

- Given recent accounting and auditing scandals, it is encouraging to note that on a 0-100 frequency scale, audit committees communicate on ethics at a frequency rate of 80.6.
- By contrast, respondents reported a low frequency (47.7) in respect of internal (individual or collective) performance reports. This appears to indicate that ethics is not viewed as a core component of overall company performance.

Box 4: Communication

Employee: "*Basically, our company is governed by core ethics or core business values… In terms of that we are very big on ethics, on how we communicate. [You said that this is what they would like you to believe.] Honestly speaking? Yes, I consider this to be a marketing tool and not an operational enabler. It is too vague. Agreed, it is there, but if you do not play around on the website, then you will not find it. [So it is not actively communicated?] Definitively not.*"

Chief Financial Officer: *"Because obviously ethics and code of behaviour and values, etc. do have a potential impact on your risk management and the way you do business… We know what we should and shouldn't do, but we are not particularly good at communicating it to all the different employees. I think that is really one area that we need to concentrate on in the company."*

Employee: *"En as jy nie internet op jou rekenaar het nie, dan sien jy dit nie, dan weet jy nie daarvan nie."*

Employee: *"We have a communications forum in our branch and when something does happen, this is how we all get to know about it."*

Communication *(continued)*

Middle Manager: *"Ons besturende direkteur het vanoggend vir ons e-pos uitgestuur oor algemene waarhede wat baie gaan oor wat jy as mens doen en moet doen. Dit is al wat ons doen in hierdie verband en jy sal dit seker by etiek en navolging ['compliance'] kan sit. Dit word daagliks gedoen en deur die hele maatskappy uitgestuur."*

Employee: "*Daar is 'n te groot gaping tussen bestuur en gewone personeel met die kommunikasie, om dit vanaf senior bestuur na ons deur te gee. Ons hoor dit altyd met draaie — nou nie eers net met etiek nie, met enigiets, hoor ons altyd met draaie. Ons hoor dit nooit direk van hulle af nie."*

Middle Manager: *"I think ethics should be communicated a lot more in terms of what it means. I am not talking about head office people. I am talking about the more grassroots people. I think it is something that they should be exposed to a lot more. I just think that it is important that people have no room to say, 'I didn't know' or 'I never understood this' or 'gee-whiz'. Just think the more it is communicated, the more no one can say, 'I never knew about this' or 'I never knew about that'."*

Employee: *"The concern is that ethics communication is very bad. It tends to be more down, than up-down and as a result I don't think that the decisions that are made are a true reflection of what actually happens in this business."*

Middle Manager: *"There is quite a bit of communication between the Chief Executive and senior management who, in turn, filter it to the organisation through meetings and sessions. We have quite an open policy; if there is a problem, you bring it up immediately. If there is a problem with ethics, you discuss it the next day at the meeting. There is a meeting opportunity every single morning."*

Employee: *"Toe hulle e-pos uitgestuur het oor sake-etiek, moes ek gaan kyk wat sake-etiek is. Dit word nie vrylik aan ons gekommunikeer nie, maar dit is wel beskikbaar mits jy gaan soek daarvoor. Dit word wel in verslae uiteengesit en baie mooi verduidelik, maar dit word nie aan almal gekommunikeer nie. Ek moes dit by 'n hulpbronne-persoon gaan haal. Dit is passiewe kommunikasie en word nie daadwerklik aan ons oorgedra nie. Mense weet nie wat van hulle verwag word nie."*

Employee: "*Our company gets these e-mail messages that pop up now and again about the code of conduct and it is stuck on the walls and it's also on the intranet, but I think most employees don't even know. You just go into the intranet and play around and then you will come across it. There is no real direct communication."*

3.1.4 Education and training

BEST PRACTICE

- *The main purpose of an ethics education and training programme is to establish an ethical organisational culture.*
- *A key objective of ethics education and training should be the acquisition of ethical decision-making skills, and a method serving this purpose admirably is case scenarios demonstrating ethical dilemmas in employees' real-life work situations.*
- *An ethics education and training programme is the best method to promote an organisation's commitment to ethics and to encourage employees to believe in and act according to their organisations' stated values.*
- *Organisations should have ongoing ethics education and training initiatives (for different levels of employment, as well as specific performance areas), supplemented by specialist courses for key personnel.*

- *Ethics education and training courses should be formally scheduled at regular intervals.*
- *Employees should receive education and training on how to apply the values and guidelines of the Code of Ethics to specific job-related or task-related ethical challenges (see 3.1.1 above).*
- *Designated individuals responsible for ethics management, as well as newly appointed employees, should receive carefully customised ethics education and training.*
- *External ethics education and training consultants should not only assist with employee ethics education and training, but should also equip the individuals responsible for ethics education and training in the organisation with the necessary skills and competencies ("train the trainer").*

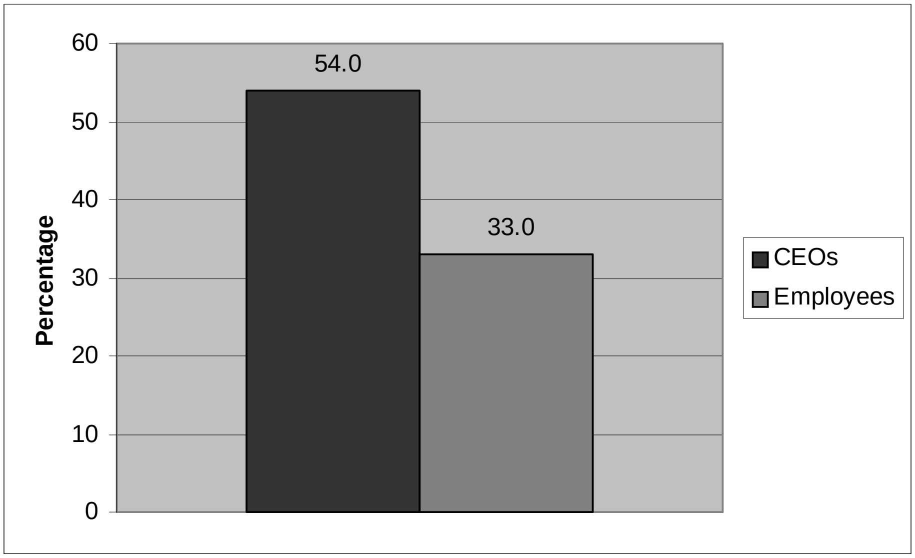
FINDINGS

Content of ethics education and training

General comment: The content of ethics education and training in organisations calls for careful review, in respect of both company Codes of Ethics and more generally. The value added by external ethics education and training needs quality control and greater standardisation.

