THE ETHICS CENTRE

TRUST, LEGITIMACY & THE ETHICAL FOUNDATIONS OF THE MARKET ECONOMY

About This Paper

At The Ethics Centre, we spend a lot of time talking to regulators, investors, business leaders and civil society. In recent years, the tone of our conversations has changed. These groups are feeling the sharp decline in trust of our major institutions, including corporations, and its threat not only to our prosperity but also to the character of our society.

The very purpose of corporations is being questioned. Business leaders are seeking to understand how to restore trust, while regulators are asking fundamental questions about what may have gone wrong. As we explore below, even the legal privileges enjoyed by corporations, their owners and investors are being reviewed.

In this paper, we examine a range of issues including the history of the corporation. We look back to the ideas of the late Eighteenth and early Nineteenth Centuries – and the idea that markets would increase the stock of common good and the privileges of incorporation and legal liability would help to realise this goal.

Most importantly, we argue that, for all its importance, the concept of 'trust' may be of less significance than that of 'legitimacy' – and apply that thinking to the role of corporations in the marketplace.

We have drawn from philosophical thinking to identify the minimum requirements for a corporation to maintain legitimacy and meaningfully contribute to a market that increases the stock of common good.

In doing so, we propose a core ethical framework (directly related to the purpose of markets and corporations) that is intended to underpin the legitimacy of these institutions:

- Respect people
- Do no harm
- Be responsible
- Be transparent and honest

We hope that this paper will serve to assist regulators, investors, business and civil society leaders in understanding the role legitimacy has to play in creating a secure marketplace.

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THE DECLINE OF TRUST

Across the world, there has been a precipitous decline in levels of public trust in institutions. In some cases, the decline has been gradual. In others, the fall has been sudden and shocking. Consequently, the issue of 'trust' – how it can be gained, maintained and lost – has been elevated to enjoy the status of *topic de jour* in the salons of the rich and powerful around the world. Trust is as important to corporate reputation as the quality of products and services[1].

The concept and phenomenon of trust has therefore become a subject for scholarly research, popular writing, endless surveys and consultants' briefs.

The 2018 *Edelman Trust Barometer*[2] found that 71 percent of countries are now "distrusters", up from just under half in 2017. The battleground in this year's report surrounds tha battle for truth, with 59 percent not sure what is true and what is not. The majority of markets (79 percent) now distrust the media.

At the same time, trust in business has increased for half of the markets assessed. A clear majority (64 percent) think CEO's should take the lead on change, rather than waiting for government to impose it. In this environment, only 15 percent of people believe the system is working.

Institutions, including business, have the opportunity to re-imagine their role and step outside of their traditional— and siloed—roles. It becomes a shared responsibility of government, business, NGOs, and media to address the needs (and ease the fears) of all stakeholders[3].

Source: 2018 Edelman Trust Barometer. Trust Volatility Measure. The net year-over-year (2017-2018) percentage point change across the four institutions (TRU_INS). General population, 28-market global total. For more details on how the Trust Volatility Measure was calculated, please refer to the Technical Appendix.

Rachel Botsman[4] argues that there are three overlapping reasons for the significant decline in trust:

- Inequality of accountability – some wrong-doers are punished while others face few consequences for their behaviour (e.g. few of the bank executives responsible for the GFC were ever publicly held to account for their calamitous, self-serving decisions. Instead the costs of that disaster were largely borne by society as a whole;
- Shift in the principal dimension of trust from experts and elite (vertical) to peers (horizontal). We trust sleeping in the home of a stranger based on the other side of the world to a degree greater than we trust, say, academics who have studied an issue for a lifetime;

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[1] Edelman *Trust Barometer* 2018
[2] Edelman *Trust Barometer* 2018
[3] Edelman *Trust Barometer* 2018
[4] Botsman, *Who Can you Trust*, 2017

- Technology is shifting the way information is mediated, creating echo chambers that reinforce (rather than challenge) a person's views and fears.

Trust is no longer simply a key factor in product purchase or selection of employment opportunity; it is now the chief factor influencing the functionality of society. This has significant implications for business.

