

## **Managing the Risks of Global Ethics and Compliance for Marketers**

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# Managing the Risks of Global Ethics and Compliance for Marketers

## **Introduction**

The risks of an ethical misconduct disaster have never been greater due to the complexity of the global business environment. Increasing regulation and enforcement as well as stakeholder scrutiny can create an unexpected organizational crisis. In this paper we will provide a foundation for understanding organizational ethical decision making and provide two examples of companies that found themselves dealing with an organizational ethical disaster.

One approach to understanding business ethics is to take an individual perspective and focus on personal morals, character and the person. This approach assumes that virtues linked to the high moral ground of truthfulness, honesty, and fairness are self-evident and easy to apply in a complex global environment. This approach would assume that organizational values and ethics training may be more appropriate for individuals with unacceptable moral development. It also assumes that employees will be able to control their decision making environment independent of managers and co-workers. Another approach to understanding business ethics is to assume that organizational values and compliance systems are necessary to prevent people from engaging in unethical conduct. This approach recognizes the risks and the complex decision-making environment in a global environment. Business ethics programs and organizations combine values and compliance, which requires training and constant vigilance. All organizations will face ethical lapses, unintentional misconduct, and complacency from employees when they observe serious misconduct.

The scandals and unethical conduct that have occurred globally have taught us that some people deliberately break the law or engage in inappropriate behavior. Many others never see ethical issues when devising what they think as an innovative scheme for success. In the U.S.

the Supreme Court and the Federal Sentencing Guidelines for Organizations (FSGO) hold organizations responsible for the conduct of their employees, most firms have decided to implement ethics and compliance programs to prevent misconduct and diminish the risk associated with employee wrongdoing. The 2004 Amendments to the FSGO hold the governing authority, usually the board of directors, responsible for ethical leadership including an effective ethics program and internal ethics audits. In addition, an ethics officer with adequate resources is required to report directly to the board or a committee of the board. Even though the majority of employees want to do the right thing, many people don't know the exact nature of the law and are totally surprised when they are charged with violations that were never anticipated. The legal system and the nature of civil litigation make ethical decision making a 'mine field' for possible error without adequate knowledge of the potential risk of a decision.

Marketers need to understand how ethical decisions are made and the environment that influences ethical decision making. Marketers face the same business ethics risks as others but marketers should be more aware of those special risks associated with customer contact and interaction with their relevant stakeholders. While there may be many significant and meaningful aspects of ethics that can be taught to employees that will help them live a better life, there should be some foundational concepts taught to business employees that will help them obtain a holistic understanding of business ethics.

Many marketers have a difficult time understanding that ethics requires going beyond minimal legal requirements. Trying to find a framework that helps marketers see the benefits of conducting oneself according to the highest ethical standards is difficult indeed. The best opportunity for achieving this goal would be an understanding of stakeholders that shape and

form ethical issues and evaluations, and a description of how leadership, corporate culture, formal ethics programs, and individual character are important to ethical decision making.

The Ethics Resource Center reported, in the 2005 National Business Ethics Survey (NBES), that 52% of employees observed at least one type of misconduct in the past year. Just over half (55%) reported the misconduct to management, a 10 percentage point decrease since the 2003 NBES survey. In addition, organizations with strong ethical cultures and full formal ethics programs are less likely to observe misconduct. Formal ethics programs were found to be an essential element of a strong organizational culture.

The reality is that employees are at a high risk for observing or engaging in misconduct. According to the NBES survey, in the last year one-third of all employees encountered a situation at work that they think invites ethical misconduct. Formal programs and strong ethical cultures significantly reduce the pressure to engage in misconduct, the observation of misconduct, and the need to report misconduct. The Open Compliance Ethics Group (OCEG) reports that firms that have an effective ethics program and culture do not have scandals and events that cause significant legal or reputation damage. In fact, no firm with a strong ethics program for 10 years has had a major ethical scandal in the last 5 years. The U.S. Sentencing Commission reports that no firms with an effective ethics program have had significant legal or reputation damage in the last 5 years.