- Only 40.5% of all respondents indicated that they had received education and training on their Code of Ethics. Since education and training are regarded as central features of a sound ethics management system, this low percentage is disconcerting.
- Interestingly, while 54.0% of CEOs believed their employees had received basic familiarisation with their Codes of Ethics or ethics generally, only 33.0% of employees themselves indicated this to be the case – a significant discrepancy of 21.0 percentage points. It appears that, despite senior management's good intentions, ethics education and training do not reach key target audiences. See Figure 9.
- Only 16.8% of respondents reported training in ethical decision-making skills, and only 21.2% reported case-study training.
- A relatively high percentage (32.8%) of all respondents indicated attendance of seminars, conferences or short courses. In many cases, however, the quality and depth of these seminars cannot be ascertained, and it is therefore unclear whether they enhance ethical capacity and skills in South African organisations.

Figure 9: Employee ethics familiarisation



Who receives ethics education and training?

General comment: Questions in this regard were addressed to senior management only. Clearly, ethics education and training are at unacceptably low levels in all categories (new appointees, established employees, individuals in leadership positions, including Ethics Officers). Since education and training are essential components of an ethical organisational culture, this indicates a considerable ethical risk area. Insufficient ethics education and training lower the profile of ethics and diminish employees' confidence in an organisation's commitment to ethics.

- A very low percentage of chief executives (CEOs, CFOs, COOs) (19.6%) and ethics managers (17.3%) indicated that they had received ethics education or training in or through their companies.
- Of senior management, only 27.4% indicated that newly appointed employees received ethics education or training. This percentage might arguably be lower, considering the result for employee familiarisation with Codes of Ethics (see above) – while 54.0% of chief executives believed it was being done, only 33.0% of employees indicated this to be the case. The same trend might apply.
- Of senior management, a mere 17.3% indicated that established employees had received ethics education or training.

Box 5: Ethics education and training

Employee: *"We've got a little booklet on the code of conduct, on which we all had to attend a training session. Everybody went on this training session where they were given a booklet, which is a pocket guide, so you have it in hand."*

Middle Manager: *"Yes, we've got twice-weekly meetings and monthly meetings where these things are brought up and discussed, sometimes in a hell of a lot of detail. And of course we have our own in-house newspaper that comes out monthly where ethics and compliances are written about and case studies presented — that's very well done."*

Employee: *"Everyone knows what you are allowed to do and what you are not allowed to do when you operate within the company ethics, but I wouldn't say there is an actual initiative to make you more aware of or improve your ethics or anything like that. But I mean, should anyone step out of line, then he could be disciplined."*

Middle Manager: *"As ek moet eerlik wees, ek dink nie daar is enige spesifieke inisiatief wat etiek in hierdie stadium aanspreek nie."*

Employee: *"I can't speak for the whole company, but I know of only once that a guy from head office came to speak to us as far as ethics and these kind of things are concerned, but I do not know about the rest of the organisation. I would be lying if I said to you I know."*

Designated Ethics Officer/Compliance Officer: *"I think it is building capacity amongst the employees, or giving them the understanding as to what the company considers good ethics to be. For example, the company might consider something to be an ethical issue, whereas individuals in their experience and upbringing, through no fault of their own, might consider it to be a common practice."*

Middle Manager: *"We have an internal newsletter that goes out. And some aspects of our values are discussed on a weekly basis."*

Employee: *"Ek dink die groot probleem van ons maatskappy in dié stadium is die feit dat ons landswyd verspreid is met baie takke en 'n verskriklike groot hoeveelheid personeel. Ek dink nie dat die etieknavolging, die gedragskodes en al die interne inligting altyd goed genoeg gekommunikeer word nie. Al die mense op grondvlak besef nie presies watter tipe maatskappy ons is en waarna ons streef nie... Ja, ek dink dit is alles deel van dieselfde – dit moet ook heeltemal deursigtig wees."*

3.1.5 Enforcement, monitoring, reporting and guidance

BEST PRACTICE

Enforcement

- *Enforcement of ethical standards via disincentives – such as a warning, a reprimand, probation, demotion, temporary suspension, discharge, required reimbursement of losses or damages, or referral for criminal prosecution or civil action – play a valuable role in maintaining good ethics governance standards.*
- *Importantly, enforcement should satisfy the following two broad conditions:*
    - *Enforcement should be supported by a system ensuring that individuals are well informed about the standards of conduct applicable to them, especially conduct outside common-law crimes, such as theft. Thus, organisational policies regarding, for example, gifts, conflicts of interest, or use of company resources (Internet, e-mail, etc.) should be clear and properly communicated (see Communication – best practice).*

- *Enforcement should be supplemented by positive incentives designed to encourage ethical conduct. This does not mean that an organisation is expected to reward an individual for not stealing, and the like, but rather that channels should be created for reporting unethical conduct. Exemplary ethical conduct should, however, receive recognition and praise.*

- *The following four conditions should ensure consistent enforcement:*
    - *Codification and thus standardisation of company values;*
    - *Responsible ethical leadership;*
    - *Effective communication; and*
    - *Appropriate training programmes.*
- *Organisations operating internationally have to contend with divergent legal and cultural standards. For such organisations it becomes particularly important to institute these four consistency requirements.*
- *Using the analogy of bad apples versus bad barrels, proper enforcement seeks not merely to eradicate the unethical conduct of individuals (bad apples, through a warning or reprimand, etc.), but also the structural elements in an organisation allowing or encouraging unethical conduct (bad barrels). While a bad apple can be removed, transforming a defective corporate structure requires considerable effort and time. Still, reconstructing the barrel to decrease the incidence of bad apples is the only effective and enduring remedy.*

Monitoring

- *Organisations should formulate clear monitoring policies and communicate them to all staff.*
- *Organisations should not engage in surreptitious monitoring, unconnected with known policy or specific investigations.*
- *Blanket (as opposed to incident-specific) monitoring or recording of telephone conversations or e-mail correspondence presents a serious invasion of privacy and is, therefore, ethically unacceptable. Exceptions relate to investigations and specific business activities, such as call-centres and trading floors.*

Reporting

- *Organisations should institute a confidential hotline, whistle-blowing line or tip-offs function for internal stakeholders to report unethical activities by colleagues. Importantly, organisations should communicate their hotlines and hotline policies actively and explicitly.*
- *Organisations could outsource the operational aspects of their hotline functions.*
- *A hotline policy should communicate clearly that malicious use of the facility is wrong, and that it is exclusively intended for real ethical issues, not petty interpersonal issues or gripes trivialising ethics.*