Individuals and organisations will find it difficult (if not impossible) to operate effectively if they do not enjoy the trust and confidence of the community in which they are located. Consider the case of a mining company that has been issued all of the formal licences needed to operate in a particular area – but that is not acceptable to the local community. Such a company will struggle to succeed and if it does, then only at considerable additional cost that could otherwise have been avoided.

The 'informal' acceptance granted to an individual or organisation by a local community is called a 'social licence to operate'.

Typically, 'social licence to operate' requires the presence of three components - legitimacy, credibility and trust[5]. The argument of this paper is that the progressive loss of trust has now started to be eclipsed by a far more serious type of failure: the loss of legitimacy.

TRUST IS LEGITIMACY'S CHILD

While reduced levels of trust invariably cause considerable damage, the loss can be compensated for by an increase in the deadweight costs of increased transparency, oversight, etc. However, in our view, the loss of legitimacy cannot be compensated for – and will often be fatal.

By way of illustration of the broader concept, in this paper, we consider the legitimacy of two related institutions; namely, 'the market' and 'the corporation'.

But first, what is the difference between 'trust' and 'legitimacy'?

Legitimacy: is a recognized and well-founded right to claim a certain status, role or function.

Trust: is a belief that a person or institution will perform their role or function in accordance with its obligations or where not bound by duty, in a predictable manner - often in accordance with its interests.

The less formal distinction is as follows: where low trust can be compensated for by a higher degree of 'checks and balances' (deadweight costs), a loss of legitimacy cannot be compensated for at any cost.

We see this asymmetry often on display. A low cost/high trust environment would be one in which an agreement can be sealed with a handshake. If the agreement is broken and trust eroded, then dealings can still proceed. However, the low trust/high cost environment will see the imposition of compensating 'burdens' like formal contracts, enforcement provisions, etc. The key thing is that a low trust relationship is still a relationship. As such one can maintain legitimacy even when trust is low.

On the other hand, when legitimacy is lost then no amount of cost can offset the resulting deficit. This is currently being played out at Bell Pottinger, the UK PR Agency, following allegations that it sought to exploit racial tension in South Africa. The CEO and several executives have resigned, and the firm has been stripped of its membership to the Public Relations and Communications Association. As a result, all compensating factors of trust have been eliminated and legitimacy destroyed. Countless shareholders have withdrawn (even with no equity in return) and clients have distanced themselves from the company.

[5] See: https://socialicense.com/definition.html

Similarly, whole communities across Australia have rejected the mining of coal seam gas. This loss of social licence is so high in these regions, that one could argue that there has been a complete loss of legitimacy. This is evident in the fact that many states have now banned the practice.

THE COSTS OF LOSING LEGITIMACY

Legitimacy comes to the fore during periods of profound change – especially when organisations and institutions are perceived to be failing in their capacity to respond to the needs of their stakeholders and the wider society in which they are set. Such is the case with the institutions of the market and the corporation. The threat to their legitimacy does not arise solely as a response to events like the Global Financial Crisis (and the relative feeble response of governments and regulators when it came to holding accountable those who perpetrated the disaster).

A growing number of people are fearful that the fruits of science and technology, as well as globalisation, may be about to displace them from their jobs (through the employment of robots and expert systems). They sense profound social changes are just around the corner – driven by changing demographics, new patterns of engagement and the like. Instead of feeling optimistic about the transformative power of science and technology, people are inclined to anticipate a dystopian future. As such, innovations that could prove to be a massive boon to humanity risk being blocked – along with those that should be better set aside. This indiscriminate opposition risks being at the cost of all.

If this was not bad enough, people fear that those nominally 'in charge' couldn't care less about the interests of the community as a whole; that the majority has become invisible to those with economic and political power. Thus, the revolt at the ballot box – a lashing out at a system that has broken faith with the people it was meant to serve. Thus, the increase in the number of people who reject 'free trade', embrace nationalism and believe that corporations take more than they give.

Populism and the rise of the anti-establishment, anti-politicians are responses to a crisis in the legitimacy of institutions that are no longer thought to serve the common good. In response, governments are beginning to 'think the unthinkable' – to contemplate changes to the essential fabric of institutions that, today, most people take for granted.

