The Sloppiness of Business Ethics

Marianne M. Jennings
Arizona State University

1. Introduction

The magazine *Business Ethics* ranked Fannie Mae as the most ethical company in America in 2004. By 2005, Fannie Mae's chairman and CEO, Franklin Raines, would be forced out as government auditors tried to sort through what they found to be "an unethical and arrogant culture" that was manipulating earnings, to the tune of a $7 billion restatement.[1] Juniper Networks was also on the list in 2005, but by August 2006, the company issued a release explaining that its earnings back to the beginning of 2003 could not be relied upon and had to be restated because of problems with backdated stock options given to executives. The amount of the company's restatement was $900 million.[2] Hewlett-Packard finished seventh on the list in 2005, but then headed down a path of boardroom spying on its directors. These pretexting activities would cost the company a $14.5 million settlement as well as a good chunk of its executive team for their complicity in what appeared to be a strategy of "we'll fix them."[3] Southwest Airlines has been on the list for the eight years of the list's existence, but in 2008, Southwest paid a $10 million fine for its failure to conduct structural inspections on its planes.[4] Moody's has long been part of the Top 100, but found its CEO hanging his head before Congress as an email surfaced in which an employee wrote that the firm's ratings of mortgage-based securities demonstrated that "we are incompetent at credit analysis" or "we have sold our soul to the devil for

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[1] James R. Hagerty and Gregory Zuckerman, "Fannie Mae Accused of Rulebreaking," *Wall Street Journal*, April 7, 2005, p. A3.

[2] Juniper Networks Inc. 8-K, issued December 20, 2006, accessed online at: http://www.sec.gov.

[3] Jim Hopkins and Michelle Kessler, "HP Gets Out of Suit for $14.5 Million," *USA Today*, December 8, 2006, p. 1B.

[4] Andy Pasztor and Melanie Trottman, "New Safety Setback Grounds Southwest Planes," *Wall Street Journal*, March 13, 2008, p. B1.

Reason Papers 31 (Fall 2009): 109-24.

revenue."[5] Some ironies in the list speak for themselves: Wachovia and WaMu—if only they still existed in all their ethical glory; Merck, if only its major new drug, Vioxx, were still on the market. The examples, illustrations of incongruence between accolades for ethics and hitches in simple acts of compliance with the law, are too numerous to list. Were this any other field, there would be some humiliation in touting failed companies, in product, performance, or existence, as stellar examples of performance. Rankings ought to have some predictive qualities about future performance of the companies that have been ranked.

However, this field of business ethics, a relatively new one, has taken a turn toward ideology. That turn creates a disconnection between ethical evaluations of companies and their actual ethical standards and practices. The simplicity of the criteria used for ethics rankings and ratings attracts the dashboard artists. They can meet the simplistic criteria, and then some thereby win ethical stature and perhaps elude close examination. Bernie Madoff was generous to synagogues and universities; he and his wife were known for their generosity and involvement with charitable organizations. Few companies had a finer record on diversity or community involvement than Fannie Mae. Perhaps the spit and polish with which they shone in some areas deflected attention from their financial statements and operations. Perhaps the perception of their goodness created a fog of ethical righteousness that afforded them a pass on scrutiny for the inexplicable on the financial side.

Without an appropriate level of scrutiny, company practices that harm shareholders and stakeholders continue undetected even as the extent of the harm evolves into practices that can damage markets and economies. For example, most of the Silicon Valley companies have had some form of a dust-up with stock options. Internal and external investigations, restatements, loss of shareholder value, and significant income and tax implications for the employees of these companies have been the effects of this widespread practice. Yet, a side-by-side comparison of the stock-option companies with the "most ethical" lists shows significant dual appearances. Microsoft, Apple, Brocade, and others have all been touted as forward-thinking companies in ethics evaluations. But these three companies and others have had to grapple with options issues. Companies such as Halliburton have never appeared on any list for ethical companies. Yet, Halliburton has always followed a simple practice of dating stock options as of the meeting day when the board grants them—no changes, no complexities, no revisits. Stock options are a contract and when a contract a signed, a price is included.

[5] "Credit Rating Agencies and the Financial Crisis," Hearings of the House Oversight Committee, October 22, 2008, p. 7, accessed online at: http://www.oversight.house.gov.