- *The individual(s) responsible for a hotline function should be senior in the organisation and, preferably, widely respected.*
- *The individual responsible for a hotline function should have sufficient training and a personality encouraging confidence and trust. Someone trained solely in law or finance might arguably lack the necessary interpersonal skills, while someone from a purely human resources background might lack the required technical knowledge. The ideal is a balanced mix of skills and competencies.*
- *A policy of zero tolerance should support an ethics hotline, while strictly avoiding a culture of spying and distrust.*
- *It would be wrong to assume that employees read passive communication, such as e-mail correspondence or office circulars. Management should inform employees explicitly of these reporting channels, and encourage their usage.*
- *Organisations should formally institute a confidentiality policy, within the limits prescribed by law, regarding reporting of misconduct to line management (supervisor), since line management is often the first base for reporting misconduct. Likewise, organisations should adopt a formal non-retaliatory policy designed to address employee fears of reprisals for reporting misconduct.*
- *Organisations should provide a confidential reporting mechanism allowing employees to bypass line management when approaching a supervisor may be impossible or uncomfortable, or the line manager may be part of the problem.*
- *At least one mechanism for reporting misconduct should allow for anonymity, and capacity should be created for validating anonymous claims of misconduct.*
- *In addition to a hotline for internal stakeholders, organisations should provide a well-advertised confidential or anonymous mechanism enabling external stakeholders to report unethical practices or unethical individual conduct.*

Guidance

- *An organisation should designate a person – typically the Ethics Officer – authorised to interpret the Code of Ethics since it is frustrating receiving information not backed up by authority. Such a service is a helpline, as opposed to a hotline.*
- *Many organisations use either a direct line to the Chief Executive or the pre-existing confidential hotline to facilitate such calls.*
- *In most cases, when employees have questions and seek ethical advice, they should bring those questions to their immediate superior.*
- *In cases where approaching one's supervisor may be impossible or uncomfortable – or if the supervisor is part of the problem – the employee should contact the company helpline for ethical guidance, or take the problem to the supervisor's immediate superior.*

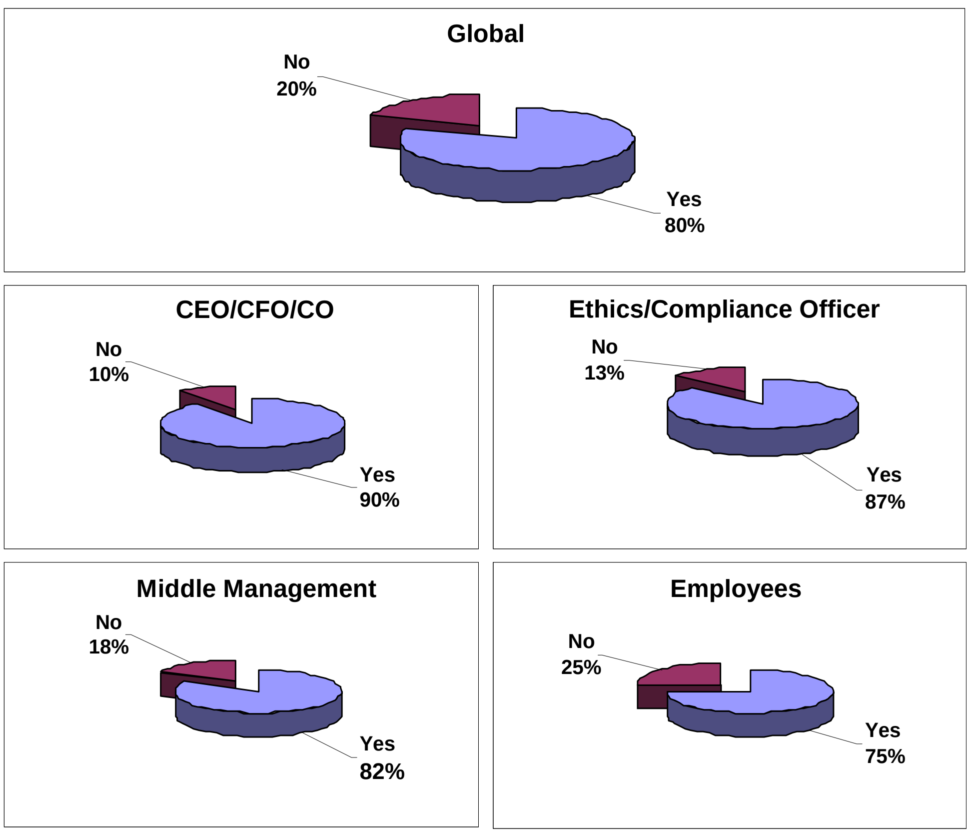
FINDINGS

Proactive ethics enforcement and channels for seeking ethics guidance

General comment: Enforcement is predominantly reactive rather than proactive, and junior staff members have less scope for seeking guidance or advice on ethical issues than senior management. See Figure 10.

- Enforcement of ethical standards has a strong reactive and disincentive bias. Almost all respondents (96.0%) indicated that their companies have formal, written disciplinary procedures, while only 17.3% indicated the presence of proactive incentives for ethical conduct, a discrepancy of 78.7 percentage points.
- In response to the question whether respondents were aware of avenues for seeking ethical guidance, 25.0% of employees and 10.0% of CEOs, answered in the negative.

Figure 10: Availability of ethics guidance



Confidential and anonymous mechanisms for reporting internal misconduct

General comment: Fewer than half the surveyed companies appear to have external hotlines, while respondents indicated that only a quarter of companies have internal hotlines. Reporting to line managers (supervisors) appears to involve considerable confidentiality risks, and employees are far less convinced than senior management that at least some reporting mechanisms allow for anonymity.

These findings call for greater ethics education and communication, as well as confidential and anonymous internal misconduct reporting mechanisms.

