

Human Capital Strategies

The Ethical Enterprise: State-of-the-Art

This Human Capital Strategy Report is based on a global survey that included more than 1,100 respondents, in-depth discussions among a team of ethics thinkers, and an extensive review of the business ethics literature. The report was written and the survey conducted by the Human Resource Institute in partnership with the American Management Association, which sponsored this effort.

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Introduction

Throughout human history, there have always been notions about right and wrong. To function, any culture needs to define proper and improper behaviors. There are rules and laws in any complex society, but underlying these is always a set of moral values. These values are the roots of what we call “ethics,” which has been defined as “the discipline of dealing with what is good and bad and with moral duty and obligation” (*Merriam-Webster, 1996*).

For centuries, ethics has been among the great, deep subjects of philosophical study and debate, but only in the 20th century did the modern idea of what we now call “business ethics” truly emerge. Private enterprises have become powerful creators of wealth in today’s world, but this power has, at times, been abused. So, there’s a clear social need to investigate and influence the ethical foundations of these enterprises.

It’s no wonder, then, that ethics has become a critical business issue. The Human Resource Institute’s 2003-2004 *Major Issues Survey* found that, among North American companies ranking 120 different issues, “ethics in business” was among the top three most important in terms of its impact on workforce management.

The *AMA/HRI Business Ethics Survey 2005* clearly illustrates that businesses view ethics as having a big impact on their brands and reputations as well as on customer trust and investor confidence. In other words, business ethics isn’t only about “doing the right thing” or even avoiding the kind of scandals that can utterly devastate a company. It’s about good business.

The AMA/HRI Business Ethics Survey 2005 Results

The American Management Association (AMA) commissioned the Human Resource Institute (HRI) to conduct a global business ethics survey that received responses from 1,121 executives and managers.

Key Results

Top Five Reasons to Run a Business in an Ethical Manner

- Protection of brand and reputation
- The right thing to do
- Customer trust and loyalty
- Investor confidence
- Public acceptance/recognition

Top Five Business Drivers of Business Ethics

- Corporate scandals
- Marketplace competition
- Demands by investors
- Pressure from customers
- Globalization

Top Five External Environment Drivers of Business Ethics

- Legal: laws, regulations
- Economic environment
- Political environment
- Social values
- Privacy

Top Five Processes/Factors for Ensuring an Ethical Business Culture

- Leaders model ethical behavior
- Leaders communicate consistently
- Ethics are integrated into the fabric of the organization
- Ethics are a component of the performance management system
- Ethics are a consideration in recruiting and selection

Top Five Internal Practices for Ensuring an Ethical Corporate Culture

- Code of conduct
- Ethics training
- Corporate social responsibility programs
- Ombudsman available
- Ethics helpline

Top Five Board of Directors Practices and Programs

- Director's code of conduct
- Ethics training
- Independent directors
- Diversity among directors
- Non-management directors

Top Five Supplier Ethics Practices and Programs

- Supplier's code of conduct
- Ethics audits
- Ethics training
- Ethics surveys
- Access to organization's ethics helpline

Ethics Practices Important to an Organization's Investors

- Transparency of information
- Corporate social responsibility programs
- Ethics surveys
- Access to organization's ombudsman
- Access to organization's ethics helpline

Ethics Practices Important to an Organization's Customers

- Transparency of information
- Corporate social responsibility programs
- Ethics surveys
- Access to organization's ombudsman
- Access to organization's ethics helpline

Top Five Drivers of Unethical Behavior

- Pressure to meet unrealistic business objectives
- Desire to further one's career
- Desire to protect one's livelihood
- Working within a cynical, demoralized environment
- Ignorance that the act was unethical

Top Five Most Important Leadership Behaviors

- Keep promises
- Encourage open communication/ensure no retaliation
- Keep employees informed
- Support ethical behavior/discipline transgressors
- Both internal and external discussion of the importance of business ethics

Top Five Business Ethics Effectiveness Measures

- Ethics survey results
- Customer ethics complaints
- Ethics audit results
- Achievement of ethics goals
- Theft/fraud

