

PRACTICAL APPROACH TO ETHICS IN CZECH SMES: LEARNING FROM EXPERIENCES OF OTHER COUNTRIES

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Abstract:

This paper deals with a controversial issue – practical ethics in day-to-day business. Companies publish their corporate governance statement in their annual reports, but this almost never critically assesses whether these codices have any meaning in their ongoing business. Their main purpose reduces to the attempt to attract the attention of new customers and possible investors in order to raise sales and improve profits. We approach ethics in corporation as a discipline with practical and measurable outputs. To arrive to quantifiable variables we link the company ethics with measurable and attainable goals and suggest to employ the approach of Kaplan and Norton (1992), who proposed the definition of key performance indicators to measure vaguely defined phenomena. Linking with the experience of our German partners, our paper contributes to current stream of literature in highlighting pragmatic ethics as an important part of corporate social responsibility. The resulting study provides a new approach to practicing ethics especially in small and medium sized companies.

Key words: Ethics, Corporate Governance, Small and medium sized enterprises, Key performance indicators, Balanced score card

JEL Code: M14, M11, M19

Introduction

This paper deals with a controversial issue – practical ethics. How can ethics possibly be practical? The term corporate ethics is usually understood as a system of rather stiff rules and regulations by which the company at least formally manages itself and which it then proudly announces to the outside world in its annual reports in a hope to attract attention of new customers.

We approach ethics in corporation as a discipline with practical and measurable outputs. We suggest to measure the goals and progress achieved through the system of key performance indicators, and to apply the BSC approach in a similar way as in general management, strategy building and control systems.

Our paper contributes to current stream of knowledge highlighting ethics and its practical and pragmatic use as an important part corporate social responsibility. To certain extend the study builds on the experience of our German partners. The study analyses the current understanding of ethics and corporate social responsibility in the international business in society, investigates the institutional background of rules of corporate governance, and explores modern approach to ethics and its place in the corporate governance. The resulting study provides a picture of the current state of a new approach to practicing ethics in companies.

The paper is structured as follows: after the introduction, part 1 covers the importance of ethics in corporations. Part 2 discusses decision making and challenges of decision makers. In part 3 we explain how implementation of CSR can be used as an intangible asset to create value in company. In Part 4 we explain the approach of our German colleagues and learn from their experience in dealing with this question in big companies. The last part concludes the paper and summarises future challenges.

1 The Importance of ethics

Because of the influence of technical development, informational technologies, and globalization of markets the distances between enterprises are diminishing and the world becomes more intertwined. Further development of cooperation calls for deepening corporate culture which is based on responsible management between cooperating companies. This needs to be realised in the field of their innovative activities, in the field of strategy and development and managed subjects. In the opposite case the lack of deepening cooperation within the country and in the international field could negatively influence both business and political environment.

Issues of corporate governance are narrowly linked with corporation's ethics. This is apparent mainly in the view of recent corporate scandals around the world. We need to stress here, that corporate governance and ethics are closely related fields and ethics or ethical behaviour needs to be understood as necessary precursor of good corporate governance.

“Ethics begins at home, so to speak, which in this case is at the office with one's co-workers.” Chismar (2001, p. 170)

Ethics comes first. It is a prevention measure, not a cure for consequences of bad behaviour. Corporations need to be viewed as open systems, in contrast to shareholder management

which manages corporations as separate entities. The struggle for ethical and responsible management is only at its onset. It entails a wider complexity of management, which should be able to measure not only quantifiable outputs using norms and physical standards but it should also extend the measurement to non quantitative features. It needs to be stressed, that taking in consideration qualitative features of corporations extends the room for ethical behaviour and decent attitudes in management. Greater involvement of ethical management requires resolution the basic problems of management. (Harvey, 2008)