For example, in 2016, the UK Government's Green Paper on Corporate Governance specifically raised the question of limited liability as a privilege that risks being abused. In response to the Green Paper, the influential Institute for Business Ethics (IBE) submitted that: "We agree that reform should bring unlisted companies into the net. In this context *we are struck by the reference to the "privilege" of limited liability. It occurs to us that limited liability should not be an inalienable right but one which is earned by recognition of responsibility.* In cases of really egregious behaviour it should be possible to remove this right."

So, the nation that brought the world the legal privilege of limited liability (a cornerstone of corporate architecture the world over) is now actively debating whether or not that privilege should be abridged or rescinded in cases of serious corporate wrongdoing. How has it come to this?

THE ETHICAL FOUNDATIONS OF THE MARKET

From the time of Scottish Moral Philosopher, Adam Smith onwards it has been understood that markets, for the free exchange of goods and services, have no intrinsic value. They are merely tools designed to increase the stock of common good.

So, the ‘ideal’ market can be imagined as follows: two people meet at the crossing point of a stream. One person has wool. The other has wheat. The former is hungry. The latter is cold. They openly exchange wheat for wool – and then go on their separate ways; the condition of each improved by the other. As Adam Smith makes clear, in *The Wealth of Nations*, neither person need be motivated by benevolence. All that is needed is the operation of the ‘invisible hand’ to ensure that the self-interest of each is converted into the good of the other.

However, here it must be noted that, for Smith, the legitimacy of the market as an ideal (and as an actual institution) rests entirely on its ability to deliver what the ‘invisible hand’ promises to do. That is, the market is only legitimate if it makes everyone better off than they would otherwise be if the market did not exist. That is an objective test – and one that markets can (and sometimes do) fail.

As noted above, Smith believed that markets will be most likely to meet pass their test of legitimacy if they are free. As Professor of Moral Philosophy at the University of Glasgow[6], Smith argued that the market could only be free if it rests on a secure ethical foundation that denies legitimacy to those who lie, cheat or use power oppressively (all sources of ‘distortions’ in otherwise free markets).

[6] Before writing *The Wealth of Nations*, Adam Smith had published *The Theory of Moral Sentiments* in which the concept of ‘the invisible hand’ first appears. Smith believed that while people might be motivated to trade as a matter of self-interest, *how* they traded should be informed by an ethical framework at the core of which he proposed the principles of ‘sympathy’ and ‘reciprocity’ (the latter being an expression of the Golden Rule to ‘do unto others as you would have them do unto you’.

THE ETHICAL FOUNDATION OF THE CORPORATION

Although corporations existed in the Ancient world, their modern form was only established in the mid-Nineteenth Century. Prior to then, corporations had been formed either by the express permission of the British Crown or Parliament. Indeed, for the 100 years prior to 1825, the formation of a joint-stock company had been illegal – and an indictable offence.

However, inspired by the arguments of Adam Smith, and by the political temper of the times (and after more than 50 years of contentious debate), the British House of Commons eventually decided to enact separately (and then in one, consolidated, Act) legislation that:

a. allowed a corporation to be formed by the simple act of registration, and
b. accorded to investors the extraordinary legal privilege of limited liability.

The first of these innovations allowed for the creation of a legal (non-natural) individual person. Potentially 'immortal', this person had an identity distinct from any other person – including stock holders, directors, employees, etc. Indeed, corporations are the owners of their assets (not their shareholders), enter into contracts, etc. entirely on their own account. All corporations have an obligation to maintain their essential viability – thus the need for commercial corporations to secure capital, attract employees, build essential relationships and do the other things necessary to be sustainably profitable.

The second of these innovations created a remarkable legal privilege in which stock-holders might enjoy unlimited 'upside' in terms of capital gains and dividends but be liable for no more than the unpaid capital associated with the percentage of issued stock for which they had subscribed. If a person had subscribed just one pound of capital, then that would be the extent of their liability – irrespective of what harm might have been done by the company. In return for this privilege, stock-holders would not exercise direct control over the corporation – leaving that to its directors whom they might elect from time to time.