### **Stakeholders Define Marketing Ethics Issues<sup>1</sup>**

A stakeholder perspective facilitates the understanding of how agreements, collaborations, and even confrontations exist on ethics issues. Stakeholders designate the

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<sup>1</sup> Adapted from Isabelle Maignan, OC Ferrell, and Linda Ferrell, (2005) "A Stakeholder Model for Implementing Social Responsibility," *European Journal of Marketing*, Vol 39, #9/10, pp. 956-977.

individuals or groups that can directly or indirectly affect, or be affected by, a firm's activities (Freeman, 1984). Stakeholders can be viewed as both internal and external. Internal stakeholders include functional departments, employees, boards of directors, and managers. External stakeholders include interest groups, consumers, competitors, advertising agencies, and regulators (Miller and Lewis, 1991). The various relationships should be identified and interests understood.

Another view of stakeholders characterizes them as primary or secondary. Primary stakeholders are those whose continued participation is absolutely necessary for business survival; they consist of employees, customers, investors, suppliers, and shareholders that provide necessary infrastructure. Secondary stakeholders are not usually engaged in transactions with the business and are not essential for its survival; they include the media, trade associations, non-governmental organizations, along with other interest groups. Different pressures and priorities exist from primary and secondary stakeholders (Waddock et al., 2002). Unhappy customers may be viewed with less urgency than negative press stories that can damage a business (Thomas et al., 2004). Highly visible secondary stakeholders such as an interest group or the media may at times be viewed with greater concern than employees or customers. Remote stakeholders at the fringe of operations can exert pressure calling into question the firms' legitimacy and right to exist (Hart and Sharma, 2004). The three critical elements in assessing stakeholder influence are their power, legitimacy and urgency of issues (Mitchell et al., 1997).

Power has been defined as "the ability to exercise ones will over others" (Schaefer, 2002). Legitimacy relates to socially accepted and expected structures that help define whose concerns or claims really count and urgency captures the dynamics of the time-sensitive nature of stakeholder interactions (Mitchell et al., 1997). Power and legitimacy may be independent but

the urgency component sets the stage for dynamic interaction that focuses on addressing and resolving ethical issues.

*Shared ethical values and norms.* Major stakeholders may have different needs and a fine-grained approach may be needed to ascertain even differences within major stakeholder groups, such as customers, employees, suppliers, and investors (Harrison and Freeman, 1999). On the other hand, usually, a certain number of individual stakeholders share similar ethical values and norms (Maignan and Ferrell, 2004). Some of them choose to join formal communities dedicated to better defining, and to advocating, these ethical values and norms.

*Stakeholder issues in business.* Stakeholder ethical values and norms apply to a variety of business issues such as sales practices, consumer rights, environmental protection, product safety, and proper information disclosure (Maignan and Ferrell, 2004). Noticeably, stakeholder values and norms concern both issues that do and do not affect stakeholders' own welfare. For example, consumers may worry not only about product safety, but also about child labor, an issue that does not impact them directly. Stakeholder issues are the concerns that stakeholders embrace about organizational activities and the residual impact.

*Stakeholder pressures.* As illustrated in Figure 1, various stakeholder communities are likely to exercise pressures on the organization and on each other in order to push forward their own ethical values and norms. Figure 1 further illustrates that, in spite of disparities across communities, stakeholders conform to broad and abstract norms that define acceptable behavior in society. Noticeably, each business has its own values and norms depicting desirable behaviors based on its corporate culture and operations. These organizational values and norms overlap with those of some stakeholder groups, and especially with those of primary stakeholders since they are in the best position to exercise an influence on the organization.

## **A Framework for Understanding Organizational Ethical Decision Making<sup>2</sup>**

In understanding marketing ethics it is necessary to understand how people make ethical decisions. Within the context of an organization, there is an ethical component to business decisions and this decision may be influenced by the organization, the specific situation, or pressure exerted by coworkers. Figure 2 illustrates a model of ethical decision making in an organizational environment. External stakeholder interests, concerns or dilemmas help trigger ethical issue intensity. Organizational culture (internal stakeholders) and individual moral philosophies and values influence the recognition of ethical issues and business ethics decisions. The decisions or outcomes are evaluated by both internal and external stakeholders. While it is impossible to describe precisely how or why an individual or a work group may make a specific decision, we can generalize about average or typical behavior patterns within organizations.