In the Czech Republic the previous questionnaire research concentrating on ethics was run by Dytrt in 2010 and 2011. Here the investigation questionnaires were distributed to 2500 respondents in predominantly small and medium sized firms. The response rate was 18%. The authors proposed that there were two key problems destroying ethical enterprising. The first finding confirms that there is not enough knowledge about usefulness and necessity of ethical management. The second problem is the insufficient interest in changing current managerial practices; i.e. managers rely on the past practices and this confines their future capacity and creativity. This contributes to deepening consumerism in management, basis of which is the non-ethical thinking in the society as a whole. (Dytrt, 2011)

2 Decision making

In contract to conventional economics people are not calculating machines. They are influenced by a variety of factors, external and internal. So even when companies agree on a written code of conduct of corporate governance, this might feel abstract in day-to-day business. Driven by assumptions (i.e. not being able to win a contract without bribery), uneasiness in communicating with other people especially those, who are in a dependency relationship (employees) or other emotional issues, business leaders and business owners and also managers on all levels tend to forget their noble intentions and act irrationally.

“We live simultaneously in two different worlds – one where social norms prevail, and the other where market norms make the rules.” (Ariely, 2008, p. 1055 / Kindle Edition)

Making ethical considerations part of the overall corporate and business strategy is a complex process. It involves not only agreeing on a set of behaviours. To embed ethical reasoning in the day-to-day decision making process, companies need to first create a conscious culture and second to make sure that a ROI (Return on Investment) is very clearly specified to the

firm as well as to every member of the organization. This means that the decision making processes needs to be much more transparent and has to be based on a well designed process.

In his latest book Ariely and his colleagues try to answer a question, what makes people take unethical decisions (Ariely, 2012). The first and probably not very surprising finding suggests that we are all prone to cheat, at least a little bit. Crossing the line to outright unethical or even illegal behaviour and/or business practices is just a next qualitative step.

The interesting point is that Ariely and his colleagues found that a whole process gets started by some minor lapse, which the researchers call the “What-the-Hell” effect. You start small and after a while you lose track. On the other hand, people tend to cheat only to such level which allows them to keep up their own self-image and personal integrity.

Their findings also suggest that most of the minor violations of ethics are done more or less unconsciously without much consideration. It also seems that people need some strong reminders before they take decisions.

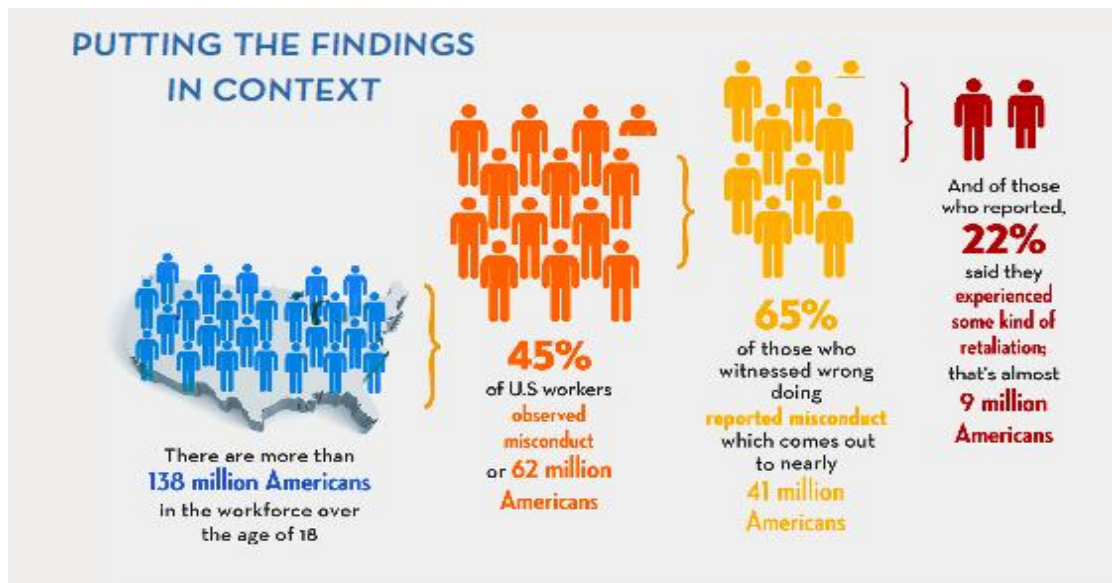
In business we are very often in a situation where we face a conflict-of-interest. The research of Ariely suggests another more unforeseen result: people tend to cheat more when they can do well to someone else who has some importance for them. So, we can assume that many people in a company, especially in a small or mid-sized business have a strong relationship with their firm, and mostly also with their business owner. People in small companies want their company to succeed. So they are tempted to bend the rules from time to time. Creating a reliable control mechanism without falling back into outdated leadership models seems to be essential to keeping the business in ethical business practices at all levels.