As noted above, these decisions were highly controversial – and were only made after overcoming the objections of many who felt that the severance of bonds of personal responsibility would increase the risk of harm to individuals and society. Indeed, in 1844, a Report of a Select Committee enquiring into the provisions of the *Joint-Stock Companies Bill* (enacted later that year) had used headings such as "Form and Destination of the Plunder", "Circumstances of the Victims" and "impunity of the Offenders".

The contrary argument was that the combination of easy incorporation and limited liability would ultimately increase the stock of common good – both of a particular and more general kind.

The 'particular' good to be achieved concerned the relative ease of suing a corporation (as a distinct legal person) as opposed to having to sue each of the separate members of earlier 'commercial collectives'. The general good was that increased economic activity (based on diminished personal risk) and an expression of personal liberty (to form associations) would be good for society as a whole. Indeed, this had been Adam Smith's animating belief. For him, the 'market' was merely a means to an end. Of no intrinsic value, a truly free market, he believed, would improve the conditions of all.

Indeed, in arguing the case for easy incorporation and limited liability, one of the greatest champions of reform, Robert Lowe MP (and Vice-President of the Board of Trade), made the explicit point (during the 1856 consolidation debate) when asking:

> Who could have imagined it possible that a state of society resting on the most unlimited and unfettered liberty of action, where everything may be supposed to be subject to free will and arbitrary discretion—would tend more to the prosperity and happiness of man than the most matured decrees of senates and of States? These are the wonders of the

> science of political economy, and we should do well to profit by the lesson which that science has taught.

So, from the beginning, the purpose of the corporation *per se* was to advance the “prosperity and happiness of man”. As a creation of society, the corporation was never intended to provide an exclusive (or even dominant) benefit to shareholders. That is, a limited focus on increasing shareholder wealth is not a purpose of the corporation.

Although Statute and Common Law has evolved since the 1850s, the general purpose of the corporation has not changed.

As noted above, whether or not the privilege of limited liability should be maintained in all circumstances is now becoming a genuinely open question. The proposal that the State pierce the ‘corporate veil’ and wind back (if not eliminate) the privilege of limited liability is not entirely novel. Related suggestions have been made in the past. For example, Professor John Braithwaite, of the Australian National University, has argued for what he has called the ‘capital punishment’ of corporations in which, if found to be guilty of some crimes, they would effectively be ‘confiscated’ by the State – to owners’ and investors’ ultimate detriment. In an interview with *Corporate Crime Reporter*[7] in 2014, Professor Braithwaite said:

> “The main hope is in the ethical cultures of corporations,” Braithwaite said. “The criminal law has a big role to play in constituting that ethical culture.”
>
> “But the idea of the regulatory pyramid is that you want most compliance with the law to be driven by internal compliance systems. But internal compliance systems won’t work if there are no consequences for not taking internal compliance systems and corporate ethical cultures seriously.”
>
> “You need that escalation up the pyramid. The deterrence penalties become greater and greater as you move up the pyramid. And at the tip of the pyramid, you have corporate capital punishment. You take the organisation over and have the government run it, or there is a forced sale of the corporation to an ethical management team.”
>
> “I’m a great believer in not only criminal punishment, but corporate capital punishment as well.”

[7] See: http://www.corporatecrimereporter.com/news/200/john-braithwaite-on-corporate-crime-in-the-pharmaceutical-industry/

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The difference today is that such proposals resonate with a much wider body of public opinion. The reason for this is that, in political conditions of mounting populism, democratic governments are being pushed to adopt increasingly severe measures to allay the concerns of a general public that feels that ‘the system’ and its ‘elites’ have failed to meet their obligations and ‘increase the stock of common good’. Indeed, a certain brand of populism claims that the whole system has enriched the few at the expense of the many. Thus, the political inclination to elect outsiders who will purge the system.

Given the underlying purpose of markets and the contingent (and fragile) nature of the legal structure on which corporations (and therefore markets) ultimately depend, it is essential that businesses operate within the ethical boundaries set by society. For the most part, the ethical environment for business is sufficiently flexible to allow room for mistakes to be made and corrected. For example, when corporations stray just outside the boundaries of acceptable conduct, they usually suffer a loss of trust or confidence. In turn, this will typically lead to an increase in the ‘deadweight’ costs that they are required to bear – either through the imposition of new regulatory burdens, or as a general increase in transaction costs imposed by those who are wary of doing business with such an entity.