Halliburton, as an energy company with a former military contractor subsidiary, is pure poison when it comes to ethics rankings, but it is scrutinized by friend and foe alike. Apple, a darling of ethics rankings, has a Securities and Exchange Commission (SEC) investigation pending into what it knew and when about Steve Jobs's illness and whether it should have been more forthright with shareholders, employees, and the markets on the extent of his illness. Apple's general counsel took the hit for its stock-options issues. Did Apple escape questions and scrutiny because it has the approval and assumed goodness of the social responsibility rankings?

These inconsistencies in scrutiny may be a normal response to the halo effect of a high ethics ranking. In some cases, those halos may be well earned and deserved. But ethics may indeed be in the eyes of the beholders, these developers of screens and lists for ethics. Halo awards are grounded in ideology, are not granted on a scientific basis, and cannot be applied universally in a manner that helps shareholders or stakeholders determine whether their trust in investment, employment, or contract relations with the company is well placed. Why is Google on the list of Ethisphere's Ethical Leaders, but Amazon and Zappo's are not? Touting Starbucks as one of the most ethical companies in the world, as all such ratings lists do, does not mean that Starbucks is immune from the buffetings of markets and economic cycles. When those forces hit, Starbucks must downsize just as General Motors, Boeing, and other industrial firms do.

The sloppiness in analysis behind these rankings does not provide a means by which a vendor, a customer, a potential employee, or an investor can examine a firm for purposes of its trustworthiness. Just because a company manufacturers missiles, does not mean it backdates its options grants. And just because a company sells cinnamon-sprinkled foam lattes made from only fair-trade beans, does not mean that it has a good business strategy for growth. Equating ethics rankings with success in business is not grounded in data or sound evaluation. Equating ethics rankings with ethical behavior provides too much of a shield for companies which can very easily meet the superficial screens for those rankings. The rankings and their use require a closer look at methodology and criteria. That closer look yields insight into how to improve these systems for evaluating the ethical culture and commitment of a company.

2. The Criteria in the Existing Rankings

Existing screens for these rankings are predictable. For example, the *Business Ethics* rankings are based on the following criteria of KLD Research and Analytics: Environment, Community, Corporate Governance, Diversity, Employee Relations, Human Rights, and Product Quality and Safety. Apart from the obvious observation that we have no standards for measuring most of these factors, there is the clear ideological screening that will occur. Philip

Morris (now Altria) has one of the finest cultures for diversity that can be found anywhere in the world in any industry. If a company wanted to understand how diversity is achieved, how it is made part of the fiber of a company, and how it becomes a natural force, Philip Morris would be the company to study. Philip Morris, however, will not appear on any ethics list because it sells tobacco. It is what is called among the social responsibility folks a "sin stock." Sin stocks include companies that sell tobacco, alcohol, and weapons, the three top killers in the world, except for terrorists with box cutters.[6] Those who market things that could harm us need not apply for a position in the ethics rankings. Oddly, McDonald's does appear on the list of the 50 most ethical companies in America (litigation and fast-food-nation dogma aside). KLD, in a bow to the fact that sometimes people just have to sin, has created separate rankings for the "sin stocks." For example, there is now a ranking for ethics among alcoholic-beverage makers. These firms are not permitted to sit at the big table for ethics rankings because of what they sell, but they can be best-in-class for alcoholic-beverage makers. They earn that slot through restrained marketing efforts: They must have a marketing plan that is directed at young people, one that reminds them to be responsible when sinning, that is, drinking. They can inch even higher if they have a program that works to prevent under age people from drinking.

The original screens of no weapons or vices have given way to the newer Environmental, Social, and Governance (ESG) screens. Perhaps in a tip of the hat to the profits of vice or maybe as a means for actually tying these ethics screens to profits, the ESG screens are touted as a second layer of research for evaluating companies' strategies for addressing these issues, the theory being that such hand-wringing on the part of a company is a proxy for evaluating creativity, which is necessary for competitive advantage and profit sustainability.[7] While referred to as well-thought-out screens, the connecting data between those factors and Return on Investment (ROI) is not quite there. In fact, the connection lives only in the assertions of the fund managers who employ ESG screens in differing, albeit nebulous, forms: "We believe that over time the second layer of research can add significant value to a portfolio."[8]

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[6] So strong was the former aversion to alcohol that Pax World Management sold its Starbucks holdings when Starbucks went off the tracks by allowing its name to be associated with a coffee liqueur product.