Top Five Ethics-Related Global Workplace Issues

- Forced labor/child labor
- Working conditions/health/safety
- Discrimination/harassment
- Financial malfeasance
- Fraud/theft

The State of the Art in Ethics

Exactly what does it mean to be state-of-the-art in the field of business ethics? Unlike many other managerial areas, where success is relatively easy to measure, it's difficult to pin down exactly what best-in-class ethical practices look like. After all, no company – and especially no large corporation – can guarantee every employee will act in an ethical and legal manner in every case. Even companies with solid mission statements, employee hotlines, ombuds and other programs can run into trouble. Nonetheless, we believe that a systemic approach – one that incorporates a variety of factors such as culture and leadership and formal programs – is most likely to result in a truly ethical corporate environment.

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The Composite Perfect Company 2005

One way of depicting a best-in-class organization is through the creation of an "ideal company." This fictitious company, which we'll call the Composite Perfect Company (or CPC), is based on a review of the ethics literature, on data from the *Business Ethics Survey 2005*, and on the expertise and corporate experience of the AMA/HRI research team.

The Composite Perfect Company has been a Fortune 1000 company for 25 years. Critical to its long-term success has been the protection of its brand and reputation. This involves not only having the right business strategy but executing that strategy in the right way. The CPC leaders know that their customers, stockholders, co-workers and the communities where they do business expect honest and ethical conduct and that such conduct is the foundation of their reputation.

The Foundation: An Ethical Culture Based on Values and Principles

At CPC, top management focuses on ensuring an ethical corporate culture throughout the company. To maintain such a culture, CPC has

based its system on a set of longstanding principles and values, which have been set out in a mission statement. "Our mission statement is well known throughout the company," states CPC's CEO. "It's not something that we just have socked away in a filing cabinet somewhere or just use as window dressing in my office. It clearly sets out our purpose, values and principles. Everything else we do is based on these."

CPC's culture is built on concepts such as values, trust, and transparency. "One of our mandates is to always maintain the trust of our employees, customers, investors, suppliers and communities," notes the CEO. "We're determined to deliver value through a trusting work environment."

Top Six Most Internal Practices/Programs for Ensuring an Ethical Culture

1. Code of conduct
2. Ethics training
3. Corporate social responsibility programs
4. Ombudsman
5. Ethics helpline
6. Ethics audits

Business Ethics Survey 2005

The Code of Conduct

The company has created the CPC Code of Conduct, built around its principles and values. Its purpose is to establish a common vision of CPC's ethical standards and practices. The code must permeate all business dealings and relationships, but it is not an exhaustive guide to all the detailed laws and regulations in the various countries where CPC does business.

In conducting business and making decisions, the code recommends that employees ask themselves these questions:

- Does this comply with the law, the CPC Code of Conduct and the company's policies?
- How would customers, shareholders, general public and co-workers view it?

The code provides guiding principles on issues such as the treatment of employees, conflicts of interest, gifts, equal employment issues, harassment, fraud, insider information and trading, and other matters. Not only has CPC made sure the code is clear to everyone, it constantly reinforces the code through an array of behaviors, work processes and programs. The corporation recognizes that, as the *AMA/HRI Business Ethics Survey 2005* clearly shows, an excellent code of conduct that applies to all members of the organization is the single most important *program or practice* a company has for creating an ethical culture.

The code of conduct clearly lays out how employees are expected to behave, always with the highest standards of integrity and ethics. Employees annually sign a commitment to the code, and timely and appropriate action is taken for any violations.

Ethical Leadership

CPC has long known that leaders throughout the company set the tone in a corporate culture, but even CPC's top managers have been im-

pressed by recent studies on the subject. These clearly show the critical nature of leadership in establishing an ethical culture. The *AMA/HRI Ethics Survey 2005* showed, for example, that the top two organizational *processes* for ensuring an ethical corporate culture were having leaders support and model ethical behaviors and consistently communicating ethics messages.