First, as previously discussed, organizations can identify the importance of stakeholders and stakeholder issues, and gather information to respond to significant individuals, groups, and communities. Next, in the decision-making process, managers should identify the importance or relevance of a perceived issue— i.e., the intensity of the issue (Jones, 1991). The intensity of a particular issue is likely to vary over time and among individuals and is influenced by the organizational culture, values and norms; the special characteristics of the situation; and the personal pressures weighing on the decision. Personal moral development and philosophy, organizational culture, and coworkers, determine why different people perceive issues with varying intensity (Robin, Reidenbach, and Forrest, 1996).

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<sup>2</sup> Adapted from O.C. Ferrell, Nature, Scope and History of Marketing Ethics in Marketing and Public Policy. Marketing and Society, (forthcoming), Thomson South-Western, OH, William Wilkie, Greg Gundlach and Lauren Block (Eds.).

Perhaps one of the greatest challenges facing the study of business ethics involves the role of individuals and their values. Although most of us would like to place the primary responsibility for decisions with individuals, years of research point to the primacy of organizational factors in determining ethical decisions at work (Ferrell, 2005). However, individual factors are obviously important in the evaluation and resolution of ethical issues, and familiarity with theoretical frameworks from the field of moral philosophy is helpful in determining ethical decision making in business (Murphy et. al, 2005). Two significant factors in organizational ethics are an individual's personal moral philosophy and stage of moral development. Through socialization, individuals develop their own ethical pattern of behavior, including judgments about right or wrong actions. This socialization occurs from family, friends, formal education, religion, and other philosophical frameworks that an individual may embrace.

Although individuals must make ethical choices, it is also true that they often make these decisions in committees, group meetings, and through discussion with colleagues. Ethical decisions in the workplace are guided by the organization's culture and the influence of others, such as coworkers, superiors, subordinates. In fact, more ethical misconduct is done to benefit organizational performance rather than to satisfy personal greed.

The ethical climate of an organization is a significant element of organizational culture. Whereas a firm's overall culture establishes ideals that guide a wide range of behaviors for members of the organization, its ethical climate focuses specifically on issues of right and wrong. The ethical climate is the organization's character or conscience. Codes of conduct and ethics policies, top management's actions on ethical issues, the values and moral development and philosophies of coworkers, and the opportunity for misconduct all contribute to an organization's

ethical climate. In fact, the ethical climate actually determines whether or not certain dilemmas are perceived as having an ethical intensity level that requires a decision.

Organizations can manage their culture and ethical climate by trying to hire employees whose values match their own. Some firms even measure potential employees' values during the hiring process and strive to choose individuals who "fit" within the ethical climate rather than those whose beliefs and values differ significantly. A poor "fit" can have very expensive ramifications for both organizations and employees. Beyond the potential for misconduct, a poor employee-organization ethical fit usually results in low job satisfactions, decreased performance, and higher turnover (Sims and Kroeck, 1994).

Together, organizational culture and the influence of coworkers may foster conditions that limit or permit misconduct. When these conditions provide rewards, such as financial gain, recognition, promotion, or simply the good feeling from a job well done – the opportunity for unethical conduct may be encouraged, or discouraged, based on ethical climate. For example, a company policy that does not provide for punishment of employees who violate a rule (e.g., not to accept large gifts from client) provides an opportunity for unethical behavior. Essentially, this lack of policy allows individuals to engage in such behavior without fear of consequences. Thus, organizational policies, processes, and other factors may contribute to the opportunity to act unethically.

Opportunity usually relates to employees' immediate job context – where they work, with whom they work, and the nature of the work. The specific work situation includes the motivational "carrots and sticks" that superiors can use to influence employee behavior. Pay raises, bonuses, and public recognition are carrots, or positive reinforcement, whereas reprimands, pay penalties, demotions, and even firings act as sticks, the negative reinforcement.