3 Implementation of CSR as an intangible asset to create value

Reliability and accountability in business practices help companies to compete on fair basis. Unethical or outright illegal practices like for example corruption or slavery create an anarchic and completely unpredictable environment. This is why governments and also the EU try to introduce corporate governance procedures and processes, because an unregulated environment is running wild and it will also damage the national / European economies in medium and long-term. The current crisis stemming from unethical, while not illegal, risk taking in banking industry is a good example of how unethical behaviour damages society. This practice has an unwelcoming power of taking the whole economies down, and not only in the EU. Due to globalization, we cannot get away from the complexity and interrelationships. And this also has an important impact on small and medium-sized enterprises.

The ERC (Ethics Resource Center) in the US has just published its “2011 National Business Ethics Survey”. This survey is sponsored by several large corporations including Wal-Mart who currently has some severe backlashes in the pursuit of its CSR / Sustainability program (corruption case in Mexico). Nevertheless the report gives some information, which is worth to be considering also in the context of Czech SMEs.

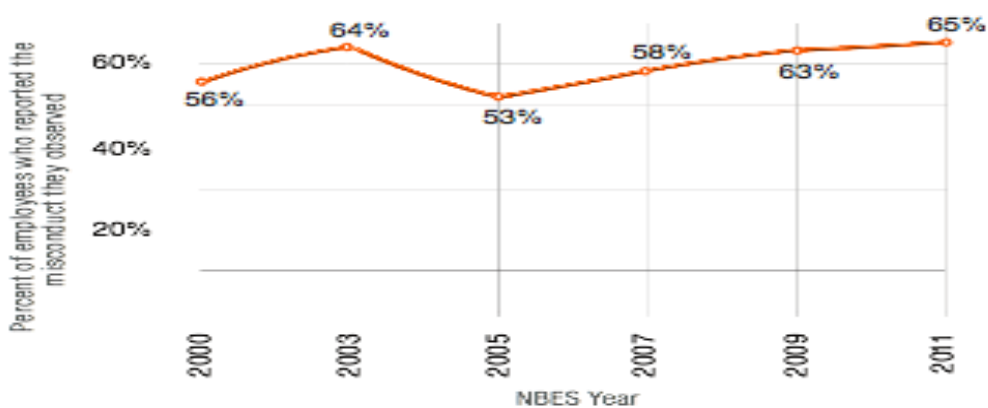
Fig. 1: Putting the findings in context



Source: ERC, 2011 National Business Ethics Survey.

At the first glance we see proof of what Ariely reports in his book, that „cheating“ is a part of human life and behaviour. What is positive is the number of people who reported misconduct – a number that has risen from the last survey in 2009 (see figure 2).

Fig. 2: Record number of employees choosing to report observed misconduct



Source: ERC, 2011 National Business Ethics Survey.

This indicates that people – especially those we consider as talents – are less tolerant towards misconduct or unethical or even illegal behaviour.

While the rate of observed misconduct falls to 45% – a historic overall low – a substantial increase in certain unethical and illegal practices and behaviours is reported in some special areas (see table 1).