At CPC, top management wanted to find out more about how the workforce felt about ethics of leadership in the organization. Management decided to amend the annual CPC survey to shed light on this, and it hired a third party to conduct some focus groups. It paid special attention to four categories, which research from the Ethics Resource Center suggests are important in reducing workplace misconduct: the degree to which leaders set examples of ethical behavior, talk about the importance of ethics, keep their promises and keep workers informed. As it turned out, CPC scored above average in most of these categories but found there was room for improvement.

In particular, the study suggested that the top leaders at CPC weren't as trusted as were managers at other levels, and top managers viewed themselves in a more ethical light than did employees. Since CPC principles emphasize trust, this was taken very seriously. The study also found that a considerable proportion of employees didn't believe that top leaders spoke about the importance of ethical behavior often enough.

As a result, top management took a number of steps. First, they listened to the feedback and reexamined their own actions and strategies in light of the concerns voiced by employees. Second, they initiated a series of gatherings throughout the organization to meet directly with employees with whom they wouldn't normally have much face-to-face communication. They spoke to employees who represented the demographics of the entire employee population. They listened to employees speak about how values play out at work, and they spoke about their own values and how these intersect with the corporation's princi-

ples. Third, managers used various corporate media – from videoconferences to newsletters to company Web portals – to more effectively communicate their message about ethics.

The fourth step was to work with HR to develop more stringent practices to ensure leaders were receiving unvarnished feedback from employees regarding possible ethical problems. They also made sure that employees knew that top management – even up to the board level – had engaged in leadership development coursework that focused on ethics.

The next step was to look again at the programs intended to provide warning signs of unethical conduct. The goal was to insure that, for every program, there was some measurable indicator of its effectiveness and processes for holding people accountable. “We are determined to make sure the programs aren’t just seen as window dressing,” said CPC’s CEO. “Of course, trying to ‘measure’ ethics has its own set of challenges, and some programs you’ve got to initiate just because it’s the right thing to do. But we want to be sure we are seen to be taking the subject seriously.”

Integrated Goals and Processes

Another key factor in creating and maintaining an ethical corporate culture is ensuring that ethics are “integrated into the organization’s goals, business processes and strategies,” reports the *AMA/HRI Business Ethics Survey 2005*. CPC has set out to ensure that all employee actions reflect core values. “In essence,” notes CPC’s director of human resources, “we make sure that every new hire understands that these are conditions of employment.” The importance of ethics is reinforced through a number of cultural supports:

- During the recruitment process, staffing professionals work hard to hire people who seem to share the company’s values and passions.
- During the onboarding process, new employees are schooled not only in the fun-

damental principles such as trust and transparency but also in core value issues such as integrity, accountability, mutual respect, and corporate citizenship. New employees must sign the code of conduct.

- All formal weekly or biweekly team meetings include a section during which CPC values and ethics are reinforced.
- CPC works to foster an emotional commitment with each employee: the stronger that commitment, the stronger the bond between employee and the company’s culture.
- CPC has a “certification of accountability” program that all employees are required to participate in once a year.
- CPC conducts regular audits and surveys.

CPC’s surveys and audits help alert the organization to ethics problems as well as identify roadblocks to ethical behavior, whether they stem from work processes or individual actions. These audits measure the degree to which employees 1) understand the company’s ethical principles and its code of conduct, and 2) follow those codes of conduct.

In the past, CPC has found that some operations or reward systems actually discourage ethical behavior. For example, there was the call center in which employees were rewarded on the number of calls handled rather than the degree to which customers were actually helped. “This went dead against one of our fundamental values: the need to establish a deep sense of trust with our customers,” noted CPC’s CEO. “So we changed the reward system to emphasize quality and customer satisfaction and engagement. At CPC, we really emphasize aligning our work processes with our business values, which we also align with our larger corporate strategies.”