[7] Carolyn Cuim, "For Money Managers, A Smarter Approach to Social Responsibility," *Wall Street Journal,* November 5, 2007, p. R1.

[8] Ibid.

Goldman Sachs has attracted international attention for concluding that its ESG screens identified forty-four companies that outperformed its other companies by 25%. Goldman uses screens for human rights, labor standards, environment, and anti-corruption, where, as it notes, information is available. However, the companies in the Goldman Sachs group are not always publicized, the hoopla being that ESG improves the bottom line. Goldman has both energy (five oil companies) and mining companies (four) among its forty-four top companies, companies that are screened out of ethics ranking and often banished among the sin stocks, the sin being fossil fuels.[9] Royal Dutch and Shell were included in the Goldman "Green is Gold" list, as were five pharmaceutical firms. Sixteen of the companies are alternative energy and environmental technology firms. It would not be difficult to predict that these companies would enjoy a boost to their bottom lines because political winds send favor and funding their way. The remainder of the Goldman forty-four portfolio has the likes of Pepsi, Nestlé, pharmaceuticals, and a slew of biotech firms, some of which, like Genentech, have been the target of criticism for the nature of their products as well as for one-year requirements for use. Goldman's evaluation is actually more of a measure of responsible operations. A mining company that is not plagued by strikes or mandatory reclamation will indeed be more stable and profitable. A pharmaceutical firm whose products consistently reach market and remain there without recall, something that reflects adequate up-front testing and warnings, will enjoy sustainable growth. The screens, however, may simply be measuring a quality business operation that does not withhold information, is prudent in product development and testing, and focuses on long-term success over short-term profits. In other words, the business is well run, a strategy that keeps it both profitable and out of legal, ethical, and social difficulty.

ESG ratings remain fluid, with new metrics being added. Carbon emissions are a new data point, something used as a proxy for sustainability devotion, which is theorized, although not proven, to mean greater creativity at that company, thereby leading to a better bottom line, thereby leading to a competitive edge, thereby leading to long-term survival, that is, sustainability. In some evaluations, carbon emissions are not a data point, but there is a more general category of devotion to addressing climate change. This emerging screen offers no clear definition or measurement criteria.

Gender diversity is a new category that carries no definition, thereby confounding the author's simple notion that gender diversity was long ago

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[9] The Goldman report, "Global Introducing GS Sustain," can be accessed online at: http://www.unglobalcompact.org/docs/summit2007/gs_esg_embargoed_until030707pdf.pdf.

conquered with the formula: "males" + "females" working in the same place = gender diversity, something that we have had since Cleopatra was in charge near the Nile. Apparently, there are nuances in that formula that must be met to be truly gender diverse, and gender diversity means more creativity, which means a better bottom line, and so forth.

Not surprisingly, executive pay is also a new screen emerging on the rankings and ratings radar. This screen is distinct in that it does actually permit comparisons in some form across companies. However, how the numbers used in this screen will be used remains a mystery. Some advocates of this number-as-a-means-of-ethics commitment employ a ratio formula limit between the lowest salary in the company and that of the CEO, à la Ben & Jerry's pre-Unilever. An example of this metric would be that in ethical firms the CEO's pay cannot be greater than ten times the lowest salary or the mean or median compensation for non-executive employees in the company.

3. The Methodology in the Existing Rankings

As important as the criteria used for the ranking would be, the methodology used for gathering the information on how well the firm did on the criteria is more important. KDL, the firm that is used by *Business Ethics* for its rankings, uses a five component model:

- Communications with company officers
- Research partners (ESG firms)
- Media reviews
- Public documents (SEC 10K's, proxy statements)
- Government and Non-Governmental Organization (NGO) information

Of the five components, only one and one-half (public documents and government information) would not carry some form of interpretation and possible bias. Which NGOs are tapped, company officer spin, ideological foundations of ESG firms, and differing media outlet standards and ideology would affect the information obtained from the remaining three and one-half sources. Ironically, the data are gathered from those who are committed to obtaining reforms, with those reforms being their view of the issue. Companies are thus rated by the research firms and organizations that have set their own standards for ethics and social responsibility and who have outlined their conclusions about appropriate courses of action on social, environmental, and governance issues. For example, an NGO committed to human rights may have a standard that prohibits companies from having any business activities in countries in which there are human rights violations. Yet the presence of companies and business activities in China may well be helping dissidents there. The ideological screens of NGOs affect the ratings, ratings that do not consider nuance in either the issues or in a company's expansion and presence in a particular country.

