Integrity - the fundamental pillar of business culture

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Do companies exist solely to advance the interests of their shareholders, or do they have a broader social obligation?

This question has been debated since the advent of the limited liability company in the seventeenth century. However, a question that previously remained largely confined within a scholarly domain has recently become an issue of mainstream social concern.

In Australia, this has come about due to a seemingly endless litany of corporate wrong doing, particularly within the financial sector. Hidden and unfair client fees, deceptive and misleading advice, manipulation of key interest rates, and, in more extreme cases, the outright theft of clients' assets has shifted the issue of social licence from the middle to the front pages of the newspapers.

In a sense, this development is not surprising. In earlier times, when companies were little more than well-funded partnerships, the impact of their activities was largely contained within the shareholder group. However, as financial companies have grown to the point where they are now systemically important, the impact of their activities has spread far beyond the shareholder constituency and is now felt across society.

Much has been written about a need to improve corporate culture. Although this represents a noble sentiment, it misses a critically important point. Culture is simply the group of traits or characteristics that define a group, whether it be commercial, sporting, cultural or religious. Whether those traits fit with the host society's ethical notions of good and bad is another question altogether. Hence, culture is simply the manifestation of certain traits. In order to change culture, it is necessary to delve into its defining traits and effect change at that level.

Effecting change at a fundamental level is, in effect, dealing with integrity. When considering the concept of integrity in a mechanical sense, Harvard Business School academic Emeritus Professor Michael Jensen, one of the most distinguished and cited scholars in corporate governance, uses the analogy of spokes in a bicycle wheel. If one is broken, it undermines the working, or integrity, of the whole wheel. Jensen extends the mechanical concept of integrity into the field of finance by way of the idea of a whole or complete person. To achieve this state, the person must honour their word. Simply, this means they say what they do, do what they say, and stick to it. In essence, when a person of integrity makes a statement, it is accepted and trusted as a fact.

Dr John Laker, previously chairman of the Australian Prudential Regulation Authority (APRA) and current chairman of ethics advocacy group The Banking and Finance Oath (BFO), has urged senior Australian bankers to sign the Banking and Finance Oath. He is correct in saying this would send a positive signal from those at the pinnacle of financial institutions that only the highest standards of behaviour are acceptable.
Nevertheless, nobody is naïve enough to believe that high standards of integrity can be instilled within an organisation simply by means of a directive from the top. CIFR researcher Associate Professor Elizabeth Sheedy of Macquarie University demonstrates the validity of this point in a study which shows that organisational behavioural standards are largely independent of senior directives. Instead, these are set at the coalface. Thus, organisational integrity is the sum of the collective integrity standards within individual operational groups.

In terms of behavioural standards, it is important to recognise that the integrity of one's word does impose an obligation to deliver. However, circumstances can change to the extent that delivery in the intended form may not be possible. Integrity demands that when people become aware delivery is no longer possible, they must immediately say so. Furthermore, when things go wrong, integrity demands that reasonable steps be taken to repair any damage.

Integrity and, by extension, culture cannot be changed via black letter law. This point has been publicly made by Australian Securities and Investments Commission (ASIC) chairman Greg Medcraft in his recent calls for higher standards of corporate behaviour. The latest additional funding resources to be directed towards ASIC should be expended on surveillance and investigative activities at a micro level.

Implementation of such an approach can be thought of in terms of the proverbial carrot-and-stick. It should be made clear to the business sector that the punitive costs associated with remediation will be set at levels that greatly exceed the cost of doing things right the first time. Extending this line of thinking, a greater business focus is required to identify and recruit employees who espouse the values and standards advocated by their superiors who have taken The Banking and Finance Oath. To use a driving analogy, when hiring a person to occupy a position of trust it surely makes better sense to hire someone who has an unblemished record rather than someone who has a string of de-merit points.

A holistic regulatory regime that provides powerful incentives to do the right thing should not be seen as something that is simply nice to have. There is a substantial economic and broader social dividend to be derived from the efficiency gains that will inevitably flow from a financial system that functions with a high level of individual and corporate integrity.

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