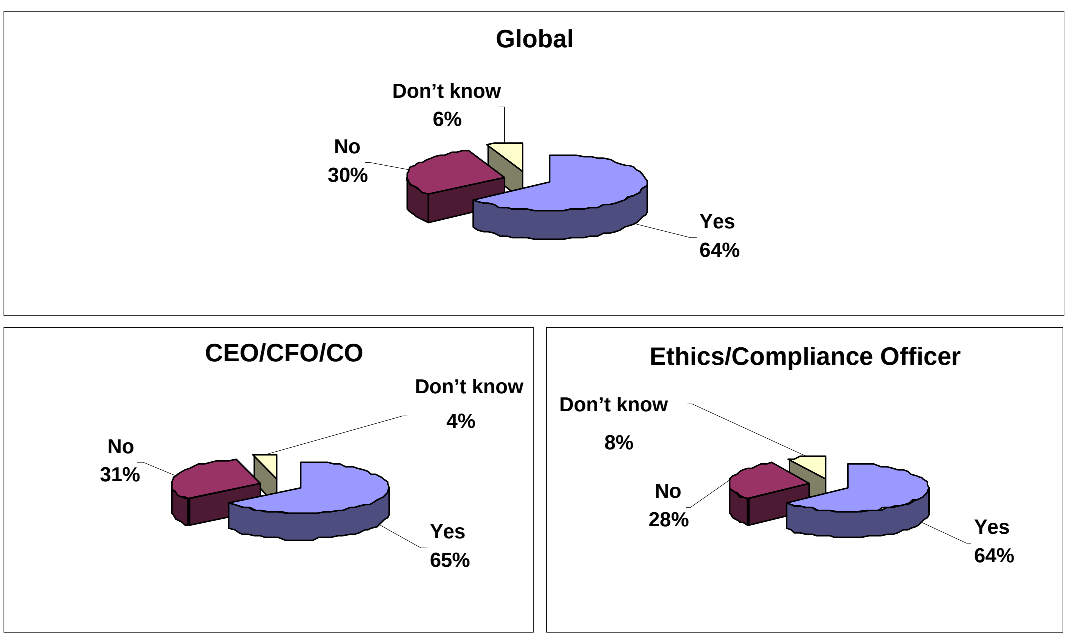
- Whereas 43.6% of senior management indicated that their companies had an externally operated hotline, only 19.3% of employee respondents confirmed this. Once again, the existence of an ethics infrastructure is not communicated adequately.
- Almost one out of four employees (22.7%) indicated that their superiors did not maintain confidentiality. Considering that 97.5% of all respondents indicated that their superiors were the primary avenue for reporting misconduct, this could be a significant ethical risk area.
- Only 25.4% of all respondents indicated that their companies had internally operated hotlines.
- Only half (52.0%) of all respondents indicated that reporting mechanisms allow for anonymity. An explanation might be that employees report ethical issues directly to their superiors.
- Of senior management, 69.5% believed that their reporting mechanisms allowed for anonymity, while only 45.0% of employees agreed, a significant differential of almost 25 percentage points. Again, this highlights clear failures in ethics communication.

Confidential reporting mechanisms for external stakeholders

General comment: Questions in this regard were addressed to senior management only. More than one out of three companies apparently still need to institute confidential mechanisms for external stakeholders (shareowners, suppliers, contractors, etc.) to report misconduct. This constitutes a significant ethical risk area. See Figure 11.

- Only two-thirds (64.4%) of all respondents reported that companies provide external stakeholders with confidential mechanisms for reporting misconduct.

Figure 11: Confidential reporting mechanisms for external stakeholders



Box 6: Enforcement, monitoring, and reporting

Employee: *"Well, you have people running around not really knowing what to do and whom to report it to."*

Employee: *"We don't have somebody we can go to with our problems. We have to go to the open meeting on Wednesday; there is no confidential way to speak to him."*

Employee: *"We have a tip-off hotline, which is an anonymous hotline if you are aware of any fraud in the company. I think that is probably our biggest initiative – the one that is most frequently used. We have made mention of ethics in our general newsletter, but the tip-off line and the e-mails regarding the subject are quite frequent. They are encouraging staff members to report fraud and they must adhere to it. They are doing it well."*

Chief Financial Officer: "*I think a massive problem facing most South Africans is determining what is right and what is wrong and how do you work your way through some of these things. I think we could help our staff in that way. I think it is hugely important, because I am quite concerned in this new South Africa that there is a perception that it is okay to steal and some people do it and when someone does, then it doesn't seem that they are punished appropriately. I think that a lot of staff, particularly our managers, would benefit from undergoing some course in ethics. Some people would say ethics are culture-related. I agree with that, that is why it needs the intervention of educators in the field.*"

Designated Ethics Officer/Compliance Officer: *"(1) Firstly, there is the regular update of our ethics policy. We try to keep it as current as possible. (2) Secondly, any anonymous tips that we may receive in whatever format, we will follow them through. (3) It's regular meetings with suppliers and emphasising that good ethics is good business. We have, what we call, mentors for various suppliers and they meet regularly and they talk about health, safety and environmental issues, quality issues, as well as issues around ethics."*

Chief Executive Officer: *"On the compliance side we have an internal audit department that has a risk plan for the year. Each time that we take on a new supplier, there would be reviews of their compliance with our ethics policy. Each of those suppliers has a copy of our ethics policy and we will review it with them annually to see how they are performing, etc. There is a large portion of our staff that deals directly with clients, and our biggest risk area is unethical behaviour of our staff towards the client, because they are dealing with a lot of money, as we are a buying company. Other internal issues — we have a range of internal interest groups, some of them are looking at the environment and related issues, looking at the ethics of the products, looking at it being animal-friendly, environment-friendly, etc."*

Employee: *"There is very little that is communicated on ethics as such. We concentrate very much on the disciplinary rules, but there is nothing about morality or values as a whole. The emphasis is on what happens if you break the rules, rather than encouraging people to be honest and open. I would say I don't think they do enough to communicate to employees that they need to respect each other and the organisation as a whole."*

Chief Executive Officer: "*The 'impimpi' culture in South Africa goes back to the days of apartheid where, basically, nothing was reported because you did not want to get your colleagues into trouble. So, therefore, nothing was ever reported upward to management and that culture spread. Basically, it is not just a race-based culture; it is a common culture in South Africa of not reporting things so that you don't get into trouble with your mates. I think it is one of the biggest threats to transparent management in this country. In fact, it is the biggest … Full empowerment of people is when you empower people to take individual responsibility. It means that they have to take action against their colleagues and it is the biggest threat to empowerment, or true empowerment in the workplace. In response to this, my actions were to link financial incentives to values. I have decided that honesty is an integral value of this company and therefore the profit share should be withheld where the values are broken. It seems to have worked. I've had one incident where we had an instance of theft and we couldn't break through and I withheld the whole division's profit share. Within two days we had a culprit, we knew who it was and how it was done. The guy was dismissed. We took legal action because we do prosecute and I reinstated the profit-share. It must be linked to values. It is not an incentive scheme that we link to performance, and I would hate to link it to performance in a compliance sense."*

Enforcement, monitoring, and reporting *(continued)*

Chief Executive Officer: *"We have a whole series of levels of management. Our senior management expects free integrity and an open forum on every issue or every discussion that is held. At my level to MDs it is completely open and if an integrity or a value or ethical issue should arise we would handle it very harshly, from MD down to the department or General Manager down to the department. Any breach or theft or anything that is unacceptable would be reported at the management meeting and the handling of it would be, depending on the individual, of varying severity. Down below I do not think we implement it at the level that we could, but the staff are all very well aware that if there were any breach of, what I would call, ethical integrity, they don't really fit into our world. [Are there any proactive measures in this regard?] Not at all."*