Goldman Sachs introduces its ratings with a disclaimer that covers all the methodological flaws.

> Our proprietary ESG framework reflects the fact that all companies have to interact with the four pillars of: the economy in general, their industry, society and the environment. All companies will have some issues that surround them in respect of one of the pillars.
>
> Our methodology is not designed to be comprehensive, nor is it designed to be prescriptive in judging what is good or bad practice. It is based on a consistent approach of analyzing objective, quantitative measures which can be adjusted by industry as appropriate.[10]

One has to respect an ESG evaluation in which the evaluator confesses up front that it is all soft data, that they are not recommending any investment prescription from the data, and that, by the way, the data are not really comprehensive. In fact, there is one additional disclaimer in the Goldman Sachs 179-page ESG report that is not found in any of the media reports on the Goldman Sachs data (namely, Green is Gold) that is pure gold in terms of summarizing the entire ethics/social responsibility ratings:

> We have found no correlation across sectors or within sectors between any of our ESG metrics and share price performance. In part, we believe that this is due to the inadequate timeframe and mismatch in terms of timing in relation to the analysis: It takes some time for superior performance on ESG metrics to feed through into financial performance and stock market recognition. However, the poor performance of indexes such as Dow Jones Sustainability Index and FTSE4Good (both -10% since 2000) suggests that a simplified approach of picking stocks on an ESG basis alone will not lead to stock market outperformance.[11]

In short, dear investor, look at the financials.

The Dow Jones Sustainability Index has a layered and weighted approach to its methodology.[12]

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[10] Ibid.

[11] Ibid.

[12] This chart can be accessed online at: http://www.sustainability-index.com/07_htmle/assessment/criteria.html.

Corporate Sustainability Assessment Criteria

Dimension	**Criteria**	**Weighting (%)**
Economic	Codes of Conduct / Compliance / Corruption & Bribery	5.5
	Corporate Governance	6.0
	Risk & Crisis Management	6.0
	Industry Specific Criteria	Depends on Industry
Environment	Environmental Performance (Eco-Efficiency)	7.0
	Environmental Reporting*	3.0
	Industry Specific Criteria	Depends on Industry
Social	Corporate Citizenship/ Philanthropy	3.5
	Labor Practice Indicators	5.0
	Human Capital Development	5.5
	Social Reporting*	3.0
	Talent Attraction & Retention	5.5
	Industry Specific Criteria	Depends on Industry

The * means that only public reports are used in evaluating this issue. Other information comes from:

- Sustainable Asset Management (SAM) questionnaire[13] (completed by the company)

[13] SAM is a research firm based in Switzerland, and its criteria are the same as those of the Dow Jones Index.

- Company documents (both public documents and company-furnished reports)
- Media and stakeholder reports (including commentary on the companies)
- Personal contact with the companies

Four of these resources do carry bias in some form. The SAM questionnaire is one developed by SAM Research. Its board of directors, its website, its questionnaire, the list of companies, and Goldman's comment on the financial performance reveal that the goal is not one of measuring long-term financial viability or survival of companies, but rather, companies' commitment to the ideology of those involved in creating the metrics.

4. Going Forward: A Neater Evaluation

The diagrammed models for the evaluation mechanisms employed by the ranking/rating systems look impressive. Just the translation of gathered data and responses from the sources into the model generates impressive print-outs (if indeed printing out documents is not one of the negative measures). But, as noted in the introduction, after all the evaluations, criteria, data, and interviews, what do you have when the company fails? Those who create and rely upon these ethics evaluation systems acknowledge that they are not an effective mechanism for determining what will or will not be a good investment. Indeed, the research labs are littered with the huddled and whimpering researchers who have tried to find "good" companies. This new approach of rating a company on the basis of ethics, sustainability, and other NGO factors will prove equally elusive. The reality is that you cannot effectively separate out some of the softer factors these systems try to measure. There is a whirling set of components that make up a successful business. Those components are standard across companies and industries and, perhaps surprisingly to the compulsive rankers and raters, consist of a great many ethical factors. Companies may not always understand that their devotion to ethical principles is what has brought them sustainability, but they do have these elusive qualities of goodness.