For example, a salesperson that is publicly recognized and given a large bonus for making a valuable sale that he obtained through unethical tactics will probably be motivated to use unethical sales tactics in the future, even if such behavior goes against his personal value system. Research has shown that there is a general tendency to discipline top sales performers more leniently than poor sales performers for engaging in identical forms of unethical selling behavior (Bellizzi and Hasty, 2003). Neither a company policy stating that the behavior in question was unacceptable nor a repeated pattern of unethical behavior offset the general tendency to favor the top sales performers. A superior sales record appears to induce more lenient forms of discipline despite managerial actions that are specifically instituted to produce more equal forms of discipline. Based on their research, Bellizzi and Hasty concluded that an opportunity exists for top sales performers to be more unethical than poor sales performers.

This framework helps marketers put ethical decision making in organizational context and see how the process fits together. Once one begins to understand that good ethics is linked to organizational performance they see why it is necessary to have organizational ethics and compliance programs. Also, marketers begin to see the personal costs including reputation damage from misconduct.

### **Learning From Ethical Misconduct Disasters: Enron and Daewoo**

#### ***Enron***

The Enron disaster and trial provides an excellent case to examine organizational ethical decision making. It underscores how complex ethical decisions are in a large corporation. On May 25<sup>th</sup> 2006 a Houston jury found Enron CEO's Ken Lay and Jeff Skilling guilty on all counts of conspiring to hide the company's financial condition in 2000 and 2001. During the case the judge dealt a blow to the two defendants (Lay and Skilling) when he told the jury that they could

find the defendants guilty of consciously avoiding knowing about wrongdoing at the company. Many former Enron employees refused to testify because they were not guaranteed that their testimony would not be used against them at future trials convicting them. Many questions about the accounting fraud remained after the trial. The verdict was a total victory for federal prosecutors who had spent four years building a criminal case against the two men who had played a key role in building Enron as a role model for the energy industry. Sean M. Berkowitz director of the Justice Department's Enron Task Force said "You can't lie to shareholders, you can't put yourself in front of your employees' interests, and no matter how rich and powerful you are you have to play by the rules." The verdict was a blow to Lay and Skilling who testified that 'Enron was a fundamentally sound company brought low in a market panic spurred by short sellers and negative media reports.' On the other hand, the government maintained that Enron used deceptive accounting and bogus claims of the growth potential of new business units.

The jury found Lay, 64, guilty of six counts of conspiracy and fraud, Skilling, 52, was convicted on 18 counts of conspiracy and securities fraud but acquitted on nine out of 10 counts of illegal insider trading. On the way out of the courtroom Lay said he was "shocked" by the verdict. "I firmly believe I am innocent of the charges against me as I've said from day one." Then juror Wendy Vaughan said "I felt it was their duty to know what was going on." Outside the courthouse prosecutors said the trial should send a message to executives who manipulate their companies' earnings.

While many people can't work up much sympathy for Mr. Skilling and Mr. Lay because so many people lost a lot of money, there is an alternative viewpoint. A number of law professors and lawyers have concerns about the Enron Task Force's prosecution of Ken Lay and Jeff Skilling, accusing the government of "criminalizing corporate agency costs." In other words

the government is accused of misusing criminal laws to punish questionable business transactions and bad management decisions. In a civilized society do we lock up people for the rest of their lives because they may have made some bad business decisions? Is it unethical or illegal to make business decisions that damage others regardless of intent? There is no doubt that this was a very complex case and even the most hard core antibusiness types are queasy with the conclusion of this tragedy. There was not conclusive evidence that there was intent to defraud investors, although investor losses were massive. The important question is whether there was complacency at all managerial levels about rule bending among some employees or whether there was massive corruption at all levels? One of the key prosecution elements was complacent negligence that Skilling and Lay just turned a blind eye. Was this part of the Enron corporate culture?