Middle Manager: *"It's more consistency in enforcing ethics, that's really what my main concern would be. It is inconsistent at the moment."*

Employee: *"In our company newsletter employees get praised for proper conduct, and that goes out on a quarterly basis all the time."*

Employee: *"If something goes wrong they are quick to tell you how wrong you've done, but if you do something right, nothing gets said about it."*

Employee: *"I think the greatest challenge is to get people to speak up when they are aware of issues because I think there is just a general fear that they will be victimised, so they tend not to. I am aware of an incident where the persons preferred not to divulge the information because they were afraid that it could have repercussions for them physically or for their careers."*

Middle Manager: *"There's normally just a reminder, probably on an annual basis, from the Board about, for instance, accepting gifts around December and so on. But not a lot is done around ethics, and I think it is needed in some areas, like people who deal with suppliers a lot, for instance. They are very exposed to fraud or bribery and those sorts of things."*

Chief Executive Officer: *"Ethics is measured in the key performance areas of all staff. We might choose words that are mostly understood by all. The value roll-out has gone well and we have certainly seen a reaction to it. We are doing it well compared to other companies, but I still think we can do more. It is something you have to keep up the whole time."*

3.1.6 Corporate social responsibility

BEST PRACTICE

- *Organisations should pursue financial profit in a manner that promotes social good and is environmentally responsible. King II refers to this as the "triple bottom line".*
- *In accordance with the "triple bottom line", organisations should:*
    - *Fully inform their shareowners by explicitly communicating their corporate social responsibility (CSR) initiatives. Remarkably, many organisations are very involved in various CSR initiatives, but through negligence or poor investor-relation management they fail to convey this information to shareowners and analysts.*
    - *Provide engagement platforms for external stakeholders (shareowners, affected communities, government departments and others) that:*
        - *Allow for communication between relevant communities, institutions, and the organisation, since accurate determination of community and environmental needs is a precondition for CSR success;*

        - *Attempt to anticipate proactively potential conflicts between the expectations of shareowners and those of other external stakeholders (communities, the state, NGOs, and the like);*
        - *Ensure that shareowners are informed of local socio-political and economic constraints and opportunities, especially when such shareownership is predominantly foreign;*
        - *Educate financial analysts and shareowners to look beyond short-term or interim results by appreciating the medium-term to long-term sustainability benefits of good CSR; and*
        - *Encourage CSR activists, rating agencies, and financial-service institutions to engage with the company in constructive debate.*
    - *Organisations should report on their CSR initiatives in a manner amenable to independent auditing.*
- *A CSR report should be incorporated as a separate section in an annual report, or be a completely separate document supplementing standard financial reporting. King II (p. 129) recommends that "Every company should report at least annually on the nature and the extent of its social transformation, ethical, safety, health and environment management policies and practices".*

FINDINGS

General comment: Many senior executives are unfamiliar with the notion of a "triple bottom line", which impacts on CSR reporting. Apart from environmental issues, reporting on "integrated sustainability" ("non-financial") issues – see King II, Section 4 – is at a high level. The test for such reporting initiatives is whether they reflect a true commitment to these issues, rather than window-dressing.

- In the light of *King II*, it is encouraging to note a high level of reporting on good governance issues (94.1%), social responsibility issues (92.1%), and black economic empowerment and transformation (85.1%).
- It is disconcerting that environmental practices were reported in only two-thirds of responses (66.3%).
- HIV/AIDS reporting was indicated by 73.3% of respondents. Given the impact of this disease on Southern Africa, this is inadequate.

SALIENT OBSERVATIONS

After interviewing 106 senior executives, we believe we are in a reasonably good position to make the following observations:

- The majority of South African companies do not yet meet international CSR standards.
- Some South African companies regard CSR initiatives not as issues of leadership and reputation management, but as marketing opportunities and exercises. Reputation management is defined as an organisation's public efforts to communicate internal good governance, with CSR being an external expression of such efforts. By contrast, in this context marketing is associated with an external portrayal of a state of affairs that might not match reality inside the company.
- Despite significant exceptions, lip service in respect of CSR is still prevalent.
- Often the reasons for South African companies not moving beyond lip service into real CSR can be found in the slackness of financial institutions to reward companies for their CSR initiatives. This is compounded by limited shareowner understanding of the benefits of CSR.
- Special care should be taken to ensure that evolving legislation and regulatory requirements do not induce strategic shortsightedness or window-dressing, with a disingenuous focus on reporting empty of matters of substance.

Community upliftment

- In general, South African companies do not yet define good CSR in terms of adding value. They tend to emphasise the quantity of social and environmental interventions. Good CSR is underpinned by responsible ethics, and ethics is not a commodity. Building six schools standing empty due to lack of community involvement is far less valuable than building one functioning school in a community. Noteworthy, however, are the significant exceptions in this regard.

HIV/AIDS

- The dividing line between private-sector and public-sector responsibility is becoming blurred in respect of health care for the HIV/AIDS population. Foreign shareowners, in particular, are less willing to sacrifice growth and return on investments to pay for healthcare, traditionally understood as falling within the ambit of the state.
- The fact that HIV/AIDS is not a notifiable or reportable disease makes the determination and management of its impact difficult.
- A very small discrepancy exists between employee expectations and their actual experiences of company efforts to accommodate rather than discriminate against HIV-positive individuals. While this is heartening, it could indicate that the full impact of the disease has not yet penetrated public consciousness – for a variety of reasons, some of which are probably peculiar to South Africa.

The natural environment

- Environmental reporting is still confined mostly to companies with a direct impact on the natural environment, such as those in mining and industry.
- South African employees have shown a low sensitivity to environmental concerns. The discrepancy between employees' expectations and the actual experience of their companies' environmental efforts is only 9.4. Considering that the average national discrepancy between expectations and experiences in the workplace is 20.3, the environmental expectation/experience differential is very low. This is probably better explained by respondents, particularly employees, being inadequately sensitised to environmental issues, rather than by the progressive nature of their companies' environmental initiatives.
- Very few companies have internal recycling policies regarding waste products not directly associated with manufacturing processes, such as paper or redundant computer equipment.
- Very few companies have any form of scrutiny of the environmental practices of their clients or suppliers, which is a major improvement opportunity.

Black economic empowerment

- Generally, South African companies have shown a high commitment to black economic empowerment (BEE).
- According to respondents, the dearth of suitably qualified candidates is a major source of frustration in meeting BEE targets. They also indicate, however, that the situation is improving.
- Many respondents stressed the need for better BEE communication and cooperation between business and government.
- Certain global companies based in South Africa face the problem of meeting government expectations while attempting to create a preferred employer status on a global level.
- Instances of racism still occur, but, according to respondents, conditions have shown a marked improvement in recent years.