Finding and counting those elusive qualities will produce a meaningful dashboard and, as a result, some meaningful ratings. The measurements will not be found in ideological-based criteria such as human rights and climate change. Rather, they will be found in a return to measuring Aristotelian qualities, which, if present, will find their way to the critical issues. For example, if we were searching for a company that exemplified ethics, then surely accurate and transparent financial statements would be a very basic requirement. If we were to list the qualities of an ethical company, then compliance with safety standards and violation-free inspections would be part of the definitional mix. Easily addressed, easily measured, and relatively easy to follow, these standards offer simple metrics. These straightforward qualities in a company are not a culled-out part of the rankings and ratings discussed earlier. But they do get at the specifics these other ratings try to measure. The following sections offer some ideas for standardized measures that could be put together to paint a fairly accurate picture of the goodness and sustainability of a company. No one factor is determinative. The purpose of this new approach in evaluating ethics and goodness is to be sure that we miss nothing in our evaluation. Fannie Mae was great on community and stakeholders, but fraud always throws a damper on the ethical evaluation of a company. The following metrics should serve to rate but also serve to throw down flags when a company is sliding into ethical and, too often, legal difficulty.

5. The Measures to Keep and Expound Upon from Existing Squishy Models

There are some factors measured in some of the models that are worth keeping in a goodness evaluation. Generally known as the governance factors, some of these are similar to those in the corporate governance portions of the ratings and rankings systems, because research shows that they have some relevance in a company's goodness, and they can be obtained through information sources that are not self-reported, spun, or ideological. However, this list goes beyond traditional governance measures because examination of some of the recent collapses shows that the critical role of a board is to make sure that the information employees have about unethical and illegal practices gets to them so that they have the information and can take corrective action. There are more factors that could provide additional quantitative information, but these are the factors that can be compared easily and can signal the need to ask more questions and obtain more information.

- Does the company have a code of ethics? If they write something down, they have two benefits: some rules, and the cognitive dissonance that sets in with someone when the rules are broken or circumvented. A new trend is for the company to track any waivers granted to the code of ethics and to whom.
- Does the company have a majority of independent directors? One caveat—check the directors for interconnections on philanthropic organizations. They may be independent for SEC disclosure purposes, but they may inextricably be intertwined in their community work and a great deal of back-scratching results from these dependencies for funds.
- Are the chairman and CEO two different people? The control of board agendas and processes by the CEO creates a conflict that other

directors cannot address effectively because their access to information is limited by the control of the process by the CEO.

- Are the executives under the same medical and insurance plans as other employees?
- What are the perks? This count is a simple numbers and cost-of-perks measure. The more the perks, the greater the risk. Trends indicate that companies have gone to straight compensation from which executives can pay for their own perks. The SEC-mandated disclosures on executive perks have cut back greatly on perks.
- Does the board of directors have a separate anonymous reporting system? Does the board of directors review all issues sent in through anonymous reporting systems? WaMu, Wachovia, and Moody's all had employees who were aware of the basic flaws in their business models and that they were participating in them, but that information could not make it through the officer team that had structured the business model. This end-run access to the board is there as a pressure relief valve when employees cannot obtain responses through the usual ethics/compliance channels. Even the sales force at Merck was aware of the questions about Vioxx.
- How many board positions do the directors hold? The professional board member is less likely to devote the time necessary for effective meetings as well as interaction with employees in the company.
- Do board members have open access to officers and facilities? That old management theory of management by walking around (MBWA), is an important tool in understanding the openness, compliance, and ethics of a company.