The truth of the matter is that the jury would have had to understand the entire corporate culture as well as many systemic embedded business decisions at Enron to know for sure that Lay and Skilling were guilty of their charges. Bad business decisions were made but there is uncertainty as to the true involvement and intent of many of the CEO's decisions. Society and the courts tend to simplify events and blame all that goes wrong on just a few individuals. At this stage of understanding there are few people that understand how an organizational culture can evolve with complacency and constant reinforcement from coworkers driving bad decisions. In our society we are taught that the opinion of trusted professionals such as accountants and lawyers can be followed in business decisions. In this case the accounting firm Arthur Andersen, internal and external attorneys, as well as the board of directors approved the key decisions at Enron.

Mr. Lay said he never intended to harm any one, in fact, he came back as CEO after Jeff Skilling stepped down and at the insistence of the Enron board of directors to provide leadership and attempt to save the company. A decision now, that he and his wife both regret. As CEO, Lay was responsible for 30,000 employees operating in 30 countries. He managed an exceptional group of employees, as eluded to in the film *Enron: The Smartest Men in the Room*. Great leaders are often given accolades for their accomplishments and Lay was no exception in the 'hey day' of Enron. But most will acknowledge that the heart of their success, or in this case, ultimate failure, is the people they surround themselves with and place in positions of authority. The people that Lay trusted, such as Andy Fastow (convicted former CFO), were key operatives in the day-to-day decision making at Enron. It was a complex maze of events that caused the failure of Enron. (Ferrell 2006)

### ***Daewoo***

Kim Woo Choong, founder of the defunct Daewoo Group, was convicted of fraud and embezzlement, sentenced to 10 years in prison and ordered to forfeit more than \$22 billion, after his leadership role in the biggest business failure in South Korean history. The trial was watched closely in South Korea and the world and was considered by many as a test of whether the justice system extended to the leaders of a major business, just as many people globally viewed the trial of Enron Corp.'s former leaders, which ended with convictions of Lay and Skilling.

Mr. Kim, 69 years old, started Daewoo as a small textile-trading firm in 1967, building it into a conglomerate of more than 30 companies by the 1990s, with products as diverse as cars, ships and televisions. But his zeal for growth, fueled by debt-funded acquisitions, helped drive the group into bankruptcy in 1999, two years after the Asian financial crisis exposed Daewoo's weaknesses. In many ways Mr. Kim was convicted for a business disaster that damaged other

stakeholders. Could it have been prevented through ethical leadership and corporate culture that focused on global ethical and legal risks?

South Korean banks and the government incurred billions of dollars in losses in the collapse. Mr. Kim fled the country soon after the collapse, staying mainly in France. During his exile, workers in former Daewoo factories pasted up "Wanted" posters depicting Mr. Kim. When he returned to the country from Vietnam, he emerged from the airport to a crowd of protesters and a bank of bright lights and TV cameras.

Mr. Kim's defense lawyers argued that one person alone didn't cause Daewoo to collapse and cited a variety of other reasons, including the cash crunch it wound up in by investing in overseas currencies as a hedge against the then-falling won. Similar to Enron, a culture of pushing the envelope and a great deal of complacency on the part of employees and stakeholders created the disaster. Taking risks in a corporate culture that pushed complex financial matters to the edge created the environment which caused Daewoo to collapse. Both the Daewoo Group and Enron required more than one person to damage the company. It required a corporate culture of cooperation and complacency involving many employees and many failures by multiple stakeholders.