Communications and ethics programs are also integrated. Open, timely and unfiltered communications from employees are considered criti-

cal at CPC. This is all tied to one of the most important corporate values: transparency. Employees are encouraged to bring issues of unethical behavior to their supervisor, HR, legal, compliance, security or other formal channels. All employees have access to a confidential, neutral and independent ombudsman with whom they can have off-the-record discussions about ethical issues and seek guidance on resolution options. Additionally, employees have access to the CPC Ethics Helpline if they want to formally report malfeasance.

The Ethics Training Program

To ensure an organization-wide awareness and understanding of the ethical values and principles and the application of the code, CPC has developed a formal Train-the-Trainer Certification of Responsibility program. This program is executed throughout the organization, involving everyone from new employees to the CEO and members of the board. At the end of the training, participants are certified to train others in these areas.

The goal is to promote the idea that peers should be helping one another maintain an ethical work environment.

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It should be noted that while parts of the training program are standardized, others are customized for the different positions in the organization. The idea is to ensure that employees clearly understand their specific roles and responsibilities in relationship to the code of conduct.

Armed with a keen understanding of the common traits that lead to deep ethical problems for business (Jennings, 2003), CPC has strategies

to reduce the chances that any employee will be 1) pressured to perform and maintain financial goals that can't be achieved without breaking CPC's code of conduct, 2) forced to work with a manager whose style is dependent on abuse, fear and silence, or 3) placed in a situation where management clearly indicates that feedback about ethical issues is unwelcome.

Once a person is trained, he or she and the trainer sign a Certification of Responsibility and Core Values Statement. This reinforces the idea that each person is personally responsible for his or her own ethical behavior. This responsibility includes:

- reinforcing CPC values and ethics to colleagues during the course of the workday;
- holding colleagues accountable through performance evaluations, which have an impact on merit pay rates, bonuses, and promotion opportunities;
- protecting "whistleblowers" from losing their job, status or benefits;
- bringing forward/discussing perceived ethics violations through an available resource.

Ethics Committee

To ensure CPC is taking an integrated approach to ethics, it also has an Ethics Committee. This committee is made up of members who represent different employee groups throughout the company. The committee reviews the code of conduct and other practices in light of the results from the company's Business Ethics Scorecard (discussed more thoroughly below). Additionally, the committee reviews CPC's social responsibility programs.

When true ethical dilemmas emerge in the company, the Ethics Committee uses a decision-making model that is based on its ethics principles. Once an issue is decided, the committee then looks at programs and practices that can reinforce

the decision. The Ethics Committee reports to CPC’s CEO and provides a summary report of its activities to the board of directors.

Board of Directors

The board of directors is obligated to uphold not only CPC’s overall code of conduct but also a specific Governance Code of Conduct. This code clearly states governance roles and responsibilities. Each year, all directors not only sign the code, they participate in an ethics workshop that includes the Train-the-Trainer Certification of Responsibility as well as in-depth discussions regarding the application of the board’s code.

CPC also set criteria for selecting and retaining board members to ensure the board is diverse and composed of the optimal percentage of independent and nonmanagement members. For example, the Compensation and Audit Committee is comprised of independent directors.

Directors must have timely information on ethical issues and concerns. To help ensure transparency, the organizational ombudsman has direct access to the board and provides unfiltered communications. These communications include information on unethical behavior and resolutions, early warnings, and recommendations for changes to prevent issues from recurring. The board also receives data on the malfeasances officially reported on the helpline.

Suppliers, Investors and Customers

Vendors and suppliers are an extension of the CPC business, so it’s critical that they conduct

business with the same ethical standards as CPC. As the *AMA/HRI Business Ethics Survey 2005* shows, different ethics practices and programs work best for different stakeholders. With this in mind, CPC developed programs targeted toward specific groups.

CPC has, for example, a Supplier Code of Conduct that outlines the suppliers’ need to treat their workers with dignity and respect, adhere to applicable laws and regulations, and make their products in an environmentally sustainable manner. The code is part of the supplier’s contract and CPC holds the right to audit the supplier’s practices if there is suspicion of unethical behavior.