6. Safety

Part of the human rights component that is included in many of the ratings is just the way a company treats its employees. We could rely on the availability of flex-time, on-site child-care facilities, and other ideological measures, but we could begin with a metric that takes into account well-being and respect for employees even as it provides some insight into the precision of operations. One easily measurable data point in answering the general rating question of, "How are employees treated?" that is not tainted by self-reporting, spin, or ideological parameters, is the all-injury-incident rate (AIIR). All companies have an AIIR. No one interprets, fudges, or alters this rate. Indeed, the rate is determined only after the incidents have been reported and reviewed by both the reporting agency and the company. By the time we have an AIIR, everyone agrees it represents what happened at the company in terms of the number of injuries. This metric eliminates the interpretive and ideological flaws of the other rating systems. A company with a high injury rate tells us any one or all of the following: the company's safety standards are lax, the company's employees are not trained effectively, the company's employees are not screened effectively, or the company's demands on employees mean employees are moving too quickly (because of incentive programs or demands of supervisors) to comply with safety requirements. If any or all of these four behaviors is present in the company, you cannot have a sustainable operation. Long-term and productive operations require safety. The measurement of goodness must be tied to the business outcome measures for the goodness = success hypothesis to be correct.

7. Financial Performance

With financial performance, we are not looking at the standard financial measures of performance. Rather, we are exploring how the company got to these numbers. This factor measures several virtues, including that of honesty, because it is looking beyond the financial reports' being in compliance with Generally Accepted Accounting Principles (GAAP) and Financial Accounting Standards Board (FASB). This factor measures the quality of earnings. In applying this metric, we would look at the following:

- What percentage of income is from one-time events, discontinued operations, etc.? What percentage of income is from core business operations and what comes from peripheral activities such as hedging? There is nothing evil about one-time profitable transactions. However, the danger is that shareholders, employees, and vendors are duped into believing that the company is making money through its core business. For example, Ford's earnings picture in 2004 looked as if it was selling a large number of trucks. In fact, much of its financial performance came from currency adjustments and other non-core business transactions. The stock jumped 6.1% when this bright earnings picture was released. But the earnings did not reflect what was going on in the core business. Bright analysts figured that out, but most of the market did not. Therein is the heart of business ethics. Are you honest in your disclosures about your financial situation? The same types of sleights of hand were used by Enron (off-the-book debt hidden in special purpose entities), NewCentury Financial, and CountryWide Mortage (liberal interpretation of when loan values had to be written down). There is the ethical issue of a false impression here, but also the issue of how long a company can keep the sleights of hand going, that is, whether there is a sustainable revenue path present and being attended to.
- Over the past five years, how close were earnings projections to actual numbers reported? In this metric, you hope that the

earnings were off prediction because if these numbers are too close then you have an honesty issue. HealthSouth, a company that would lose many of its officers to prison and its CEO to a bribery conviction, noted in its 2001 annual report that it had met earnings to the penny for 47 quarters in a row. One of the whistle-blower letters to the SEC about Madoff Securities read this simply, "Although I cannot point to anything concrete, consistent earnings of 12%-18% for the last 20 years tells me that something is wrong here."[14] This feat of consistent, positive, and predictable earnings over long periods is not possible and provides a fairly good measure of the honesty of those running the company.

- What is the company's debt level? The higher the leverage, the less flexibility a company has in pursuing long-term strategies and the greater the pressure to cross ethical lines. Sustainability requires measured and reasonable growth that allows for some margin for error in the plan. Once again, this financial metric is a fairly accurate indicator of the ability to survive over the long term.
- What changes have been made in the capital stock structure? Manipulation here indicates that goodness may not be afoot, and this manipulation serves to conceal the true financial status of the company. In addition, manipulation here demonstrates a bit of callousness to existing shareholders. Dilution is an ethical issue. Dilute a shareholder, a person to whom you are indebted for your business capital, and the likelihood that you would be unfair to others increases.

8. Conditions of Facilities and Equipment

There are some business experts who say they can "smell" problems and demise when they walk into a business. Often just the levels of inventory are a give-away. Rite-Aid's shelves were bare just before we uncovered the problems there that resulted in a $1.6 billion restatement and the conviction of several officers. For production companies, the condition of the factories is a tool for determining sustainability. The bankruptcy of Peanut Corporation of America following the FDA's connection of that company to salmonella poisonings in forty-four states is not a surprise to those who had once worked at the company. The company's facilities had leaking roofs, cracks in walls and windows, and

[14] Kevin McCoy, "SEC Received Numerous Warnings Over Madoff," *USA Today*, February 24, 2009, p. 4B.

conditions that found employees complaining about the elements.[15] True to the change in equity question discussed above, the once-public company went private when the owner's son bought it back.