Tab. 1: Dramatic increases in misconduct posing risk

TYPE OF MISCONDUCT	2009	2011	INCREASE
Sexual harassment	7%	11%	4ppts
Substance abuse	7%	11%	4ppts
Insider trading	1%	4%	3ppts
Illegal political contributions	1%	4%	3ppts
Stealing	9%	12%	3ppts
Environmental violations	4%	7%	3ppts
Improper contracts	3%	6%	3ppts
Contract violations	3%	6%	3ppts
Improper use of competitor's information	2%	5%	3ppts
Health or safety violations	11%	13%	2ppts
Anti-competitive practices	2%	4%	2ppts

Source: ERC, 2011 National Business Ethics Survey.

Transparency International does not give a very positive evaluation of the Czech Republic – as for most of the EU countries. (Transparency International, National Integrity System Assessment Czech Republic, 2010)

“There are many weaknesses in the Czech Republic’s National Integrity System. The first step in any effort to strengthen the system must be to clearly understand the roles of individual actors and differentiate between the actions that weaken the system and those that strengthen it. At the same time, it is necessary to pay close attention to behaviour of individuals as even within the existing legal framework, with all its loopholes and problems, it is possible to behave in a predictable and transparent way.”

As in almost all other countries the relationship with judiciary, political and public organizations and representatives is the most flawed in the overall evaluation. While corporate governance, corporate social responsibility and sustainability are issues widely agreed on as desirable also in SME’s, there still is a huge gap between consciousness on the

importance of a sustainable value driven business and its implementation in day-to-day business.

Michael Porter and Mark Kramer suggested in an HBR article in 2009 that this gap can only be closed when business leaders and owners start to recognize CSR issues as part of their competitive strategy and implement it in their business strategy planning. *“To advance CSR, we must root it in a broad understanding of the interrelationship between a corporation and society while at the same time anchoring it in the strategies and activities of specific companies. To say broadly that business and society need each other might seem like a cliché, but it is also the basic truth that will pull companies out of the muddle that their current corporate-responsibility thinking has created. Successful corporations need a healthy society. ... At the same time, a healthy society needs successful companies.”* (Porter and Kramer, 2009). The authors emphasize that good CSR is much more than “just writing a check: It needs clear, measurable goals and track results over time”.

Ceres, a network of powerful international investors, companies and public interest groups, published a report “The Road to 2020 – Corporate Progress on the Ceres Roadmap for Sustainability” (2010). The survey covers a broad range of topics, with the following clear recommendation:

“Sustainability performance results are a core component of compensation packages and incentive plans for all executives.”

The message is very clear: Ann Stausboll, CEO of CalPERS, one of the world’s largest institutional investors, states in her foreword to the report: “The future will belong to innovative companies that understand that building long-term shareholder value and being an industry leader requires the integration of sustainability principles at every level, from the C-suite to operations and through the supply chain.”

We agree with Porter and other authors that CSR is more an opportunity than just a cost. Kaplan and Norton, who developed the BSC – and Strategy Map system, suggest that using these tools helps to align the organization with the adopted strategy without disrupting the structure of the firm (Kaplan and Norton, 2009). They proposed to create strategy maps in organizations to describe how the organization creates value. Linking these to the BSC system takes the rising importance of intangible assets into consideration

One of the weaknesses of most SMEs is the lack of sufficient strategic planning. Decisions are mostly made by gut feeling, and while most business owners are pretty successful working like that, the opportunities for further growth are widely neglected. The

organizations somehow adapt to the environment, and when the environment is unethical, they adjust to it.