CPC provides training to the suppliers on the code of conduct and CPC’s expectation of the relationship. Additionally, the suppliers have access to CPC’s ombudsman to discuss any unethical behavior they have observed. They also can access

the helpline to formally report malfeasance.

CPC knows that customers make purchasing decisions on the basis of the reputation of a company. CPC has a principle of transparency

and provides potential and existing customers with access to clear and complete information on all products and services. CPC provides customers with processes to provide feedback or ask questions, including access to the organizational ombudsman to discuss unethical behavior or concerns. Additionally, CPC provides customers with information about their corporate social responsibility programs and how they relate to business ethics principles.

Shareholder trust is critical to CPC’s success. CPC has created processes to provide timely and complete information and to obtain timely feed-

Top Five Ethics Practices/Programs		
For Suppliers/ Vendors	For Customers	For Investors
Code of conduct	Transparency	Transparency
Ethics audits	CSR programs	CSR programs
Ethics training	Ethics surveys	Ethics surveys
Ethics surveys	Access to ombuds	Access to ombuds
Ethics helpline	Ethics helpline	Ethics helpline

Source: *AMA/HRI Business Ethics Survey 2005*

back from their existing and potential investors. CPC's principle of transparency is manifested in the clear, timely and complete information they provide their investors on the financials, risks, strategies and priorities.

"The truth is, we've taken hits in the market for being frank at times when we might have played it a bit closer to the vest," says the CEO. "Yet, our average investors stay with us longer than your average organization. Maybe that's because they know we have a longer-term perspective. They trust us, and I think this has paid dividends when it comes to being able to nurture nascent product lines that perform poorly at first but that we think will eventually grow into blockbuster items. Trust is worth a great deal in the market, which is why we believe ethics is a bottom-line issue for us."

CPC also provides investors with comprehensive information about their corporate social responsibility programs and the principle-based decision process they used to make the investments. Additionally, shareholders have access to the organizational ombudsman.

Business Ethics Effectiveness Measures

CPC knows that just having business ethics programs and practices in place does not ensure that an ethical culture permeates the entire organization. Therefore, the CPC leadership team has developed measures and indicators that they review to determine if indeed the business ethics programs are effective. Effectiveness is measured by looking at outcomes. It is not enough just to know the results of process and activity measures such as evidence that the code of conduct has been distributed or that 100% of employees have completed a training program.

The Ethics Committee, comprised of a cross section of the CPC employee base, created an Ethics Scorecard that it uses to review effectiveness measures. Without jeopardizing individual confi-

dentiality, this committee reports a summary of the trends as well as changes to ethics programs to the board, employees, and shareholders. The scorecard includes the performance results on the ethics goals required of the entire leadership team, and it looks at potential correlations with information on the retention of high-performing employees, customer loyalty and investor confidence.

Additionally, the scorecard includes results from the employee ethics survey and the annual audit of the ethics programs and practice. The survey includes information on comfort level of employees in the reporting of misconduct, satisfaction with organizational response to reports of misconduct, and overall satisfaction with CPC's commitment to business ethics.

CPC has set the standard in collecting and analyzing customer complaints and conducting supplier audits. CPC records and analyzes the number, types, and trends of customer ethical complaints and concerns. The company also makes available the findings of the code of conduct audits of vendors or suppliers and the actions taken as a result of those audits. It includes information on the number, types and trends of theft, fraud and financial malfeasance and the number, types, trends and costs of lawsuits.

In addition to the scorecard, the Ethics Committee reviews information on unethical behavior from the ombudsman program and case data and outcomes from the Ethics Office and CPC Helpline. Finally, the committee analyzes the socially responsible programs and funding in light of their relationship to the business ethics strategy.

Ethics Practices on a Global Level

As a global corporation, CPC has found that conducting business internationally at the same ethical standards level as the national one is necessary to safeguard its reputation. This is, however, a challenge that requires a deep commitment from and to all stakeholders. After all, it means

compliance with a wide range of different laws and regulations as well as an understanding of various cultural perspectives on ethics. Therefore, CPC views ethics as a total business system commitment.

