

**COMPLIANCE AND CORPORATE CULTURE
MAKING THE MOST OUT OF CODES OF ETHICS**

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Abstract

Codes of ethics are attracting more interest in Australian business corporations. They have often been used simply to garnish the public image, or to remind employees of the law. However, they can fulfil a more important educational role in the corporation in shaping and maintaining corporate culture. They also can translate into instruments to achieve volitional and creative compliance, and in turn have a direct impact on transaction costs in the corporation.

“Key Words: codes, ethics, corporate culture, transaction costs, compliance”

* This article arises from work done in the New College Institute for Values Research, and from experience in teaching on the social theory of the business corporation. It is also an offshoot of reflections on changing the institutional culture of The Anglican Church.

For a variety of reasons the business corporation depends on a high level of compliance from its staff. This is not just a matter of orderliness in the corporation, though that is not unimportant. It is also, and very importantly, a matter of the economic efficiency of the business. The history of the last hundred and fifty years reveals a variety of attempts to deal with this question. Staff training has had, and continues to have, a role in this area. The business corporation, however, requires not simply compliance, but also creativity and contribution from its staff. With increasing technological sophistication this second requirement has become strategically more significant.

Each of these requirements is most effective when internalised by the staff in a company so that there is a correlation between the corporation's expectations and the volitional commitments of the staff. Two important elements in the creation of this situation are staff education and the perceived culture of the corporation. Staff education will go beyond the simply informational and touch the motivation and commitments of the staff. The culture of the corporation, however variegated it may be, will have an effect upon the perceptions of staff as to what is expected of them. I want to suggest in this paper that codes of ethics can perform a useful role in relation to these two elements of staff education and the identification of the culture of the corporation. Furthermore, they can perform that role in such a way that they significantly contribute to the goal of staff compliance. ¹

¹There is a growing literature on codes of ethics. The following provide an introduction to the discussion: Kenneth Feister, *How Labour Unions Views and Use Codes of Ethics*, and W Kintner, *Legal Limitations and Possibilities for Self-Employment of Codes of Ethics*, in I. Hill (Ed) *The Ethics of Economic Freedom*, New York, 1980, R T DeGeorge, *Business Ethics*, New York (MacMillan) 1982 (pp. 233-242), Y Kugel and G W Gruenberg (Eds), *Selected Reading on Automational Payoffs*, Lexington Mass, (Lexington Books) 1977, Chapter 6, L J Brooks, *Corporate Codes of Ethics*. *Journal of Business Ethics* 8 (1989) (pp.117-129), S Weller, *The Effectiveness of Corporate Codes of Ethics* *Journal Business Ethics* 7 (1988) (pp. 389-395.), P F Drucker, *The Changing World of the Executive*, London, Heinemann, (pp. 234-256). KA Getz,

Codes of Ethics in Australian Companies

Codes of ethics are not widely used in large Australian companies. In a recent survey, the results of which have been published in the *Journal of Business Ethics*, the New College Institute for Values Research tested the use made of codes of ethics in the 50 largest companies in Australia. 36 of the companies responded to the questionnaire. Of the top 10 companies, 7 responded. It is clear from the survey that the largest companies are the ones which most commonly have codes of ethics. Nonetheless, the codes in ethics in Australian corporations are a fairly recent phenomenon. In general, codes of ethics do not have a high profile in Australian business and do not appear to be extensively or rigorously used by Australian companies. This survey by the New College Institute for Values Research indicated "that the tool of codes of ethics is not a widely used method in the cultivation and enforcement of ethical standards of behaviour in Australian companies".²

The survey demonstrated that where codes were used, they covered such matters as:

- the standard of conduct required of employees,
- dishonesty,
- support for the company's policy towards customers,
- conflict of interest,
- protection of the company from fraud,
- not exposing the company to liability by providing advice beyond
 - what the employees are able properly to provide,
- confidentiality of the information obtained in the course of
 - employment,
- improper payments,
- improper use of inside information,

International Codes of Conduct: An Analysis of Ethical Reasoning, *Journal of Business Ethics*, 9, 1990, 567-577.

the enhancement of the public reputation of the company.

In general, codes emphasised that employees must keep the law, that customer relations is of great importance particularly in terms of the reputation of trust and integrity of the company, and that conflicts of interests between personal gain and obligations to the company and the confidential character of information gained during the course of employment must not arise.

