

**ETHICAL LEADERSHIP FOR IMPROVED  
CORPORATE GOVERNANCE AND BETTER  
BUSINESS EDUCATION**

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***Observations About the U.S. Business Ethics  
Scandals***

1. The biggest scandals were more corporate corruption than ethical misfires.
2. Some amount of unethical behavior is to be expected in the business system.
3. Business scandals often peak in times of extended prosperity.  
Why?
  - Pressure on management to prolong and replicate recent success;
  - a tendency for the “checks and balances” in the system to go lax during times of prosperity;
  - “good times” breed management overconfidence and risk taking.
4. This latest set of scandals is quite different than other business ethic problems of recent decades.

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***Why the epidemic of recent ethics scandals  
impugns the honesty of the U.S. business  
and financial system***

- misleading financial arrangements
- inflated stock recommendations
- ballooning options and deferred compensation, not expensed as a cost
- inattentive and passive BODs
- exploding CEO compensation

Result: Not only is the public skeptical about the integrity of the business and financial system, but the doubt has spread to the business community as well.

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### *Quotations*

- “There has been a massive failure in corporate governance.”  
- William W. George, Retired Chairman & CEO, Medtronic, Inc.
- “In their greed and their gluttony, these crooks sacrificed the retirement years of teachers, truck drivers, nurses, and farmers to enrich themselves.”  
- Paul O’Neill, former U.S. Secretary and former CEO of Alcoa
- “In my lifetime, American business has never been under such scrutiny. To be blunt, much of it is deserved.”  
- Henry M. Paulson, Jr., CEO, Goldman Sachs
- “In the mist of great prosperity and the bloom of the 1990s, there has been a [clear] erosion of professional, managerial, and ethical standards and safeguards.”  
-Paul Volcker, Former Chair, Federal Reserve Bank
- “An infectious greed seems to grip much of our business community.”  
-Alan Greenspan, Chair, Federal Reserve Board

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### *Factors Causing the Ethics Meltdown*

- The temptations and opportunities for an extended “economic boom” period (1989-2001)
- Lax accounting standards and aggressive financial growth projections
- Celebrity CEOs  
-the possible role of accelerating CEO pay

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### *Do b-schools cause or contribute to the decay of business ethics?*

- Business training may shift student predispositions
- B-school education is supposed to cover ethics issues and corporate social responsibility
- Are the morals of business strategy in opposition to “good” business ethics?
- B-schools may be instilling managers with an ethic of economic utilitarianism

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***Strategies for Improving Ethics Education in Business Schools***

- better screening of applicants for “character”
- integrate ethics discussion into functional classes (e.g., finance, HR)
- more ethics case studies in the curriculum
- include a teaching module or class on ethical theory
- majors should be taught the professional ethical norms of their specialty (e.g., Advertising/PR grads should be made aware of industry codes of conduct)
- “values” assertiveness should be learned
- MBAs should take an “ethics oath” upon graduation

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***Strategies for Improving Ethics Education in Business Schools (continued)***

- Recruiters should “test” for ethical sensitivity in the candidates they interview
- Students should be taught to measure business “success” more broadly
- Companies should fund more ethics professorships
- Don’t teach that corporate social responsibility is mostly philanthropy and volunteerism
- Don’t celebrate the hardball aspects of business practice

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***Seven Steps to Better Ethics and Corporate Governance***

1. The business system should place significantly less weight on “hitting the numbers” on a quarterly and annual basis.
2. Organizational success must be measured in a more balanced fashion.
  - The “balanced scorecard” approach
  - Prof. Lynn Sharp Paines’ Value Shift (2003)
3. The reign of the imperial CEOs should be tempered.
  - Bill George’s Authentic Leadership (2003)
  - CEO pay continues to be problematic
4. Boards of Directors require drastic reform.

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***Seven Steps to Better Ethics and Corporate Governance (continued)***

- 5. Business firms ought to be more wary of managerial fads.
- 6. Organizations must commit to developing a culture of integrity.
  - Statement of company values
  - CEO endorsement and leadership
  - Specific, communicated, enforced codes of conduct
- 7. Corporations, b-schools and professional associations must accept, teach and testify that executive level management is a vocation.
  - Michael Novak, Business as a Calling (1996)

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***Actions that might be taken to Strengthen Corporate Governance***

- Develop principles of corporate governance; punish them; report annually on conformance
- Key institutions and associations such as The New York Stock Exchange and the Conference Board should establish a Directors' Institute where corporations can send new directors for orientation as to their duties and responsibilities
- Outside directors should always constitute the majority of the board
- Audit/Compensation/Nominating committees of the board should be composed of exclusively outside directors

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***Actions that might be taken to Strengthen Corporate governance (continued)***

- The CEO and board chair should not be held by the same person; if they are one, a lead director that is an outsider should be elected to chair executive sessions
- The outside directors should meet regularly in executive session
- No more than three directors should be company executives
- Directors should be annually evaluated; if they do not attend 75% of scheduled meetings, they should not be retained

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***Key Provisions of Sarbanes-Oxley 2002***

- Increases regulatory funding for the Securities Exchange Commission
- Establishes the Public Companies Accounting Oversight Board (PCOAB) to monitor financial reporting
- Requires the separation of auditing and certain consulting services provided by public accounting firms
- Mandates CEOs and CFOs certify their financial reports for accuracy; specifies criminal penalties for “knowing” or “willful” violations
- Prohibits personal loans to top executives and directors of public companies

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***Key Provisions of Sarbanes-Oxley 2002  
(continued)***

- Requires that Board waivers to ethics code must be disclosed
- Executive bonuses must be returned if earnings are restated
- Trading of stock by company executives needs to be more promptly reported
- Separates investment banking from stock analysis in financial services firms
- Provides greater protections for “whistle blowers”
- Specifies that Board audit committees must have at least one “financial expert”

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***Possible Weaknesses of Sarbanes-Oxley  
(SOX) 2002***

- Morality cannot easily be legislated
- SOX addresses several means for perpetrating financial fraud, but does not speak to the root causes of financial dishonesty
- Costs of added compliance are significant especially for smaller companies
- Qualified directors may decline to serve because of added liability
- Restrictions on the integration of services by public accounting houses possibly reduces the quality of auditing
- SOX creates the “regulatory thicket” and generates high demand for legal and consulting services
- SOX increases the cost of audits

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