The Board of Directors is ultimately accountable for ensuring CPC complies with legal and international regulatory requirements. Much of the groundwork is, however, done by senior management teams who take on the implementation and management of the Global Ethics Strategy, carried out in conjunction with CPC's Ethics Committee.

CPC's Global Ethics Strategy goes beyond trade and commercial transactions to include social and environmental responsibilities. For example, CPC sees the need to help develop – through the building of infrastructure, contributions to schools, and the like – some of the communities where they have foreign operations. In some cases, the company has even contributed to communities where its major suppliers are based.

Among the areas of highest concern are exposures to fraud, theft and financial malfeasance in foreign operations. Also, fair and equitable global compensation is a focus. CPC ensures that employees in manufacturing facilities in other nations receive fair wages.

CPC is aware that culture, time zones, languages and organizational hierarchies all make a difference in the degree to which unethical prac-

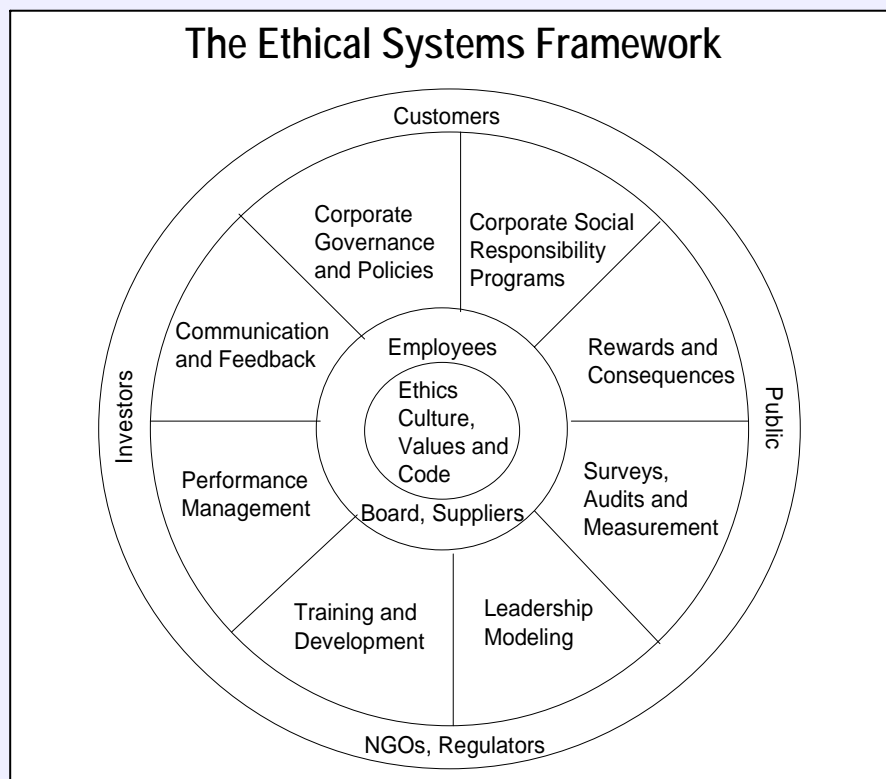
tices are brought forward. The CPC Code of Conduct is translated into the local language, and ethics training is conducted at the local level. Employees are encouraged to discuss issues with the local line and staff management or report the issue to the Ethics Helpline in the language of their choice. In some areas, there is a genuine resistance to such practices based on a history of negative consequences resulting from reporting "suspicious" activities to authority figures. Employees may well be reluctant to seek clarification on a possible conflict of interest from a remote person in a central location. To help address these concerns, the ombudsman program is global and provides a safe resource for any employee who wants to seek completely confidential, neutral and informal advice for options in getting the issue surfaced.

To address global complexity, CPC localizes some of those programs and practices while maintaining a corporate-wide culture of ethics. It customizes its training to specific cultural perspectives so that an overseas manager understands the spirit and not just the letter of the corporation's code of conduct. "Ultimately," says CPC's CEO, "we have to make sure our ethics strategy can be customized and adapted worldwide but at the same time maintain the integrity of the core organizational values."