In 1991 a group representing a variety of Australian business organisations produced a booklet entitled "Corporate Practices and Conduct". The group which produced the booklet was chaired by Mr Henry Bosh, recently retired from his position as chair of the National Companies and Securities Commission.³ The working group subsequently produced in 1993 a second edition of this corporate practices and conduct booklet. In the foreword, Mr Bosh says that "it is clear from developments in the U.K., the United States and Australia, that the corporate sector is making a significant effort to create its own framework of acceptable standards of behaviour irrespective of existing or prospective legislation".⁴ No doubt the uncertainty about corporate supervision at the level of legislation and statutory authority in Australia lies behind these remarks. It is also clearly the case that the public disquiet at corporate behaviour during the 1980s has been a significant motivation in the production of this particular booklet and of similar projects overseas.⁵

² B. N. Kaye, Codes of Ethics in Australian Business corporations, *Journal of Business Ethics*, 1992, Vol. 11, 857-862. See also the survey conducted by the University of Technology Sydney,

³ Henry Bosch has written a lively and informative account of his time at the Trade Practices Commission, *The Workings of Watchdog*, Port Melbourne, Heinemann, 1990. He draws attention to the decline in business ethics in the 1980s. "The story is complex but its many interwoven strands can conveniently be considered under four headings: cyclical factors, the decline of the old morality, the new uncertainties and the impact of competitive pressures." p.31.

⁴ H. Bosch, (Chairman) *Corporate Practices and Conduct*, Second Edition, Melbourne, Business Council of Australia, 1993

⁵For a similar resort in an earlier generation to ethics in business after a time of poor business behaviour, see B M Selekman, *Moral Philosophy for Management*, New York, McGraw-Hill Book, 1959.

Section 5 of the booklet deals with company codes of ethics. The booklet says that such codes of ethics have been found to be valuable to companies and to the business community at large. They offer, we are told, the following benefits:

- They enhance the companies reputation for fair and responsible dealing.
- They help to maintain high standards of behaviour throughout the organisation.
- They give all employees a clear idea of what the company is setting out to do and how it will do it.
- They help to develop pride among staff and to give a focus to the organisation as a whole.

The booklet then goes on to say that such a codes of ethics is, in fact, "a statement of the company's own values". Furthermore, if the code of ethics were to have real meaning, it cannot be imposed from above; it must be developed by each company to meet its own needs and aspirations and must reflect the culture of that company. Ultimately, any code of ethics should be endorsed by the Board. The booklet then goes on to outline quite helpfully the sorts of things to which codes of ethics might refer . Such things are responsibilities of shareholders and the financial community generally, relations with customers, consumers and suppliers, employment practices, responsibilities to the community and personal conduct. This brief summary also says that such a process should contain "a general statement signed by the Chairman and/or the Chief Executive emphasising the Board's, and management, commitment to the code." The section ends by saying "It is also important that the code of ethics be communicated and is well understood by all employees."⁶

⁶Bosch, *Corporate Practices and Conduct*, , p33

This helpful booklet reflects, as does the New College Institute for Values Research survey, the general attitude towards codes of ethics in business. They are statements about the values of the company issued, after consultation, on the authority of the Board and they should be communicated within the company to members of staff. There is great diversity, both in Australia and in the United States, as to the kind of sanctions that apply to breaches in a code of ethics. Nonetheless, the general tenor is that the statement of the company's values in such a code is a good thing, and that sanctions are the way in which the code, in the end, will be effective.⁷

⁷See , for example, L T Hosmer, *The Ethics of Management*, Homewood, Irwin,1991,p.185f.

Codes Can Have a Variety of Uses

In the United States of America, a survey conducted by Opinion Research Corporation of Princeton, New Jersey in August 1980 showed that codes of ethics in American corporations were often produced in the public relations, division of the company, and that the predominant focus for the codes was the presentation of a good image of the company in the public arena.⁸ In communication within the corporation the codes tended to reflect the legal obligations that the company had in a variety of fields. I do not criticise this use but simply note that here the two uses of these codes are in the area of corporate public relations, and the explication of the details of legal sanctions that apply in the corporate domain.