However, there are times (admittedly rare) when the transgressions are so serious to cause a complete loss of legitimacy – in which case the business is destroyed.

FUNDAMENTAL VALUES AND PRINCIPLES

As noted above, Adam Smith assumed that the free market would be built on a solid ethical foundation that would protect it from distortion. Likewise, we have seen how the privileges of incorporation and limited liability were justified by a broad appeal to the common good. If those privileges are to be preserved, then it may be time to establish a new, core ethical foundation for the market and corporations.

We consider, below, a **minimum 'threshold'** of fundamental values and principles that, if adopted, should minimise not only the risk of corporate failure but also the potential for unlimited personal liability if an enraged society decides to pierce the corporate veil.

1.1 Respect people

The Respect for Persons principle states that every person has intrinsic value – irrespective of their age, gender, culture, sexual orientation, etc. As such, a person may never be used merely as a means to an end. That is, a 'person' cannot be treated as nothing more than a commodity (or tool) for employed for the sake of some other purpose. It is this principle that forbids institutions like slavery or lesser forms of wrong such as forced labour, servitude, etc. It is this principle that supports the practice of stakeholder engagement – on the basis that those who contribute to the prosperity of a corporation ought to be heard when their interests are affected.

Threshold Indicators (indicative only)

- What is the quality and character of a corporation's engagement with stakeholders?
- Does the company provide goods or services that are used to undermine fundamental human rights?
- Does any part of the company or its supply chain make use of slave or forced labour; deny employees the right to free assembly; pay wages below subsistence levels; or expose employees to potentially lethal, unmediated health and safety risks?
- Does the company support its people to flourish, by offering leave entitlements and flexible work arrangements; or addressing issues of potential bias and enabling diversity?
- Does the company provide material support to governments or regimes that employ torture; impose cruel and unusual punishments; or undermine fundamental human rights?

1.2 Do no harm

The principle of non-maleficence requires that the goods and services produced by a corporation should objectively confer some net benefit to those who purchase and use them. As a bare minimum, the goods or services must be able to be used (at least to some degree) without harm[8]. The principle of non-maleficence also requires that those who profit from engaging in harmful activity disclose the nature of the risk that their conduct gives rise to – allowing those risks to be assessed and managed by those whose interests are affected[9].

[8] One of the most powerful arguments against the manufacture and marketing of cigarettes is that they cannot be used – to any degree- without causing harm to the user.
[9] This aspect of the principle lays behind the requirement that corporations report on the discharge of pollutants, like Green House Gases (GHG).

Threshold Indicators (indicative only)

- Specify products or processes that are reasonably believed to be harmful to human health and welfare; or the environment or its natural services?
- Is the company a pro-active steward of the environment?
- Does the company derive profits from activities that impose a negative burden on third parties? Specifically, GHG emissions, water services, waste sent to landfill (or otherwise not recycled)
- Are there commercial opportunities that the company might seek to exploit in managing its own risks – or the risks of others within its sphere of influence?
- Does the company proactively seek out solutions where there is harm in society (caused by another party)?
- Does the company engage in partnerships with others to resolve / alleviate harm cause by self or others?

1.3 Be responsible

This principle states that benefits should be proportional to responsibility. That is, those who derive the ultimate benefit should have the ultimate responsibility for the conduct that produced the benefit. Accordingly, one should look beyond artificial boundaries (such as the legal structures of corporations) to take into account the 'natural' value-chain. The application of this principle has a number of implications; for example, in relation to how supply chains are viewed and in relation to matters like corporate tax (and its avoidance and evasion). The principle of proportionality also requires that the corporation not act unconscionably – by which it abuses asymmetries in power and information to the detriment of weaker third parties. Given that the balance between costs and benefits can vary considerably over time, the temporal dimension of proportionality needs to be taken into account in the short, medium and long term.

