Actions speak louder than words (though words count, too)

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Some say that ethical initiatives do little to boost the bottom line, but ethics and business are not unrelated - one enhances the other.

Employee training programs, profit-sharing schemes, social programs, divesting from a country to avoid corruption problems: to what extent do ethical actions and initiatives such as these make a difference to a company's bottom line?

In their article, "Corporate Ethical Identity as a Determinant of Firm Performance: A Test of the Mediating Role of Stakeholder Satisfaction," Professor Pascual Berrone, the newest member of the Strategic Management Department at IESE, and two of his colleagues in the Business Administration Department of Carlos III University in Madrid decided to find out. Using empirical research, Berrone, Surroca, and Tribó found evidence that a strong ethical identity does help achieve a greater degree of stakeholder satisfaction, which ends up influencing the company's financial performance.

"We found that firms satisfying stakeholder demands have higher economic benefits and achieve differentiation from their competitors. Developing close relationships with key stakeholders creates intangible resources that are the basis for a sustainable competitive advantage," they write in their article published in the *Journal of Business Ethics*. "Hence, managers should recognize the importance of these relationships and place them on their strategic agenda."

New theoretical framework

Higher ethical satisfaction among all the company's stakeholders results in improved performance - or so the theory goes. To test stakeholder theory, the authors studied a sample of 398 firms from 26 countries, covering all major stakeholder issues including community involvement, environmental impact, customer policies, employment relations, human rights, supplier relations and corporate governance. Their data on socially responsible investment were cross-referenced with financial information from the years 2000-2003, providing an overall measure of the company's performance.

What the authors discovered validates some previous research, but more importantly, they developed important new measures of financial performance, which manage to capture the elusive nature of corporate ethics that has made it such a slippery, and controversial, field for managers to get hold of until now.

Corporate identity, which encompasses organizational philosophy, values, history, strategy, goals and communication, has long been used as a means for companies to differentiate themselves. The authors decided to use corporate identity as their starting point, though adapted as corporate ethical identity (CEI), which they considered in two dimensions: corporate revealed ethics (CRE), what the company communicates about its ethics and beliefs to its constituents; and corporate applied ethics (CAE), which deals with the firm's behavior, actions and policies that can be considered ethical. In other words, CRE is what the firm says, while CAE is what the firm does.

The authors came up with their own theoretical scheme and empirical test by which they could subject various hypotheses. Using their own model, they were able to confirm that CEI was positively related to high levels of stakeholder satisfaction, as thought. In turn, high stakeholder satisfaction was shown to have a positive influence on the financial performance of a firm.

However, what had not been previously tested was the extent to which CRE and CAE influenced CEI, and the role of stakeholder satisfaction in mediating those interactions.

On the one hand, it was found that CAE has a stronger influence than CRE: essentially, actions do speak louder than words. On the other hand, CRE exerted a stronger informational effect on stock market value, whereas CAE had no further impact. "This means that stakeholder satisfaction mediates the relationship between CAE and financial performance, but does not mediate the connection between CRE and financial performance," state the authors.

"We have found that ethical disclosures only affect financial performance when the disclosure is accompanied by positive CAE. This suggests a complementary role between the two dimensions of CEI."

In word and deed

The upshot of all this is that practicing managers now have new tools and a greater understanding of the interplay between what they say and what they do, and how that affects stakeholder satisfaction and, in turn, performance. Where once it was argued that social disclosure could in some cases work against shareholders' best interests, now it is clear that ethical disclosure is as relevant as ever. "Revealing ethical values and beliefs in accordance to those of the stakeholders appears to be an adequate strategy for managers to follow."

But simply tooting your own horn about your company's ethical initiatives isn't going to directly translate into profits; however, it will score points with stakeholders, who do, in the end, indirectly affect the balance sheet.

"By behaving ethically, a company generates intangible gains (e.g., good reputation, trust) that improve its ability to attract resources, enhance performance, and build competitive advantages while satisfying its stakeholders' needs."

What's clear is that companies need to pay much more than mere lip service to CEI. Ethical talk not backed up by actions "hinders [firms'] value," they insist.

Today's managers must learn how to strike the right balance between ethical words and good deeds. Because, as the authors assert, a company not doing so effectively "runs the risk of jeopardizing its own future."

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