Transnational enterprises have often used codes in order to deal not only with these two questions but to express the way in which the company relates to different legal jurisdictions within which it is operating. One of the most famous of these codes was that issued by the International Harvester Company.⁹ Supported by a letter from the Chairman of the Board, the code sets out the way in which the company would relate to the differing legal and cultural jurisdictions in the various countries in which the company operated.

Clearly, at both national and international level, codes of ethics can have a variety of uses depending upon the character of the company, its organisational design, the type of business and the cycle of its activity. It is noteworthy, for example, that banks and service and companies in the service sector have more detailed customer relations elements in their codes of ethics than do manufacturing companies.

⁸Opinion Research Corporation: 1980, *Implementation and Enforcement of Codes of Ethics in Corporations and Associations*.

⁹The letter from the chairman of the Board, WH Franklin, was dated October 1, 1974. The letter and code are published in Y Kugel and GW Gruenberg, op cit 124-132.

I want to suggest three things in relation to codes of ethics which appear not to be widely considered in the literature or in the activities of companies reported in various surveys. First, the codes can be seen as effective educational tools. Secondly, the use of codes as educational tools can make a significant contribution to the issue of compliance within the corporation. And thirdly, these codes can contribute to the shaping and maintenance of the corporate culture of the company.

Codes As Educational Tools

Codes are most commonly thought of as statements of values for the purposes of public relations or as quasi laws whose most significant internal role is their enforcement as laws or rules within the company. Mainly for this purpose they are included in staff manuals along with other instructions for staff. The code is often attached to the company mission statement and so the public relations exercised is incorporated under the general heading of establishing the identity of the corporation in the market place, and in society generally. If the code of ethics is used simply from the point of view of enforcement and sanction in relation to the behaviour of staff, then it is difficult to see how such a code of ethics can go beyond a simple restatement of the law of the land or of extensions of contractual obligations that staff have in the corporation. Inclusion of codes in staff manuals, along with other rules and obligations, only confirms the thought that codes of ethics are just elaborations, with different words, of rules or legal obligations.

Compliance and Codes Education

I wish to locate codes of ethics education within a broad context of staff compliance. That context can be marked by two trajectories. First, there is the trajectory of the minimisation of transactional costs through the internalisation of those transactions into the life of the corporation. Corporations take within their own arena of activity transactions which can otherwise be handled in the market place or through external

contracts. One of the reason for internalising in this way is the reduction of the transactional costs involved in such activity. If the transaction can be effected more economically by integration, of one kind or another, into the corporation, then that is what the corporation will to do. There is a powerful economic argument associated with this tendency.

This area of corporate strategic activity has been extensively debated in the literature particularly in relation to the contributions made by Ronald H Coase and Oliver Williamson.¹⁰ The difference that integration makes relies upon the capacity of the corporation to effect a higher level of compliance within its jurisdiction than is possible outside by the mechanisms of the market. The compliance which is possible within the jurisdiction of the corporation is a compliance of the staff of the corporation to carry out the tasks involved in the transaction with margins less than than are available by competition in the market place. Staff compliance in carrying out the task is therefore an important consideration in the economic strategy of a corporation. In the broad corporate context, the transactional cost axis highlights the issue of compliance within the corporation.

That same issue of compliance can be illustrated by reference to the analysis of the corporation as a managerial hierarchy. Alfred Chandler Jr. has demonstrated this feature of the corporation at some length in a variety of books.¹¹ On Chandler's analysis the large modern corporation has evolved into a multi unit organisation. This involves the supervision of a variety of levels of people for the purposes of carrying our tasks. This supervisory hierarchy exists not only because of the activity

¹⁰See O E Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*, New York, Free Press, 1985, *Economic Organization, Firms, Markets and Policy Control*, New York, New York Univ. Press, 1986, *Markets and Hierarchies: Analysis and antitrust implications: A Study un the economics of internal organization*, New York, New Free Press, 1975 R H Coase, *The Firm the Market and the Law*, Chicago, Chicago Univ. Press, 1988. For a comparative approach to this area see W C Kester, Governance, Contracting, and horizons: A Look at Japan and Germany, *Journal of Applied Corporate Finance*, , vol.5 1992, 83-98

in the corporation but also to secure the compliance of those carrying out the tasks in terms of what is required by the corporation.