Box 7: Corporate social responsibility

Chief Executive Officer: *"When I started here 30 years ago, there was no such thing as corporate governance and corporate social responsibility. Today it is a big issue. You know, 30 years ago there was no King II."*

Middle Manager: *"Streke verskil en ek gaan vir u sê, veral hier in die Oos-Kaap is dinge partymaal nie so maklik nie. Ek sal vir u sê, op die oomblik is my persoonlike doelwit wat ek vir myself gestel het oor die volgende paar jaar wat ek nog hier is, wil ek graag my mense uit hulle skuld kry en ek wil hulle in huise inkry. Dit is nie maklik nie. Jy veg letterlik duim vir duim vir elke stukkie grond wat jy wen. Ek gaan nou met 'n ou praat, oor behuising."*

Designated Ethics Officer/Compliance Officer: "*For instance, this HIV/AIDS thing. You know, we have now taken a decision to supply anti-retroviral drugs to our employees and their families. Now a lot of our foreign Board members find this rather strange that we are doing this in South Africa. They ask, you know – 'why is the company doing this?' And, really, it is driven by us here to fill a vacuum which is not being filled by the government…"*

Corporate social responsibility *(continued)*

Designated Ethics Officer/Compliance Officer: *"If you were domiciled in the Netherlands or the UK, corporates will not really be expected to dole out large sums of money just to keep their vicinity safe and clean. We have clinics in areas where we have operations, where we have facilities that we run, mainly for the local people and in particular for our employees. We have libraries which we put up. You know, we spend in South Africa many millions of bucks on these types of projects and that excludes this AIDS thing. Now a lot of foreigners will say these things you simply should expect the government to do because that is why they have the right to expect of you to pay your taxes. What can I say? You know, one understands that we are in Africa, still developing and all that sort of stuff, but you know, it is very difficult for us to draw a line. Where does our duty to the shareowner begin and stop? You know, there is an expectation that the company must make as much money as it can, within the proper bounds of norms and standards and all this, for its shareowners. Now, at what point do you say – 'now hang on, we are now crossing the line'. Whom are we now really serving here? You know, we are competing internationally, we are listed on foreign stock exchanges. Now, those shareowners expect us to compete in terms of earnings, with other international companies in a very competitive sector and now we have here in South Africa a moral obligation with financial implications affecting our bottom line."*

Designated Ethics Officer/Compliance Officer: *"Look, I think in terms of affirmative action there is still prejudice in operations. Not higher up so much. It is very difficult to break down… In my experience I see that sort of thing often. I think it is getting a lot better, but it is still a big problem for business."*

Chief Executive Officer: "*I think the quality of the financial assessments of all organisations by financial institutions is so weak that you are never going to achieve CSR as a goal with the current financial structures in place. [Can you explain further?] Well, financial people have no perception of long-term value creation and their thinking is purely short term, because all financial managers are incentivised on quarterly results in any case, and if you incentivise people on quarterly results, you cannot expect them to look at anything other than quarterly results of the companies they are analysing. The system that has been implemented by financial institutions is flawed and forces companies into positions of lip service regarding the 'triple bottom line'."*

3.2 Organisational culture

In respect of 35 ethical risk areas, we determined organisational culture by asking respondents to indicate their *realistic expectations* of their companies, and then to report their *actual experiences* or *perceptions.* We then measured the differential or fall-out in each case. In this study, the average national differential between expectation and experience for all 35 ethical risk areas was 20.3 (on a 100-point scale), with experience falling short of expectations. According to good standards of research theory, anything above 15 indicates a significant differential. In all, 19 factors were worse than the national average. See Figures 12 and 13.

Figure 12: Ethics Perception Index – 35 expectation/experience differentials

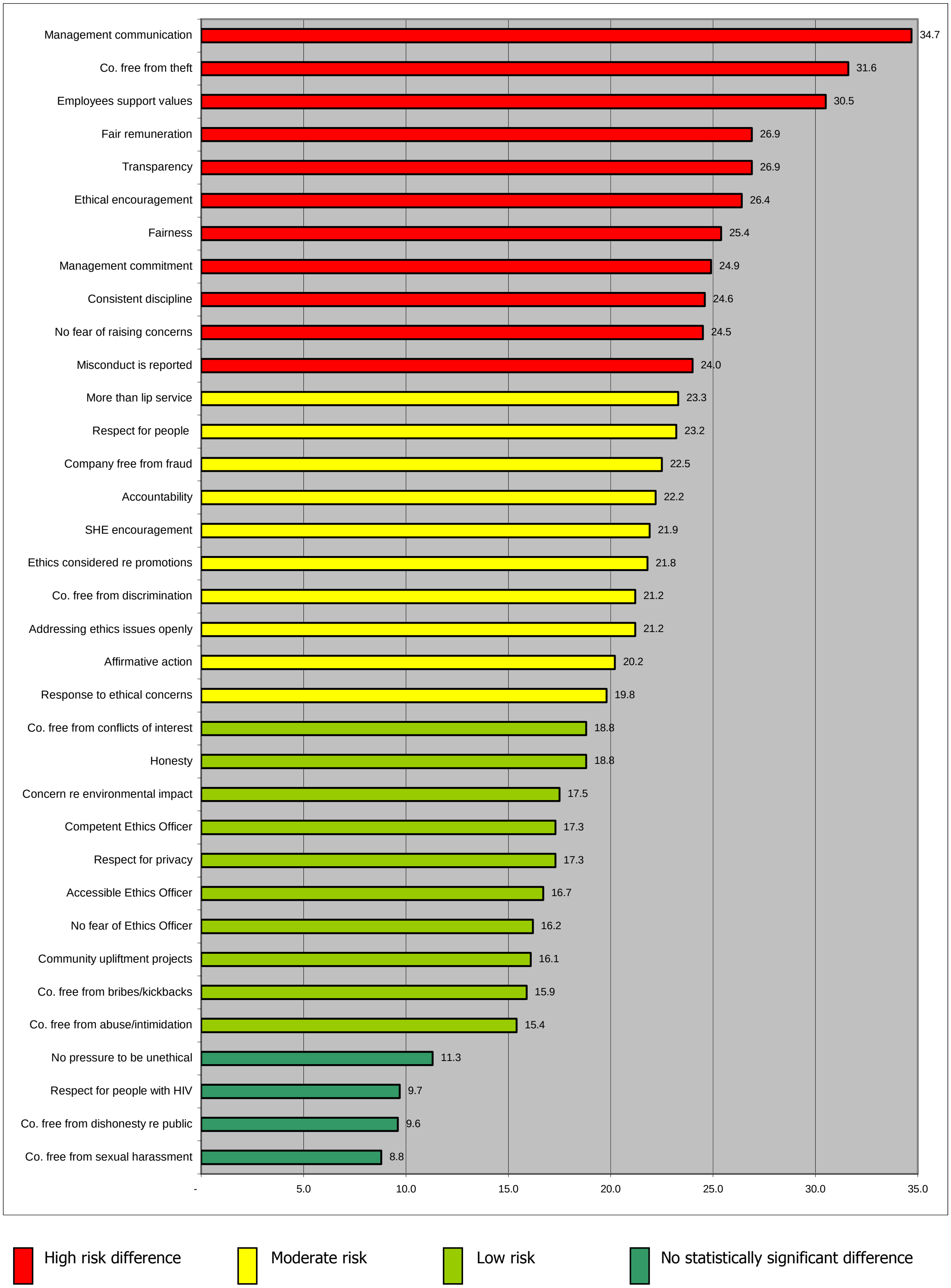
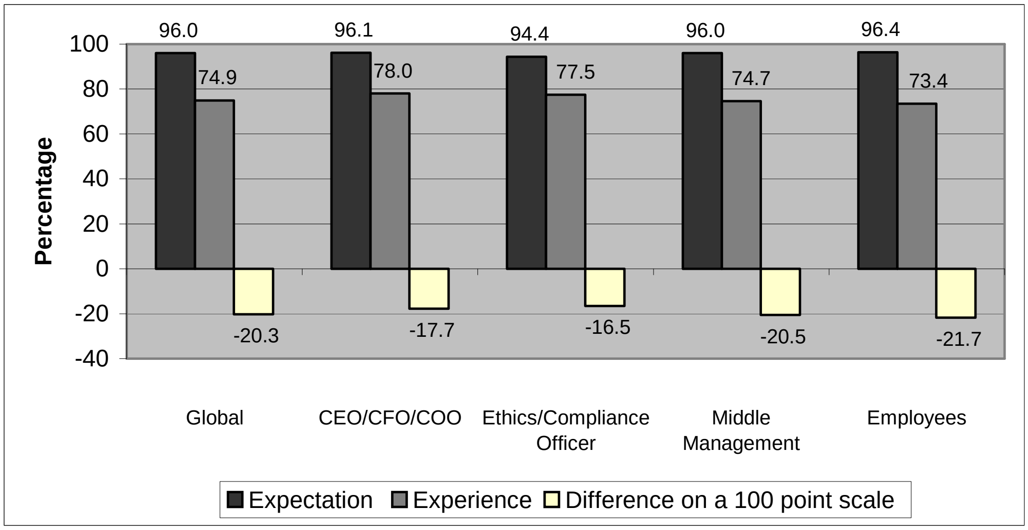