Conclusion

If there's a single lesson to be drawn from the *AMA/HRI Business Ethics Survey 2005* and the accompanying research we've conducted, it's that any approach to improving business ethics has got to view business ethics as a strategy and a system. Corporate culture is the key to creating and sustaining an ethical environment, but culture is notoriously difficult to shape and change. A culture represents years of ingrained behaviors, traditions, unwritten rules, and assumptions about what is rewarded and why. Addressing it requires a systems framework.

The best hope companies have is to begin by identifying the fundamental values and principles that undergird everything else in the organization. If the underlying values do not strongly speak to ethics and reward ethical behaviors, then companies are missing an opportunity and setting themselves up for future ethics problems. These may include litigation or the perpetuation of a trustless culture. Ultimately, culture is more important than programs, but espoused values are not necessarily the same as genuine values. If claimed values or a code of ethics have no power or resonance throughout the organization, they will not change behaviors.



The AMA/HRI research agrees with some other comparable studies that leadership is key to changing corporate culture. If leaders are dismissive about ethics enforcement, or if they simply talk the talk without walking the walk, then trying to establish and sustain an ethical culture is nearly hopeless. All the ethics programs in the world won't help.

If the right kind of leadership and fundamental values are in place, however, then programs and practices can help support and maintain an ethical culture. For this reason, we've

developed an Ethical Systems Framework (*see figure*) that illustrates how we think a systems-oriented ethics program works. In this model, an ethical culture is at center, being the strategic focus of any ethics initiative. Principles and values – and the code of conduct which is based on them – are the foundations for the ethics culture. The next circle represents the organization’s employees, board and suppliers whose daily actions are influenced by the culture and, in turn, help shape the culture. We placed suppliers in this circle because, as business partners, their activities on behalf of the organization affect its reputation and success. Suppliers will increasingly be subject to corporate codes and audits and training. More business partners will tie their financial arrangements to the progress on mutual goals related to ethics or social responsibility.

Then there are the practices, programs and processes that need to be aligned. They both reflect and reinforce the culture’s values and the code of conduct. Of these, leadership modeling and communication are the most critical, according to the AMA/HRI survey, but all play an important role. It should be remembered that this model is a simplification that doesn’t show all relevant practices and processes. The ways in which companies develop and deliver products and services, for example, also play an important role in establishing an ethical work environment.

Around the perimeter of the model are the external stakeholders. More and more, the ethical conduct of the organization will influence the decisions by these external stakeholders. They will enjoy increased organizational transparency. There will be additional methods for these stakeholders to provide feedback. For example, investors and consumers will likely have greater opportunities to take advantage of ombudsman programs and helplines, providing more checks and balances on the ethics of corporations. Over the long haul, this will serve the interests of businesses, which will benefit from paying greater attention to the external business environment.

Business ethics will become more important in the next several decades. Among the most important external influences will be globalization, pressure from customers, investors and the public and environmental issues. This means, in essence, that corporate leaders are going to need to broaden the scope of their attention in order to maintain an ethical culture. To achieve this, they will have to watch and listen carefully, both within and outside of their organizations. This will help them to anticipate and address ethical problems before those problems become full-fledged scandals.

Ultimately, in a well-managed company, business ethics pays dividends aside from simply protecting the reputation and well-being of the organization. An ethical foundation gives leaders a sense of purpose and helps them forge a strategic vision. Employees will be more passionate, committed, trusting and loyal. In short, ethics is a way of engaging and even galvanizing the workforce, creating more loyalty among customers and increasing shareholder value.

One last point: the AMA/HRI survey indicates that one of the primary reasons respondents give for running a business in an ethical manner is that “it’s the right thing to do.” This highlights the fact that, in the end, ethics is about more than just the bottom line. There is no simple division between business ethics and human notions of morality, on which whole civilizations are based. These concepts bind us all and will continue to do so well into the future.

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