Reference to these two trajectories of corporate structure should not be taken to suggest that the compliance which is looked for here is the compliance of mere slavish automata. The history of what may reasonably be called management enforcement, of course, suggests, something quite different. Scientific management theories at the end of the last century sought to establish enforcement and compliance by the arrangement of the work environment. Before the First World War, the emergence of industrial psychology internalised the focus of enforcement efforts on the part of managers. After the second World War, the rise of the school of Human Relations raised two foci in the enforcement equation. On the one hand, the task of adjusting the worker by counselling, and on the other hand, encouraging the manager to provide leadership. This period also saw the rise of interest in non financial incentives as part of the compliance equation. Other emphases have been on communication techniques, the study of groups and group dynamics. The present situation embodies elements from all of these traditions with the focus on the acceptance by all staff of a productivity and quality performance model. There is some evidence that the group dynamics model with its strong emphasis on bottom up participation in change is giving way to a more top down charismatic authoritative leader model of organisational change. ¹²

Codes of ethics have not played a significant role hitherto in the compliance equation. Insofar as they have played a role at all, it has generally been as extensions of company rules and regulations and therefore in terms of sanctions generated compliance.

¹¹Most importantly, A D Chandler Jr, *The Visible Hand: The managerial revolution in American Business*, Garden City, NJ, Doubleday, 1966, and also Chandler, AD and Salsbury S, *Pierre DuPont and the Making of the Modern Corporation*, New York, Harper and Row, 1971.

However, codes of ethics invite a different kind of role in the compliance equation. That role is best understood by coming at them as education tools. This role can be seen to arise from the two elements which are involved in this equation; on the one hand, the compliance requirements of the corporation and on the other hand, the ethical character of the contents of the codes.

The character of the compliance which corporations increasingly look for is changing. As we move more and more into knowledge based and high technology corporate activity, then the compliance that is required for the effective operation of the corporation involves a greater emphasis upon creativity and volition.¹³ Other elements in compliance will undoubtedly have their place in the future but, because of the character of the technology and the kinds of people that are being employed, volition and creativity take on a higher profile in the compliance equation. Both these aspects of enforcement highlight the need for compliance to be internalised. Staff cannot be constantly supervised in terms of the information and the technology now coming into use as much as previously was the case. Staff must be relied upon to comply willingly with the requirements of the corporation.

Furthermore, because of the high level of education and technical competence of staff in the newer industries, the corporation increasingly will look for creativity from amongst its staff. Creativity, by the use of skills through a variety of mechanisms, has always been part of the success of the industrial corporation. However, with changes in technology this will be increasingly important. The balance of research costs in comparison with other costs in such companies as Microsoft, Apple and IBM illustrate the point quite amply. If internalised compliance is what is required then the very character of ethics matches those requirements.

¹²See D C Dunphy, DA Stace, Transformational and Coercive Strategies for Planned Organizational Change: Beyond the O D Model, *Organizational Studies*, vol 9, 1988, 317-334.

Ethics have to do with behaviour in relation to people's perception of right and wrong. In other words, by their very character, they are part of the volitional behaviour of individuals and of groups. Furthermore, ethics have to do with a hierarchy of values. The ethically articulate person is conscious of the way in which different values operate in a hierarchy and need to be deployed in varying and creative ways in different particular circumstances. In the old fashioned terminology, the cultivation of virtue as a habit or disposition towards behaviour, enabled flexibility of judgment in different circumstances in relation to internalised values held in some kind general hierarchy. This model is in some contrast to a consequentialist pattern of ethics which looks to anticipations of outcomes to which values are attached in some kind of scale. That kind of decision making on this model of ethics is, in the end, exceedingly difficult to use as a predictor. Also this pattern of ethics leads, as it did for example with Jeremy Bentham, to a concern with *post hoc* considerations. In the corporate environment that means sanctions after the event. For reasons already mentioned, that model, while necessary, is increasingly inadequate.

Ethics also have to do with two other contextual issues that are important for the compliance equation. First, ethics have to do with the values of our common humanity. Those common human values lie behind the virtues that are discussed in the history of moral philosophy. Secondly, values relate to the social culture within which individuals and groups operate. For example, the Australian culture is based upon and assumes certain kinds of values. The notion of everyone being given a "fair go" is an example of the social culture of the Australian community which expresses an ethical standpoint. These values are expressed in the constitution, law and public institutions. From this perspective the corporation is also a set of social relationships.