This metric gets at the sweat shops and human rights issues as well. In fact, long before the social screens became popular, there were companies, such as L.L. Bean, that used this form of monitoring to be sure of its contractors' plant conditions, something that served to increase quality and productivity. Again, the quantitative measures provide insight for goodness but are also key drivers in the general business goals of production quality and efficiency.

9. Turn-Over: Employees and Executives

Public documents tell a story without ideology or self-interpretation: Examine the level of executive turnover in a company. Place the turnover side by side with the other factors (such as financial performance), and you have a picture of sustainability or demise. Add in the turnover among employees, particularly delineated by division, and you will generally obtain some insights into the culture of the company. Indeed, turnover in a particular plant, division, or area of the company is a signal to look more carefully. A study of Hewlett-Packard that reflected turnover there, in its board and staff, would have been a flag of the dysfunctional culture that had taken over this proud company. Yet, with all that was happening there, the metrics in the standard measures did not pick up the problem. This factor zeroes in on dysfunction.

10. Litigation and Regulation

Without exception, every company that is now in bankruptcy, has been taken over, or is the target of investigation had a precursor regulatory/litigation warning. In 2003, both employees and financial experts were issuing public warnings about the accounting practices of Fannie Mae. By 2005, Fannie Mae was given a scathing review of its accounting practices and required to restate its earnings, a reduction of $7 billion, yet its officer team remained in place. Regulators had been concerned about AIG since 2005 when Hank Greenberg was removed as CEO. That the regulators could not find much at that time does not necessarily lead to the conclusion that all was well with this financial giant. The same can be said of any pending regulatory actions and litigations involving any company. Too many screens reach the

[15] Jane Zhang and Julie Jargon, "Peanut Corp. Emails Cast Harsh Light on Executive," *Wall Street Journal*, February 12, 2009, p. A3.

conclusion that because a suit is dismissed or the regulator finds no violations, the company has been given a clean bill of legal health. However, what generally happens is that the regulator is there and the suits have been filed prematurely. There is indeed something percolating that can be destructive to the company, but the actions are not yet legally ripe. The following measurements are critical in evaluating the ethical culture of a company.

- Regulatory investigations
- Investor suits
- Employee suits
- Vendor/supplier suits
- Competitor suits (intellectual property, antitrust)
- Regulatory and litigation settlements
- Amount in litigation reserves, particularly changes in the amounts reserved

Any ratings program needs to factor in all such actions, regardless of outcome because dismissal or closure is not a determinant of either an ethical culture or that no issues remain that require resolution for the company's continued performance and financial health. This factor is one that brings in the perception of all stakeholders as well as the shareholders, and it is Aristotelian in nature: Is this company fair to those who work with and for it? Supplier suits can indicate anything from credit problems to aggressive charge-backs, the former being an indication of financial ill health and the latter being an indication of unfairness in the treatment of stakeholders who are critical to ongoing sales and operations. An additional benefit of this metric is that it comes from public records as well. There is no ideology involved in simply examining the activity of regulators and stakeholders vis-à-vis the company.

11. Conclusion

All of the ratings and rankings for ethical companies have an important purpose: they are trying to use qualitative factors and measures to provide insight into the ongoing economic viability as well as sustainability of companies. That the purpose is noble and good does not, however, mean that the metrics are predictive. Indeed, devoting attention to and determining ratings and rankings from factors such as diversity, carbon emissions, and executive pay may be detracting from the quantifiable, readily available, and easily comparable metrics recommended here. Indeed, that seal of approval for "ethics" on the basis of metrics that do not necessarily correlate to Aristotelian ethics serves to offer an imprimatur to companies that need additional scrutiny. Dedication to climate change issues does not mean that the company is not heating up its own books. This sloppy conclusion has allowed a form of green hucksterism to detract from the real hucksters. If the goal is measuring ethics and sustainability, the screens, ratings, and focus should shift to the basic measures outlined here. The ratings from these metrics might have helped us see a few of the Ponzi schemes, frauds, and risky business models that escaped us in our zeal for the ideal company that catered to our ideological views.