

Ethics Pays

Ethics is more than a moral statement of 'doing the right thing'. In the words of Patricia Hewitt, the Secretary of State for Trade and Industry, "The best businesses already know that ethical behaviour is fundamental to commercial success ... it is not only the right thing to do but that it also pays off financially."

Licence To Operate

Firstly, ethics provides the public support that companies increasingly rely upon to sell their products and services. The Economist touched on this: 'Companies that treat social issues as either irritating distractions or simply unjustified vehicles for attack on business are turning a blind eye to impending forces that have the potential to fundamentally alter their strategic future.¹ For example, this was evident when Shell was forced to change its operations in Nigeria and as a result began a systematic examination of its role in society. In the end, ethics hits the bottom line and companies need to be able to demonstrate that they are fit to operate in today's society. There are countless examples of this:

- GAP and Nike being forced to take action on their supply chains because of public refusal to buy products that used inappropriate child labour
- B&Q developing a sustainable wood sourcing programme because of environmental activism at their stores
- Starbucks selling fair trade coffee having had its reputation tarnished when the unfairness of its coffee sourcing was exposed.

Creating Goodwill

Ethics also creates goodwill. Why do nearly all of the FTSE100 companies voluntarily produce Corporate Social Responsibility Reports? Is it because they are nice people, is it down to competitive pressures or is it because they know that CSR helps to get investors, customers and key stakeholders on their side? Values are not all financial and social values can often be a driver behind buying decisions.

Furthermore, the goodwill of employees is also of critical importance. It is difficult to directly measure the financial benefit of this to a company, but it can't help but have a major impact when a report from Development

Dimensions International concluded that a third of employees are so disengaged from their employer that it significantly reduces productivity, with 10% actually thinking that their employer would be pleased to see them leave². Contrast that with businesses with a clear ethical purpose, where employees join because of this purpose.

Superior Financial Performance

Concepts such as integrity and fairness are generally only measurable using indirect indicators, but research shows that companies with a clear commitment to ethical conduct outperform those who do not³.

Companies with codes of ethics:

- generated significantly more economic added value (EVA) and market added value (MVA) in the years 1997 - 2000
- outperformed on three out of the four measures of corporate value used in the study over the period 1997-2001
- experienced far less Price/Earning Ratio volatility over a four year period.

Other research has suggested that a stable P/E ratio tends to attract capital at below average cost; so having a code may be said to be a significant indicator of consistent management.

Attracting New Business

A growing number of companies have recognised that 'doing the right thing' or declaring values as a core part of what is being promoted can have a very positive impact on the bottom line. The Co-Operative Bank is perhaps the best known example of a company taking a strong moral stance and reaping the financial benefits. These are such that one third of the profitability of The Co-operative Bank can now be attributed to its ethical policies⁴. Most significant perhaps, is the fact that a quarter of the Bank's corporate customers join the bank precisely because it is prepared to turn away certain sorts of business.

However, its not just the Co-Op Bank that has ridden the wave of ethical consumerism. Companies like Café Direct, Body Shop, Ben & Jerry's have built very successful businesses on their values.

Sustainable Profits

Nor is it just consumer facing businesses that have used ethics to enhance their long term profitability. For example, the world's largest provider of floor coverings is embarked upon a mission to re-create itself as the first truly



sustainable corporation, and eventually a restorative enterprise. Interface aims to become the first name in industrial ecology, a corporation that cherishes nature and restores the environment, taking no more out of the world than it puts back in. This is an incredibly ambitious goal for what is the largest carpet company in the world. Yet it is taking this action because it believes that it is in the long term interests of its shareholders as well as the wider world.

A Good Investment

In fact the evidence shows that socially responsible investments perform at least as well as conventional investments. Bauer, Koedijk & Otten concluded that 'We find no significant differences in risk-adjusted returns between ethical and conventional funds'⁵. Similarly, social researchers EIRIS compared the performance of five ethical indices with the FTSE All Share Index. If anything, the ethical indices performed better than the FTSE All Share Index over the ten year period of the study⁶.

This performance has led to an increase in the total value of SRI assets in the UK from £23 billion in 1997 to £225 billion in 2001.⁷

Avoiding Costs

One of the reasons for the success of socially responsible businesses is the avoidance of unnecessary costs. These can take many forms such as:

- Fines from the regulator

- Litigation
- Environmental restoration
- Energy and other resources
- Staff turnover

The arguments for energy conserving measures are well rehearsed and these can have a very short pay back period. I also touched on the positive impact that the goodwill of employees can have on a company's bottom line, and this is particularly true for staff retention and a consequent reduction in recruitment costs. 93% of organisations experience difficulties in recruitment⁸ so an organisation where skilled people want to work is clearly going to find it easier to find and retain good staff.

There are also long term costs which can be avoided by going beyond compliance and moving to an ethical culture which avoids potential litigation and costs in the future. Examples abound of companies which would have benefited from embedding an ethical culture in their business practice. Financial services is an excellent example of this. Instead of responding to the requirements of the regulator, companies can design structures and working practices that ensure that the customer is treated fairly with a resultant decrease in both the costs of compliance and regulatory fines for misconduct.

In conclusion, over the long term, it pays to be ethical. What ethics means, will of course vary from business to business and individual companies will have to interpret what that means for them. However, whatever the exact nature of the ethical culture, if properly embedded in business culture, there is little doubt that it will enhance long term corporate performance.

¹ *The Economist*, 28 May 2005. ² Development Dimensions International Spring 2004 Report of 1000 staff from companies employing more than 500 employees. ³ Webley & More, April 2003 – 'Does Business Ethics Pay' Report for Institute of Business Ethics. ⁴ Co-Operative Bank 2004 Sustainability Report ⁵ Bauer, Koedijk & Otten, 2002 Study of The Performance of Ethical Funds. ⁶ EIRIS, 'Does Ethical Investment Pay', September 2003. ⁷ EIRIS website, June 2005. ⁸ Institute of Directors Survey, January 2004



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