¹³See for example, PF Drucker, *Post-Capitalist Society*, New York, Harper Collins, 1993.

An education programme which sought to use a code of ethics would involve articulating the rationale for the company's relationships. A company is a human institution which seeks to maintain some continuity of relationships between property and people with a view to certain outcomes. These continuing relationships not only imply and assume certain ethical values, but they also, at the same time, reinforce and can change or shape the values. To some degree people internalise the structured relationships within which they work. To that extent, they also internalise the values which are implicit in those relationships. The process of articulating the rationale for the company's structured relationships would uncover the ethical values upon which the company relies within that institutional context.

The compliance equation looks to the ethics of individuals within such an institutional context as well as to the ethics of the institutional pattern itself. For example, the level of detailed supervision that a structure implies is in some measure an indicator of the kind of trust which the agent is facilitated to demonstrate, or is expected to fulfil, from the point of view of the principal. High levels of trust operate in more open ended patterns of supervision. Close, tight and detailed patterns of supervision and surveillance imply and often overtly declare a different assumption about the trust that is assumed in the relationships in that structure.

Furthermore, the rationale for particular surveillance and supervisory systems will shape and differentiate ethical assumptions. A surveillance mechanism which is clearly understood by the explicit rationale offered by the company to be for the protection of the agent will engender a different volitional commitment from staff than a surveillance mechanism whose rationale is in terms of sanctioned management control.

Any programme designed to develop an education of values by use of a code of ethics will involve the articulation of the rationale of the company's relationships and that will inevitably bring the educational programme into the arena of ethical

discourse about the character of the relationships which define the institutionality of the corporation.

Because such an educational programme brings the discourse into the arena of ethics, that education programme will involve the commending of the ethical rationale of the corporation. The reason why the corporation structures its affairs in one way rather than another will imply a different ethical or value profile. The development of an educational programme in this context will involve not simply the articulation of the ethical rationale of the corporation but the commending of it, in an effective way, to the staff and the corporation. That process of education and commendation will require the values of the corporation to be brought into effective relationship with the values of the staff as individual human beings. An effective process of education involves interacting with where people are and persuading them to move to a modified or new position. Because this corporate educational process is looking for volitional and creative outcomes, it will need to be an interactive and persuasive model of education which makes contact with the values of the staff as human beings and brings them into relationship with the ethical values and commitments of the relationships that pertain in the corporation. Thus, such an educational activity will relate the company's rationale for its structure and organisational relationships to a hierarchy of ethical values. It will also relate that hierarchy of values to the values of the staff so that they interact with them in a persuasive fashion.

A company values education process, hooked on to a code of ethics, will thus involve articulating the rationale for the company's structural relationships, and thus the ethics lying behind that rationale, and commending that ethical rationale of the company to the staff.

This sophisticated model of education related to codes of ethics may look too hard and complex for a corporate staff training programme. However, the end benefits in

terms of the self-understanding of the values of the corporation and the volitional and creative aspects of the outcomes in the compliance equation are very substantial indeed. Benefits in this area will directly affect transactional costs.

Corporate Culture and Codes of Education

It is a common place to observe that corporations have their own particular culture.

The corporate practices and conduct booklet referred to earlier identifies the need that a code of ethics should "reflect the culture of that company"¹⁴. In popular notions, one can think of such phrases as, "This is the way we do things here."

Culture, in this context, means the perception by individuals within the corporation of the public persona and style of relationships which prevail in that corporation. It is manifest from a comparison of corporations that cultures exist, are influential on what happens in the corporation and differ from corporation to corporation.

Amanda Sinclair has recently disputed this idea of corporate culture and claimed that corporations are really sets of sub-cultures.¹⁵ Furthermore, this plurality of sub-cultures in the corporation is more productive. As a general point it is hard to disagree that a level of plurality is beneficial in a corporation. But it remains the case that the corporation, if it has any overall identity, will have also some form of overall culture. The real question is not whether we think there is one or many cultures, but what relationship or profile exists, or should exist, between the hegemonic culture inevitably present in a corporation, and the plurality that also is present in the corporation.