Threshold Indicators (indicative only)

- Has the company 'mapped' the sustainability impacts of its value chain of its goods or services?
- Has the company been penalized for unconscionable conduct; collusion (anti-trust) conduct; or tax evasion or illicit transfer pricing?
- What (if any) is the extent of any potential liabilities for environmental damage (across the value/supply chain)?
- What commercial opportunities does the company see arising from the mitigation or response to any social or environmental challenge emerging in its sphere of influence?
- Does the company identify and address any areas of power asymmetry with stakeholders?
- Has the company addressed the true value of its environmental and social externalities?

1.4 Be transparent and honest

The values of transparency and honesty are fundamental to the operation of free markets – in which stakeholders (notably owners, investors, customers, employees and suppliers) are able to make fully informed decisions about the extent (if any) of their involvement with the corporation. The value of transparency requires corporations to make clear that basis on which decisions are to be made. As such, they need to disclose details of the ethical frameworks that they employ when deciding whether or not a decision is 'good' or 'right'. In the absence of that information, no stakeholder can reasonably predict or assess a corporation's decisions. Allied to this value is that of honesty – in that the information disclosed must be true, relevant and complete – thus ensuring that a person depending on that information is not misled.

Threshold Indicators (indicative only)

- The company should provide:
  - a copy of the ethical framework that underpins its decision-making process.
  - evidence that the ethical framework is relevant to and suitable for the type of business and its operating environment.
  - evidence that it relies on to be assured that its ethical framework is being applied in practice (note: compliance programs will not satisfy this criteria).
  - evidence of the extent and quality of assurance processes used in the preparation of information relevant to stakeholders
- Has the company (or anyone in its value/supply chain) been convicted of any offence for dishonesty (theft, fraud, etc.)?
- What measures is the company taking to build or reinforce trust and legitimacy?

ENABLING LEGITIMACY IN CORPORATIONS

Good corporate governance goes well beyond mere compliance – a necessary but not sufficient requirement. Company performance is directly linked to corporate governance and culture. It is self-evident that the conduct of corporations is a product of the decisions and actions of natural persons (directors and employees). In a well-regulated corporation, employees (from the CEO 'down') should make decisions and engage in conduct that the corporation would endorse as being legitimate.

But, how do employees know what counts as a good decision within the context of the corporation? After all, the employee has a limited right to answer such a question according to their own, idiosyncratic, ethical world view. Rather, as agents of the company, they are bound to evaluate their choices according to the companies own definition of what is 'good' (values) and 'right' (principles) – with the content of that framework being aligned to the particular purpose of the corporation.

> "Leaders die, products become obsolete, markets change, new technologies emerge, and management fads come and go, but core ideology in a great company endures as a source of guidance and inspiration."
>
> Collins & Porras *Built to Last*

One method for achieving consistent business conduct is to build rules and regulations that bind and shape individual decision makers acting for the organisation. These 'side constraints' depend upon compliance (willing or otherwise) and limit or remove the capacity of individuals and groups to exercise judgement when making decisions. In their most extreme form, 'side constraints' might be designed with the intention of defining and constraining all decision making.

An alternative (and complementary) approach to governance is to establish an ethical framework that guides (rather than directs) decision makers. In this approach, decision makers are required to exercise judgement, in accordance with reasons they are able to defend with reference to an ethical framework. This method is particularly effective within the volatile and uncertain conditions that business faces today.

The ethical framework consists of purpose, values and principles. Together these form the bedrock for all decisions, behaviours system and processes of organisations. An ethical framework sits at the heart of the governance structures of an organisation – serving as a common and authoritative point of reference for all decision makers. It enables the delegation of authority to a distributed network of responsible decision makers while maintaining organisational integrity.

Once established and formally adopted by an organisation's principal governance body, then all aspects of the organisation (current and prospective) should be assessed and if required, aligned with the tenets of the framework. If misalignment is to be allowed, then the exception must specifically be justified and approved.

In this way, an Ethical Framework is different from a code of ethics or a code of conduct, in that codes articulate decisions to be made in specific circumstances. An ethical framework however, provides guidance on any decision regardless of its unique circumstances.

The ethical foundation of a corporation is a driving force of corporate responsibility and legitimacy.

Directors' duties

The attainment of coherence and consistency in decision making is one of the principal tasks of those responsible for the governance of corporations. Failure to undertake and complete this task limits the capacity of a corporation to act with legitimacy.

