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A code of conduct to ensure responsible business practice is a common feature in most businesses – but is yours truly effective? Leo Martin argues that a change in approach is needed.

'The business community is under the spotlight like never before. We either demonstrate that we operate responsibly or we risk losing our licence to trade. Corporate responsibility has become mainstream because the concerns of society about business behaviour are real and because businesses have failed to respond adequately.'

This dramatic-sounding statement from Lord Sharman, the Chairman of Aviva and of the GoodCorporation Advisory Panel, sums up one of the major issues facing business today – that of responsible business.

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It's true, also, that companies are doing their best to tackle this head on. However, the reality is that boards have almost no information on how reputable they are, whether values are entrenched or ignored, and whether codes of conduct are just gathering dust on top of a cupboard. Indeed, even in companies where codes of conduct have been in existence for a long time, the truth is that attempts to establish whether they work are still in their infancy. The challenge for the company secretary, therefore, is to identify ways to audit business behaviour and to make sure that the board does have adequate information to allow it to debate and challenge current business practices.

Speaking in code

Most codes of conduct cover sensible ground in terms of setting out the overall values of the organisation, the tone that is expected, the treatment that stakeholders can expect and what to do if problems arise. The best codes make a conscious effort to tackle difficult issues head on and to cover how all stakeholders will be treated, including shareholders, customers, suppliers and often the local community and environment. Good codes also cover how employees should act on behalf of the company and what they can expect in return in terms of fair treatment.

However, there is a problem in many codes of language and definitions. In particular, problems exist in three areas:

- the confusion with the word 'ethics';

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- the overlap with areas of corporate responsibility (CR) and corporate social responsibility (CSR); and
- the overlap with compliance and risk management.

The word ethics is often unhelpful in business. It is too often associated with personal morality rather than business conduct, and should therefore be avoided. The concept of 'responsible business behaviour' is far clearer to most business managers – albeit not always easy to apply. The ideal is that responsible business behaviour is acknowledged by the organisation to be a profit-maximising strategy, which reduces reputational risks significantly and saves precious management time from having to clear up complex situations that arise from irresponsible behaviour.

Additionally, the content of many codes of conduct overlaps often with the content of CR and CSR reports. However, for many in business, the CR and CSR topics are off-putting as, all too often, they are associated with community projects, employee volunteering, environmental protection and not much else. If pushed, most managers would accept that issues like fairness of contracts, paying suppliers on time, combating bribery and so on are also CR or CSR issues: however, these labels are fundamentally unhelpful and should also be avoided.

This confusion has arisen from the fact that CSR/CR activities in most large businesses sit in either a communications or corporate affairs function. They are therefore explicitly or implicitly a part of the marketing and promotional activities of the organisation. This is usually a world away from the work of the company secretary, the risk and compliance managers and the internal auditors. It is this group that are often cynical about CSR/CR, but who in fact grapple with the day-to-day implementation of responsible behaviour.

Finally, the content of codes of conduct is often different in tone from the language that has traditionally been used in the compliance and risk management worlds. However, the risk and compliance officers, and others working on these issues, see the contents of the code of conduct as a list of business practices which need to be 'complied with' or as risks that need to be managed. Again, there is a danger that adopting this language can be deadening, that they can reduce subtle and important topics of corporate behaviour and tone to legal compliance, a simple tick-box exercise or a list of issues in a risk register.

The most useful approach in terms of language may therefore to be to simply use the term 'code of conduct' and talk about embedding its principles. This has the advantage of avoiding any terms that may cause confusion.

How not to audit codes of conduct

The more important question than language is how can the board actually embed the principles of the code of conduct?

Unfortunately, too many companies carry out overly simplistic audits relating to the code of conduct, which do not prove that the code is being embedded effectively.

These types of audits typically count:

- the number of people who have received the code of conduct;
- how many have received training relating to the code of conduct;
- how many have signed the code of conduct to say that they have abided by its principles; and
- how many issues have been reported through the whistleblowing hotline.

These activities are not useless; however, they are only the first step in ensuring that the principles in the code of conduct are actually entrenched inside the company. This approach is also not surprising given that the auditing professionals' first instinct is to find something quantifiable to analyse. However, as with many other types of measurement of non-financial performance, it is better to measure what is important – however imperfectly – rather than to audit

and measure less important aspects of performance which happen to lend themselves to quantified measurement.

The approach that GoodCorporation takes fits into a growing group of activities that are trying to measure and evaluate how well business practices are actually working, and whether or not they protect reputation in reality.

This type of approach recognises firstly that codes of conduct were not and are not designed to be 'auditable'. In general, they stick to a high-level set of principles of fairness and responsible behaviour, and rarely stray into more detailed territory about business practices that should be adopted to support the principles of the code of conduct.

