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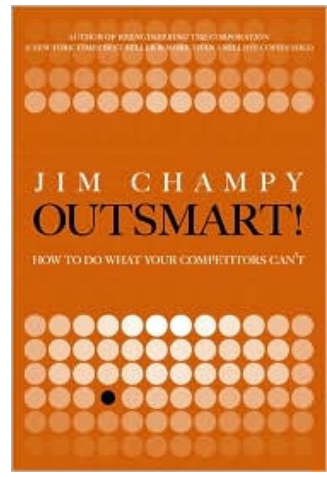
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## March 18, 2008

### Is Goodwill Bad Business?

By David R. Butcher

Today's increasingly conscience-focused marketplace demands more ethical business processes and performance than ever. But can strong corporate ethics and global competitiveness coexist?

Last week's news of New York Governor Elliot Spitzer's [link](#) to a high-priced prostitution service and his resultant resignation is only one in the latest developments that has brought back focus on ethical behavior in the public arena.

In today's increasingly conscience-focused marketplace, the demand for more ethical business processes and actions is increasing. [Recent](#) McKinsey Quarterly [surveys](#) reveal that today's business leaders are called upon to play an increasingly significant role in helping to resolve some of our most pressing social issues, from health care to climate change.

"The definition of a company and its involvement in wider society is expanding, as is the expectations of shareholders, employees and consumers," [Forbes](#) editor Paul Maidment recently wrote. "Traditional corporate social responsibility is starting to be replaced with a new notion of corporate citizenship, which for larger companies means global corporate citizenship."

The now infamous Enron created offshore entities to hide huge losses. Analysts turned sour on the company in the summer of 2001; Enron filed for bankruptcy before year's end. The equity is now worthless, and key executives are serving prison sentences on charges including securities fraud and insider trading.

Is crumbling to deception and greed a blunder? It is when you consider the thousands of employees who had bet their retirements and children's future education on now-worthless Enron stock. And then there's the fallout in the form of more burdensome regulation and higher costs for honest entrepreneurs.

Integrity and ethical behavior are considered one of the commonly accepted principles of corporate governance. The definition of business ethics may vary across countries, companies and cubicles, but let's say such behavior can be summarized in three points: 1)

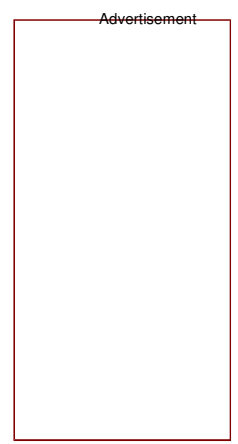
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corporate responsibility management, 2) environmental sustainability and 3) stakeholder accountability.

"The social and corporate agenda is being integrated, and often involves partnership with other companies, government and nongovernmental organizations — which is a challenge to those who hold to the traditional narrow economic definition of a company as an entity that is meant to maximize profits for shareholders," Maidment continued.

Although companies are primarily business organizations run for the benefit of shareholders (i.e., to make money), they have a wide-ranging set of responsibilities to their own suppliers, customers and employees, to the communities in which they are located and to society at large.

"Most corporations recognize these responsibilities and make a serious effort to fulfill them while trying to utilize their business ethics as a source of competitive advantage," noted a July 2006 report by Rania A. Azmi at [Alexandria University's Faculty of Commerce](#). "This has been defined as the 'hidden logic of business ethics.'"

In fact, many leading businesses no longer debate the legitimacy of the role and importance of ethics. Rather, they are finding new ways to put ethics into practice. And most, it seems, are recognizing that the challenges for tomorrow's business leaders will be even greater.

The same McKinsey reports mentioned earlier have determined that corporate leaders are already increasingly incorporating environmental, social and governance issues into core strategies. Executives indicate that companies are improving when it comes to managing socio-political issues and understanding what the public expects of them.

Organizations are developing codes of conduct that promote ethical and responsible decision making. Many are also establishing compliance and ethics programs to minimize the risk that the firm steps outside of ethical and legal boundaries.

The issue of corporate governance became a matter of concern especially because of globalization and, particularly, the investment by the foreign financial institutions in the emerging markets.

But do strong business ethics hurt global competitiveness?

For example, many entrepreneurs argue that initial public offerings (IPOs) are going overseas because Sarbanes-Oxley (SOX) compliance costs are too high in the United States, therefore undermining the nation's economic competitiveness.

The goal of the Sarbanes-Oxley Act of 2002, created in response to a number of significant public registrants issuing financial statements and reports that were grossly misleading, is to improve transparency in financial reporting and advance the accuracy and timeliness of public company disclosures.