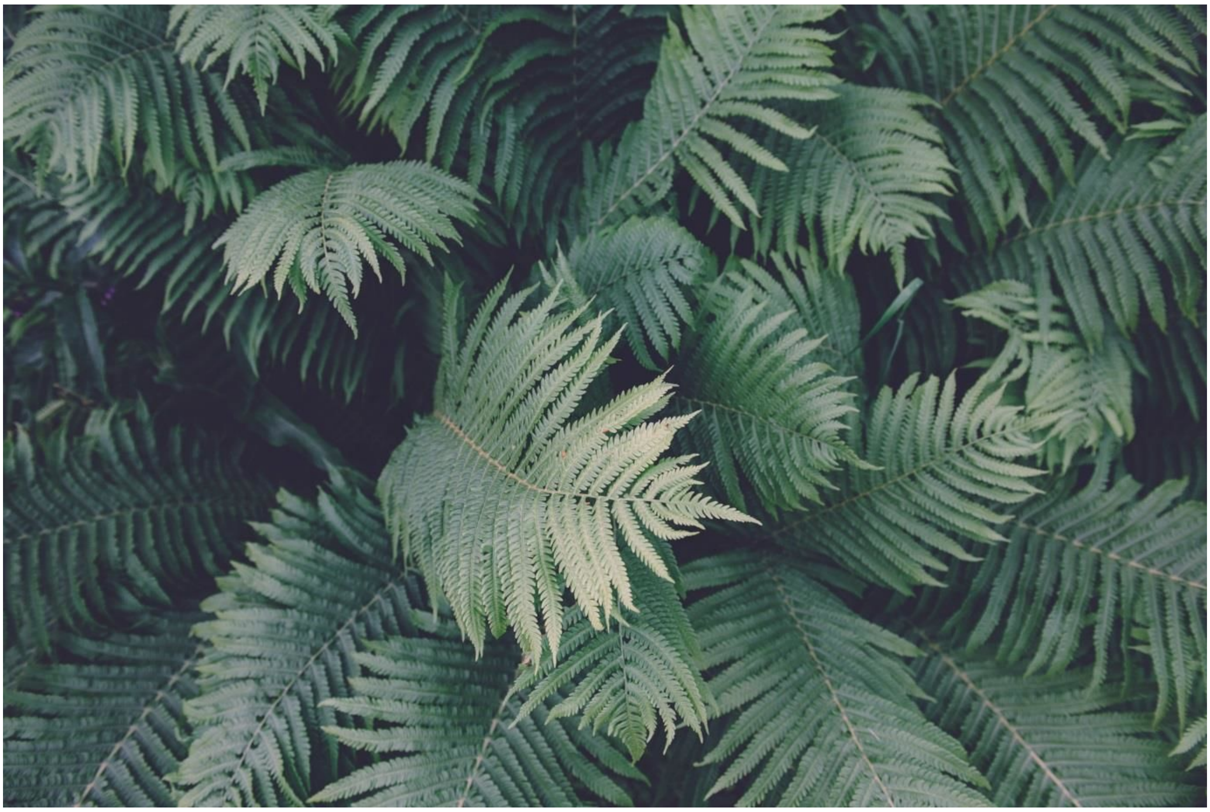
The ethical foundation a Board sets will ultimately be expressed in ways that set the culture of the organisation – including its self-referential and reinforcing artefacts (such as remuneration practices, policies, etc.).

A board might reasonably be expected to set the foundations and form a view about whether or not it is being lived.

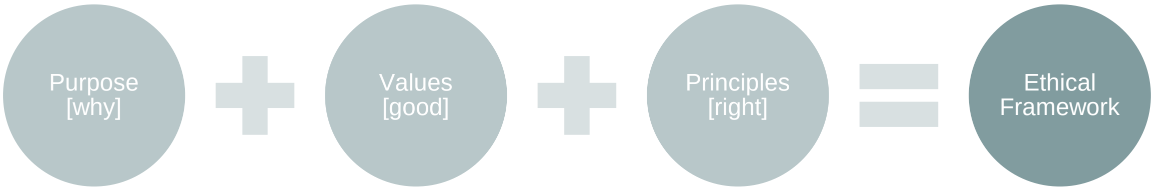
In particular, a prudent Board will need to ensure that the company is not setting policies, building systems or establishing practices that might reasonably be expected to drive conduct that is at odds with the declared ethical framework.