One of the more interesting ways into this notion of culture is by the narrative meaning of a community. Robert Coles at the Harvard Business School now teaches business ethics by narrative.¹⁶ He tells stories which reflect a way of seeing the

¹⁴op cit p.33

¹⁵Amanda Sinclair, *Approaches to Organisational Culture and Ethics*, *Journal of Business Ethics*, Vol 12, 1993, 63-73.

¹⁶See the account in *Harvard Business Review*, 1987, Teaching Ethics at the Harvard Business School.

world and a set of ethics values that are implied in that perception. Such a way may involve telling the story of how the company got where it is as a way of explaining something about the culture that prevails in that corporate community. The narrative meaning of a community is thus affected by the tradition and history of the particular corporate community. That tradition is not simply the rigid past but the way in which the past impacts upon the present and is being changed with a view to present problems and future possibilities. Tradition and history in this context need to be seen in a continuum of evolving culture over time for the corporation. That continuum provides one of the reference points for the effective culture of the corporation. One of the great problems which large corporations face in a time of rapid change is what is sometimes referred to as "morale". One of the significant factors in the degree of morale loss at bad times is the loss of an effective and creative tradition as to the meaning of the corporation's internal relationships.

In a community like a corporation, as indeed in other enclosed communities as well, meaning can be indicated by the symbols of the corporate community life. Companies are well aware of this and it is reflected in the attention given to signage. The Nissan jacket is a form of signage and it is important as an instrument in meaning formation. It not only identifies something which the corporation wants to reflect but also it is an instrument to create and sustain the reality which is itself being reflected. Symbolic actions by leaders in corporations have a similar signage value. The Executive Chairman's visit to a disaster may not affect budgetary or financial decisions in relation to that disaster but it will undoubtedly affect the way in which those involved in the disaster respond in their relationships within the corporation. The architecture, the symbolic statements made by the office style of leaders within the corporation, carry a meaning message which imply a values hierarchy. The systems that operate within the corporation in regard to particular individuals (who has what kind of cars, for what kinds of purposes) convey something about the overall culture of the corporation in its internal relationships. The way in which communication is conducted via the medium of such things as the

company paper or newsletter all convey image and signify something about the character of the corporate culture.

Meaning is also indicated in corporate life by rituals. The awarding of prizes of one kind or another to staff, and the public image that is given to such awards. The way in which the Annual General Meeting of the company is presented, particularly the way in which it is presented to the staff of the corporation, indicates something about the culture of that corporation. Installations and departures are also rituals which carry value messages. Connections with public activities or events are also ritual in character and convey meaning messages.

What I am drawing attention to here is the narrative meaning of a community and suggesting that those considerations should be applied to the corporation and its culture. The tacit assumptions and values within the company are only powerful if they are fostered, nurtured and articulated in a diverse and effective educational programme within the corporate community.

It is in this context that codes of ethics provide an opportunity, as a kind of curriculum or syllabus, for educating the corporate culture. The signs and markers of the culture in the corporation can be reinforced in such an educational programme. Codes of ethics can be used in this process as a point of reference, offering a rationale and justification for these symbolic and narrative activities in the corporation. Thus the code is a vehicle for the identification, articulation and reinforcement of the ethical values upon which the institutional relationships in the corporation rely its effective operation. The embodiment of elements of the code of ethics in stories about the corporation which reflect the corporate culture can be an important part of such an educational programme.

The impact of the culture of the corporation on overall performance is of course not always easy to measure except when things are going very well or very badly. Then

we are more aware of that pervasive culture within the corporation. Even though it is difficult to measure in precise balance sheet terms, any experienced manager knows that the 'culture', however configured, is a very important force in corporate life. It is wise therefore to sustain and nurture it in the right direction.

Conclusions

In addressing the compliance equation and looking for volitional commitment and creativity from staff, a corporation does well to identify its culture and the ethical values in that culture. Codes of ethics can be a useful tool in precipitating the values of the company in relation to the broader context of social values. The ethical focus can become a powerful tool in securing volitional compliance, which is likely to be more effective and more creative in the life of the company especially in the future trend to knowledge industries.

Codes of ethics, therefore, can be a useful tool in the overall educational activity of the company and the fostering of a persuasive and influential culture in the company. At the same time, this educational use of codes of ethics and the focus on institutional ethics will itself help to clarify the essential human and social ethical character of the corporation itself.

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