In many circles, however, SOX has become a whipping boy for everything that is wrong with the nation's burdensome regulatory regime and even, in some cases, its controversial foreign policy. Of

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all the allegations against SOX, it is the claim that the act has eroded America's competitiveness that has had the most resonance throughout the country's boardrooms.

A recent report from consulting firm [Lord & Benoit](#), as [IMT](#) addressed in January, determined that "for non-accelerated filers, the total average first-year cost for management assessment and additional audit fees is \$78,474."

Yet Lord & Benoit also contends:

*Compliance costs are not without corresponding benefits. The improvement in procedures has removed volatility in reporting and this, in turn, has contributed to the recent dramatic decrease in security class action claims against companies. In addition, the market capitalization to revenue ratio of companies with good financial reporting procedures and filings results in higher stock values.*

Chief executives are responding to increasing pressure from consumers and employees, but "some also see opportunities to gain a competitive advantage," according to McKinsey's findings.

"The importance of building a strong ethical corporate culture is integral to the reputation, growth and finances of any organization," Azmi continued in the [Business Ethics as Competitive Advantage for Companies in the Globalization Era](#) report. "It builds a brand that attracts the best talent and creates trust among the stakeholders."

Indeed, a Hill & Knowlton report released in January, entitled [Corporate Reputation Watch](#), showed that almost three-quarters of the 530 MBA candidates surveyed worldwide said reputation plays an extremely important or a very important role when considering where to work after graduating with an MBA. Factors that drive reputation included quality of management, quality of products and services, social responsibility and use of corporate assets.

Another 2006 report that addressed [competitiveness and corporate social responsibility](#) concluded that not only can scaling up corporate social responsibility be "more effectively achieved where it supports, and is supported by, national and regional competitiveness strategies" — but also that "public policy aiming to scale-up corporate responsibility practices should be established within broader competitiveness strategies."

In theory, notes a recent [World Trade Magazine](#) piece, "U.S. statutes are clear and prohibitive of bribing foreign officials for the sake of getting business. In practice, there are grey areas that make for ambiguity. And other countries are much less restrictive on their companies, despite protestations to the contrary."

Yet in July 2007, China executed the former head of its state food and drug administration for dereliction of duty and taking 6.5 million yuan (about US\$850,000) in bribes from the manufacturers of substandard medicines that had been blamed for several deaths. Zheng Xiaoyu, who headed the agency from 1998-2005, had become the symbol of the quality control crisis in China's trade arising from the export of tainted goods — for some of which the authorities in Beijing had blamed him. The sentence was meant to reflect Beijing's resolve to wipe out corruption and to ensure consumer safety.

The impact of this action? As recently as January 2008, the U.S. trade deficit with China widened to \$20.3 billion, up from \$18.8 billion in the previous month.

Today's organizational challenge is to achieve targets with limited resources — which is hard enough in the typical economic environment, but is even a more acutely terrifying task now.

"The cloud of economic gloom could yet have a silver lining for companies that are serious about being responsible," says a recent [Ethical Corporation Magazine](#) editorial. "The credit crunch could separate those companies that can back up their sustainability pledges from those that cannot." According to companies interviewed for the magazine's latest cover story, a recession is an opportunity for those firms that have spent money on doing good to reap the rewards of that investment.

"When times are tough," the publication goes on, "a good reputation — and the trust it engenders in employees, especially — is priceless."

Do strong ethics hurt global competitiveness? Let us know your thoughts below.

**Earlier:** [Is SOX Compliance Undermining Your Edge?](#)

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[Felled by Scandal, Spitzer Says Focus Is on His Family](#)

by David Kocieniewski and Danny Hakim

The New York Times, March 13, 2008

[CEOs on Strategy and Social Issues](#)

by Debby Bielak, Sheila M. J. Bonini and Jeremy M. Oppenheim

The McKinsey Quarterly, October 2007

[Assessing the Impact of Societal Issues](#)

by Sheila Bonini, Jieh Greeney and Lenny Mendonca

The McKinsey Quarterly, November 2007

[Re-Thinking Social Responsibility](#)

by Paul Maidment

Forbes.com, Jan. 25, 2008

[Business Ethics as Competitive Advantage for Companies in the Globalization Era](#)

by Rania Azmi

Alexandria University Faculty of Commerce, July 2006

[Global Study of Elite MBA Students Reveals Winners and Losers in the War for Top Talent](#)

Hill & Knowlton, Jan. 16, 2008

[Competitiveness and Corporate Social Responsibility](#)

by Laszlo Zsolnai

Social Science Research Network, December 2006

[Do Strong Ethics Hurt U.S. Global Competitiveness?](#)

by Gail Dutton

World Trade Magazine, March 2, 2008