Figure 13: Average expectation/experience differentials per respondent class



The three most significant expectation/experience differentials, and therefore ethical risk factors, were:

- The effectiveness of senior management's communication on ethics and compliance (34.7)
- Maintaining an environment free of theft (31.6)
- Employees' lack of belief in their companies' stated values (30.5).

The fact that senior management's *communication* on ethics and compliance constitutes the most significant differential corroborates our finding that even though companies may have ethics infrastructures – such as Codes of Ethics, training, or hotlines – employees are often insufficiently aware of these. Clearly, there needs to be improved communication on ethics that is both ongoing and consistent.

The fact that respondents report a big discrepancy between their expectations and experience of a working environment free of *theft* indicates that fraud and theft remain significant problems in South African companies, despite the fact that many of them maintain strict controls. This presents companies with the challenge to instil a values-driven culture that would proactively assist in combating the problem.

The third most prominent risk factor manifests itself in respondents' experience that *employees lack genuine belief in their companies' stated values*. Considerations such as the following may explain this problem: Companies do not make their Codes of Ethics available to job applicants; do not include ethics training in their induction courses; and do not communicate the existence of their ethics infrastructure to employees.

One interpretation of these three differentials is cause and effect. It is possible that poor communication leads to insufficient of belief in a company's stated values, which, in turn, contributes to unethical conduct, such as theft.

Interestingly, the smallest differential is in respect of sexual harassment in the workplace (8.8).

Box 8: Organisational culture

These qualitative comments include references to unethical practices, such as fraud, theft and bribery

Chief Executive Officer: *"We don't like talking about ethics theoretically. Daily we consider tenders and, with great regularity, people wanting bribes. We regularly decide to say no to that. Our industry lends itself to bribes and we operate throughout the developing world, where bribe taking is part of the normal modus operandi. Our rules are very clear and no debates are entered into."*

Chief Financial Officer: *"Given the concerns about fraud and theft, [we] constantly [seek] to improve our systems to whittle down the almost constant stream of those issues being reported. This is done by increased systems controls and improved reporting procedures, I suppose; not necessarily surveillance as such."*

Chief Executive Officer: *"Ek beskou dit as die grootste enkele ding. Diefstal, en bedrog. 'n Derde van alle sake wat ingedien word by ons maatskappy – 'n derde het een of ander element in van verneukery, hetsy by die kliënt wat die prys opjaag of vals eise indien, of die ou by ons wat 'n 'kick-back' kry. Kyk, daar is 'n helse bewusmakingsveldtog. Die mense 'check' mekaar op. Jy kan nou sê daar is slegs reaktiewe maatreëls. Dit is reaktief om 'n hele eenheid te hê wat se 'job' dit is net om goed te ondersoek, om na tendense te kyk, om rekenaarprogramme te hê, om ontledings te doen. Dit is alles nie slegs reaktief nie – ek sien dit as proaktief in 'n baie groot mate."*

Designated Ethics Officer/Compliance Officer: "*The major challenge we face, in fact, is removing the fraudulent practices that exist in our organisation, in our day-to-day business. Ja, the concern is that fraud in certain parts of the business, and I am talking external fraud more than internal fraud, is really inherent in the way business is done."*

Designated Ethics Officer/Compliance Officer: *"[Our greatest challenge] is the overall honesty and reduction of fraud. Fraud in Africa is endemic and really… and it is on a low level and high level of management one of the biggest concerns… and I think we are lucky in our company… and we've never had serious incidents."*

Divisional Chief Executive Officer: *"Maintenance contracts are a great risk. Let's say there is an over-declaration of work and sharing the benefits thereof; for example, there is a maintenance contract in place and the contractor is paid to do things 100% per day, but he only does 60% a day. The organisation does not know about it and signs it off as 100% of services rendered and the difference between those two, the saving that the contractor has, is split essentially with the associated contractor and the administrator in the organisation."*

Employee: *"You know, we are a big company. It is difficult to screen everybody. There is a lot of theft going on in the company. At times, I think, management could be a little more transparent and outgoing in this regard."*