We strongly recommend that especially SMEs start to use structured approaches in their strategy development so that they not lose their competitive advantage in a global market in which large players more and more lock niche markets for SMEs, which are not able to compete. We strongly believe that also unlisted companies should engage in corporate governance, a question the EU raises in its Green Paper on Corporate Governance in 2011. Not only to make the world a better place, but also to improve the business performance of SMEs and their sustainable competitive advantage

3.1 Implementation of Ethical Thinking and Behaviour

To embed ethical thinking and behaviour deep into an organizations culture, Strategy Map/BSC framework needs to be developed especially for SMEs. Implementation of such a scheme means to start a distinct change management project in the company. The research project investigates the successful approaches in other countries, and translates these best practice experiences to Czech business environment. The aim is be to develop an easy-to-use framework which SMEs can adopt to their specific industry and situation. The framework will also be presented to the EU initiative of Corporate Governance to list in the EU sponsored approaches.

These powerful methods and tools will provide firms with guidelines to implement a consistent strategy throughout the whole organization. They offer a holistic approach. And as a relatively new scientific area of behavioural economics, they claim, that people need incentives to apply a certain way of thinking and behaving. While this does not eliminate all biased decisions, it is a powerful way to shape an organization's culture and inner personality. We propose to make ethical behaviour part of the culture-leadership-teamwork and people management in general.

4 Experiences from German Studies

In 2006–2008 an EU project has been undertaken by a German organization as part of an EU initiative. The aim of the project was to make opinion leaders and SMEs aware of and qualify for CSR. Surveys of SMEs were conducted in Germany out in Germany – and in cooperation with project partners also in France and Poland.

The following main issues were researched:

Businesses' level of awareness of CSR
CSR activities they have practiced and planned themselves
Interest in using CSR strategies
Estimate of CSR's importance in relation to other business-relevant factors
Determination of factors that stand in the way of employing CSR
Determination of the positive effects of CSR
The significance of image building due to CSR

(Documentation of results for the EU Project: Zukunft Mittelstand) Erfolgsfaktor Gesellschaftliches Engagement / Corporate Social Responsibility (CSR), 01.05.2006–30.04.2008) as part of the pan-European EU Programme: “Mainstreaming CSR among SMEs”, GILDE GmbH)

“All things considered, by networking with various opinion leaders from all over Germany, the broad impact of the project has been achieved to a great extent. The services provided, such as workshops, teaching materials and advice to the target groups of SMEs, universities, vocational further training agencies and opinion leaders have been very well received and successfully integrated.”

While this study concentrated on rising awareness we aim at proposing the method based on an extensive study a framework for Czech SMEs how to not only be aware of the issue but also how to implement CSR successfully in their business strategy.

Our approach is close to the study accomplished by the Leuphania University in Lüneburg, Germany, conducted in large corporations: From Knowledge to Application – Dissemination of sustainability management tools in large German companies, 2011: “The analysis shows that both the average knowledge and the average application of management tools have increased between 2006 and 2010”. The study reports a rising awareness about CSR in general and more knowledge on tools to implement CSR strategies. Our aim is to translate these findings to the special Czech SME sector. Therefore we already contacted the Leuphania University for establishing a partnership in knowledge sharing.

Conclusion

The findings of Ariely and other behavioural economists are at the first glimpse a bit depressing. On the other hand, there are many indicators, that observation has the power to

change unwanted behaviour. It starts though at the top, and therefore also SME business owners need to create conscious roadmaps how they want their organizations and employees to behave in the market and internally.

A way to monitor people's behaviour in organizations and at the same time design powerful strategies is provided by the system of Balanced Scorecards. We propose that SMEs engage in defining their core values and create based on that codes of conduct which can be related directly to key performance indicators which are relevant for compensation schemes. Sustainable competitive advantage in a predictable political and business environment is in the best interest of each and every market participant. It is necessary that all relevant stakeholders engage in creating such an environment. As the reports show, the main problem in the EU countries is the political sector with all its implications. The overall environment changes and becomes more predictable and transparent only if business owners start to adopt new ethical practices in day-to-day business. And this is the basis for sustainable business success also in SMEs, and also in the Czech Republic.

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