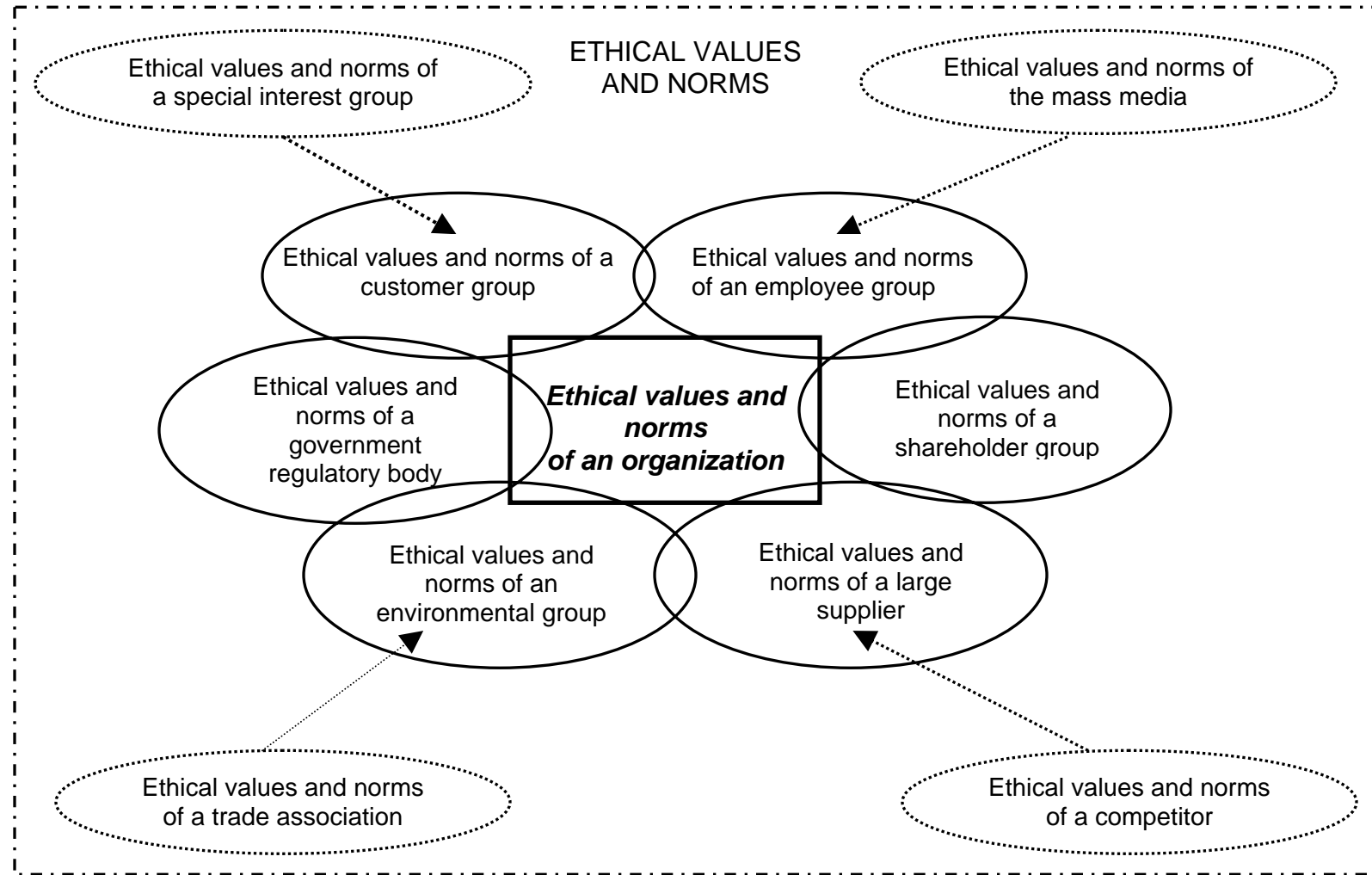
## **Conclusion**

Using a stakeholder and an organizational decision making framework helps to link societal, organizational, and individual interests. The use of critical thinking is an important part of ethical decision making especially in ambiguous areas. While the development of personal character is important, it must be linked to competence in understanding risks and approaches to

managing ethics and compliance in a complex organizational context. The national culture and regulatory system is also an important area that can affect ethical decision making.

Business ethics in organizations requires values-based leadership from top management, purposeful actions that include planning and implementation of standards of appropriate conduct, as well as openness and continuous effort to improve the organization's ethical performance. Although personal values are important in ethical decision making, they are just one of the components that guide the decisions, actions, and policies of organizations. The burden of ethical behavior relates to the organization's values and traditions, not just to the individuals who make the decisions and carry them out. A firm's ability to plan and implement ethical business standards depends in part on structuring resources and activities to achieve ethical objectives in an effective and efficient manner. Enron and Daewoo provide excellent examples of highly visible firms who have failed to provide the ethical leadership necessary to avoid misconduct that has damaged their reputation, and created ethical disasters that have damaged many stakeholders.