For this reason, GoodCorporation's approach is to 'unpack' the code of conduct to allow the company to understand the business practices that it encompasses. For example, where the code says that the organisation will be fair to its customers, a code of conduct audit should measure issues like:

- whether clear and fair contracts are in place;
- whether there is an effective complaints process;
- whether customer feedback is sought and used to improve ;
- whether customer data is protected;
- whether products protect customer health and safety; and
- whether advertising is honest, fair and doesn't offend.

These types of business practices are clear and easy to understand for a business manager. They also allow an audit to focus on the meat of how the organisation operates.

The next challenge is to work out how to 'audit' these types of business practices. In reviewing each business practice, the approach taken by GoodCorporation is to carry out four tests. The assessor checks:

- that a policy exists (by reviewing policy documents);
- that a system is in place to implement the policy (by examining those systems);
- that records exist which show the system works in practice (by reviewing a sample of records);
- that stakeholders, when asked, agree that the system works and is fair (by holding interviews with employees, customers, suppliers, shareholders, and community and environmental groups).

The first three tests represent normal audit activity. However, our approach is to ask at each stage whether the policy and system are working in such a way that reputation will be protected on the ground, rather than just finding a well-documented, well-understood policy that might be having a terrible impact in terms of reputation. It is the fourth test which is crucial in this type of assessment. By conducting wide-ranging interviews with large groups of employees, customers, suppliers, neighbours, shareholders, partners, regulators and non-governmental organisations, we can find out how each of these business practices is actually working on the ground.

The interviews are carried out face-to-face wherever possible on a confidential and anonymous basis – except where the feedback is so unique that it would not be possible or sensible to try to anonymise it. For example, we have found it beneficial to interview regulators to get feedback on how well business practices are working. But clearly this type of interview has to be conducted on-the-record, because it is impossible to anonymise it.

One of the crucial elements of this type of interview is that it focuses on the company's business practices, and not on the behaviour of the stakeholder. This allows the stakeholder to relax and give useful feedback on the company's practices and how they might be improved. Obtaining stakeholder feedback provides a crucial 'feedback loop' which helps to evaluate whether or not the

business practice is working as it should. It also helps to work out whether business practices are protecting reputation in reality.

Measuring performance
We then grade each of the business practices, by deciding which of the following statements best describes the evidence that has been found.

- Fail: there is no policy or system, or it has largely broken down;
- Minor non-compliance: there is a policy and system, but it is not always working;
- Observation: there is a policy and system that works, but potential improvements have been identified;
- Merit: the policy and system work well;
- Commendation: the policy and system are examples of best practice.

From this grading exercise, we are then able to 'quantify' performance against the code of conduct and also to track performance over time and between business units. The bottom three grades in the GoodCorporation system are also accompanied by a corrective action, allowing the business to address the issues identified.

Our experience suggests that this type of measurement is very powerful, as it helps boards and managers to understand, in a concrete way, the issues that the company faces in terms of applying its code of conduct. It also allows the focus of a company's activity to be on areas that need corrective action.

Who owns what?
Many organisations are still struggling with who should be responsible for the implementation of the code of conduct.

In many organisations the code of conduct is owned by the HR function or by the communications/corporate affairs function. Not surprisingly, these functional groups find it difficult to own all aspects of the code of conduct and find it even harder to get the code of conduct embedded.

In the best organisations, however, the board allocates a member to take ownership of the code of conduct and has a direct report to the chief executive or board from a head of ethics/compliance who has responsibility for embedding the code.

Resistance to embedding responsible business behaviour comes from many directions within the company. The type of measurement and audit system described here can at least help the organisation to measure code of conduct issues and to start to consider how this measurement should be set against financial objectives and incentives. Some type of 'balanced scorecard' approach may be the natural development that we will see in boards in the future.

Often, financial incentives in companies encourage behaviour which works against the code of conduct. We have seen many examples of sales teams that become powerful in organisations while operating in clear contravention of the spirit of the company's code of conduct. The best way to tackle this is to have a measurement system that allows the negative aspect of this sales behaviour (increased customer churn or rising complaints from customers, for example) to be brought into the code of conduct audit and included in a balanced scorecard for the board.

There is also an increased merging of interests between internal audit teams, risk managers and compliance officers who increasingly see the behavioural and cultural aspects of business practices as important for protecting reputation. This alliance can help push the code of conduct as a tool of management, rather than a booklet gathering dust in the corporate reception area.

Non-executive directors can play a key role, too. Starved of real information about the risks that the company is running, they should welcome reports on how the code of conduct is really working and what is happening on the ground in terms of behaviour and culture. Indeed, we have found a strong positive response from them when we have presented the results of our audits to them.

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As the recession starts to recede, there is an increasing need for companies to demonstrate that reputable business behaviour is in place.

Getting their house in order when it comes to codes of conduct, and finding concrete measurement systems to audit the effectiveness of such codes, is crucial to this. After all, it will not only help boards to manage their businesses, but it will also reduce risk – especially reputational risk – and help directors to sleep at night.

Leo Martin is a director of GoodCorporation, auditors of responsible business practice. They can be found online at www.goodcorporation.com.