Chief Financial Officer: *"When you are producing a phenomenally expensive product, you are, unfortunately, susceptible to theft and you are susceptible to your employees being induced to partake in such theft of property and products in the company."*

Middle Manager: *"The greatest challenge is to eliminate the bribes and the backhanders. You know, it is an industry-wide problem."*

Organisational culture (*continued*)

Chief Executive Officer: *"Bribes and backhanders are having an effect on ethics. You know, in our business, other facility providers will bribe service providers to move their services. In addition, the service provider tells you, you know, I can get this from the opposition. What are you going to do? What do you offer me?"*

Employee: *"[Your greatest challenge?] Well, fraud and theft. Some of our employees are continually stealing or falsifying accounts."*

Chief Operations Officer: *"I think it has improved. I mean, everything is bloody tendering now, and every time it is three tenders, and it is all the same guys with different names. Ja, we have it all the time. We had one last week. The smarter you get, the smarter they get. We try and keep one jump ahead."*

Chief Executive Officer: *"The most important thing, and what lies closest to my heart… You know, business is very difficult these days, and I am now talking from my position as CEO… The only way to possibly succeed, is through teamwork. The only way you can possibly have teamwork, is by basing it on an absolutely sound foundation of values and ethics, in other words, trust, openness, integrity and these kinds of things. And I think that's actually the only differential or competitive advantage that one team, one company, can have above another one when their products are the same, markets are the same, where the competitive pressures are the same. That's the difference."*

Employee: *"Daar is 'n baie sterk waardestelsel wat nogal korreleer met hoë etiek in die maatskappy, alhoewel ek nie self die papiere en die opleiding en die beleide en goeters gesien het nie. Ek hoop dat julle navorsing dui iets daarvan aan en nie net dat die enigste maatstaf vir hoë etiek geskrewe dokumente en "posters" is nie. 'n Baie, baie sterk invloed op hoe maatskappye natuurlik te werk gaan, is die kultuur wat nou nie maklik gemeet kan word nie en nie 'posters' van gemaak kan word nie. Ek dink in ons kultuur is daar 'n baie sterk etiese gedragskode, maar min word formeel daaroor gesê."*

Designated Ethics Officer/Compliance Officer: *"I don't think you can just look at it within the organisation, because ethics really doesn't begin solely within an organisation. It begins in the way the country thinks and I think the biggest challenge facing us is that the country is becoming morally and ethically bankrupt, to be honest. Whilst we can do something between the hours of 9 to 5, it is what happens out there that is important."*

Employee: *"I think everybody just has to comply with the small laws, because once you comply with the small laws, the big laws will follow automatically. Do you know what I am trying to say? How many of us comply with the speed limits? Not many. If you don't comply with the speed limits, it just makes everything a bit easier to break."*

Middle Manager: *"I think transparency. I think there are a lot of things happening in the company. There are a lot of initiatives, but they are not transparent to all. Due to the lack of transparency, it often proves to be perceived as unfair no matter how well it is intended."*

Middle Manager: *"Our directors are in the sky and we are on the ground and, you know, you get these Morse Code signals and you must make out your own message. It is not as if they want to intentionally hide things from you. I don't think that is the intention. I don't think it is malicious at all, but it is perceived as being that, and the lower you go down in the organisation the worse it gets."*

SECTION 4: CONCLUDING REMARKS

King II recommends that organisations develop Codes of Ethics. The JSE Securities Exchange listing requirements likewise require companies to have Codes of Ethics.

Developing an organisational Code of Ethics is not a superficial or minimal task of simply adopting a generic document and then informing standard-setting and regulatory bodies that the organisation is in compliance. A truly responsible commitment to developing a Code of Ethics, one that testifies to integrity, credibility and trust, is an ongoing process that permeates all organisational functions and activities. Such a process involves a delicate balancing act between:

- Creating an ethical organisational *culture*; and
- *Complying* with formal requirements.

First, an ethical organisational *culture* is values-driven. It is grounded in a living commitment, by internal and external stakeholders, to core organisational and ethical values. It recognises the central importance of continuing and consistent communication on the meaning and importance of those values in all organisational functions and activities. A Code of Ethics is located in, and contributes to, building an integrated organisational culture, expressing "the way things are done here".

Second, a Code of Ethics also involves *formal compliance* with policies, procedures, and rules. After Enron and WorldCom, formal compliance structures and requirements have increasingly become part of the local and international regulatory environment.

Compliance, without building an ethical culture, however, is not the route we recommend. We need to learn from mistakes made elsewhere. Enron and WorldCom were in full compliance with regulatory requirements, but still failed miserably. They had Codes of Ethics, but lacked integrity and true commitment to those Codes. We need to understand the lesson that compliance to regulations is only one, albeit important, aspect of building an ethical organisation.

The development of a Code of Ethics involves an encompassing process whereby ethics is *institutionalised*. This process requires adopting a "Total Ethics Management" *programme*, aimed at establishing an ethical organisational culture that reflects a balance between a commitment to core values and compliance, with values informing and driving compliance. This process of institutionalising ethics in organisations has five stages:

- Securing senior management leadership and commitment;
- Performing an ethical diagnosis or risk assessment;
- Codifying values, policies, procedures and rules;
- Doing ethics education and training; and

- Setting up sustainability structures for ethics management (communication, enforcement, monitoring, reporting, guidance and external auditing).

We believe this BESA 2002 study shows that corporate South Africa has taken significant steps towards responsible ethics management. With regard to *formal* ethical compliance, almost three out of every four companies have developed a Code of Ethics, and some have begun to establish comprehensive ethics management programmes, thereby turning formal ethical compliance into *effective* ethical compliance. Moreover, in many companies an ethical *culture* is strong, minimising possible negative effects of underdeveloped ethical compliance programmes.

All South African organisations, big or small, in civil or political society, should aspire to:

- Put into place the constituents of ***formal*** ethical compliance (by developing a Code of Ethics and establishing compliance policies and procedures);
- Convert formal ethical compliance into ***effective*** ethical compliance (promoting the Code of Ethics and institutionalising ethics through an ethics management programme); and
- Establish an ethical ***culture*** (by integrating ethics into all organisational structures, functions and activities, in such a way that they promote individual ethical conduct and collective ethical practices).

The importance of building a responsible ethical culture lies in the growing evidence that medium-term to long-term financial sustainability is crucially dependent on ethical risk management and, therefore, leadership and reputation management. In short, we should build an ethical organisational culture because:

- It is the right thing to do;
- Regulations require it;
- Society demands it;
- Our stakeholders deserve it;
- Our strategic partners expect it; and
- Special interests and the media are watching us.