Thus, in well governed corporations have boards that:

+ Specify the quality and character of the culture that they seek to attain (typically done in terms of core Purpose, Values and Principles).
+ Measure the extent to which the actual culture aligns with the ideal (as defined by the Board).
+ Develop and implement measures to close any identified gaps between actual and ideal (as defined by the Board).



Ethical frameworks



In a world of accelerated disruption, changing customer and community expectations and employees seeking meaning in their work, a growing number of executives are looking to purpose to drive strategy and decision making[10].

The global *EY Purpose Survey*[11] found a widespread acceptance (90 percent) of the value of purpose in driving performance across key industry leaders. Despite this, only 46 percent of respondents said their company has a strong purpose while another 44 percent said their company is trying to develop one.

Harvard Business Review study found that 53 percent of executives surveyed whose organisations were strongly purpose led said that their business was successful in innovation and transformation; compared with 19 percent of those who had not yet considered purpose[12].

Organisations describe their purpose as a simple and concise statement to explain '**why'** they exist. This statement goes beyond self-interest and profit motives, to demonstrate its "core ideology".

A purpose statement is different from an organization's vision or mission.

- A purpose statement is a simple and concise statement to explain '**why'** they exist.
- A mission describes **what** an organization does. It's a focused and clear statement defining the business one is in.
- A vision on the other hand describes what one **wants to be**. It's inspirational and future oriented.

Values are an expression of what we think to be '**good'**[13]. They capture the essence of what one should choose if available. So, if one of a company's core values is trust, then that company (through its directors and employees) should choose those things that build, display and support trust.

Principles are an expression of what is '**right'**[14]. Their task is to shape the means by which one obtains the things that are good. Examples of principles include things like: 'do unto others as you would have them do unto you', 'only do those things you would be proud to do in the full light of day', 'treat every customer as if they are your friend', etc.

"Well-chosen values typically stand the test of time, but need to be tested for continuing relevance as society changes and business adapts". FRC 2016

Once the Ethical Framework has been established, it needs to be embedded throughout the business. That is, it needs to be embedded within the strategy and business models; it needs to be interpreted into policies and systems; and it needs to be translated into appropriate behaviours in order that employees be able to understand how the purpose, values and principles can be effectively lived in day to day decision making. Most importantly, it needs to be used every day, in big decisions, and in small ones.

[10] Harvard Business Review (2015) The Business Case for Purpose
[11] EY Purpose Survey
[12] Harvard Business Review (2015) The Business Case for Purpose
[13] The Ethics Centre, 2016: http://www.ethics.org.au/on-ethics/blog/october-2016/values-principles-are-your-organisations-dna
[14] The Ethics Centre 2016 http://www.ethics.org.au/on-ethics/blog/october-2016/values-principles-are-your-organisations-dna

CONCLUSION

Trust is ultimately the product of integrity – a consistent commitment to do what one says one will do, to be what one claims to be. Ethical conduct based on the practical application of publicly declared values and principles is therefore key to earning trust.

However, as we have argued, earning trust is not enough. Legitimacy must also be maintained – and this depends not only on competent performance. It also requires that the performance be directed at the attainment of a clear and legitimate purpose.

There is nothing improper about profiting from the attainment of a legitimate purpose. Nor are markets the only (or even the best) means for realising every purpose. Some purposes are best realised by non-market actors such as members of the professions, by government, etc.

Unfortunately, the institutions of the market and the corporation seem to have forgotten their underlying purpose – instead investing in an ideology that mutates Adam Smith's idea of 'self-interest' into 'selfishness' and that of the free market into a 'free for all'.

Those who have forgotten the purpose of the market and the corporation have helped to undermine their legitimacy – risking erosion of the foundations on which our economic system has been built.

As a result, the 'unthinkable' is now under active discussion.

Our response is to urge the restoration of the ethical foundations of the market and its principal actors; rebuilding that foundation in accordance with the values and principles outlined in Section 7 of this paper. On that foundation, legitimacy lies.

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