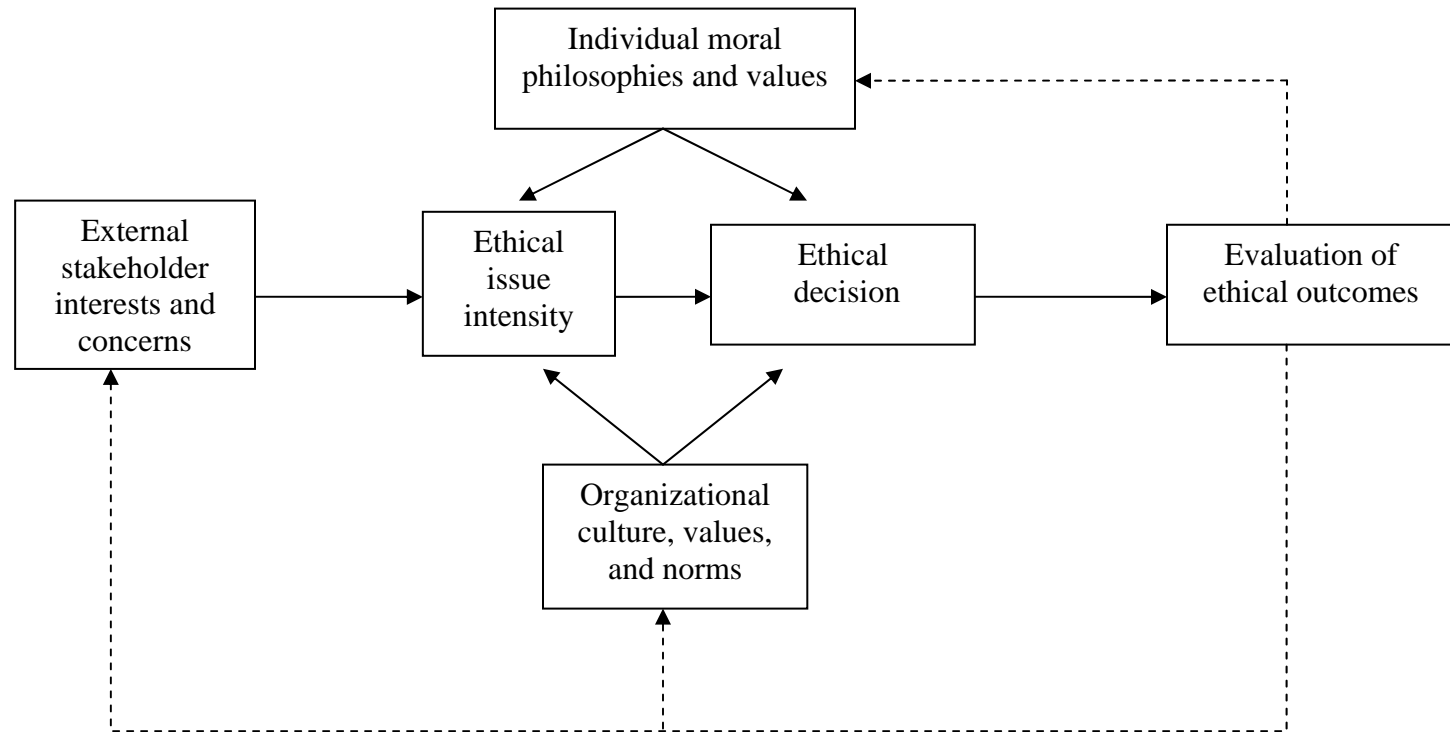
**FIGURE 1: Interactions Between Organizational and Stakeholder Ethical Values and Norms**



— Primary stakeholders;    ..... Secondary stakeholders;    - - - Society at large

*Adapted from Isabelle Maignan, OC Ferrell, and Linda Ferrell, "A Stakeholder Model for Implementing Social Responsibility," European Journal of Marketing, Vol, 39, #9.10, pp. 956-977.*

**FIGURE 2. Framework for Understanding Organizational Ethical Decision Making**



Source: O.C. Ferrell, 2005 ©

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