# 12. Ethics Training

Formal instruction in ethics for finance and investment professionals is not a new idea. As early as the 19th century, ethics was a part of business education, but decades later, during the 1980s, in the aftermath of the insider-trading scandals, business schools painfully rediscovered that educating ethically responsible leaders was vital (McWilliams and Nahavandi 2006). Corporations of all kinds also recognized the need for better ethics training for their employees. This renewed recognition of the importance of ethics training is reflected in an extensive survey conducted during that period. Out of 1,000 large U.S. companies that were asked to cite important areas for future corporate training, a clear majority listed ethics training (Saari, Johnson, McLaughlin, and Zimmerle 1988).

In the 1990s, legislation in the United States boosted corporate education and the introduction of ethical standards and compliance programs. Since 1991, the U.S. Sentencing Guidelines have provided incentives for companies to establish measures to guard against legal violations (LeClair and Ferrell 2000). In 1996, U.S. companies spent an estimated US$1 billion on ethics training (Khalfani 1996).

Lengthy ethical guidelines have had little impact, however, on preventing new corporate scandals. Rather, in the first years of the new millennium, alarming misdeeds at financial firms and other companies put ethics in the spotlight once again. The demise of such leading companies as Arthur Andersen, Enron Corporation, and WorldCom is still fresh in the minds of investors and the general public. Again, financial and investment companies are trying to address the issue by developing codes of conduct and by introducing ethics training programs.

Doubts about the efficacy of these measures, however, abound. As a recent poll conducted among finance executives shows, more than half of the chief financial officers who were questioned thought that at least a 50–50 chance exists of a fraudulent act on a scale similar to the Enron debacle occurring in the next decade (Durfee 2006). Such gloomy predictions by practitioners in the field clearly indicate the need for a fundamental ethical change in the financial and investment industry. Part of the necessary change would be a new commitment from these organizations to educating and training their members and leaders in ethical issues.

Clearly, the relationship between ethics and the business practices of financial institutions is complex in this profit-focused industry in which most workers have considered ethical behavior to be a constraint. A balance between profits and ethics can only be achieved if professionals in the finance and investment industry learn to see ethics as a value and a goal (Dobson 1997).

Previous chapters have shown the importance of leadership and organizational culture for developing such a perspective on ethics. This chapter shows how ethics in a firm can be strengthened through education and training that allows employees to understand the individual and social dynamics of (un)ethical behavior and helps them become ethically mature. The chapter reviews the efforts of organizations inside and outside the finance and investment industry to teach ethics. It describes the characteristics of successful ethics programs, the methods used in these programs, and their effectiveness and limitations.

## Characteristics of Successful Ethics Training

To be effective, ethics training and education programs should identify the program goals and focus on specific learning outcomes for program participants (Ritter 2006; Sims and Felton 2006). But what kinds of goals and outcomes are realistic for a professional training program in ethics? What kinds of seminar objectives lead to results, and which programs are efficient?

The following psychological and educational insights can assist financial leaders and managers in answering these questions. Sound ethics training and education programs should:

- *Increase finance professionals' awareness of actual ethical issues*. Rather than teaching abstract principles of morality, ethics training programs in the finance and investment industry should focus on raising participants' awareness of possible ethical issues in real-life professional situations. In a globalized professional world and a constantly changing business environment, finance professionals may often face new situations, and the ethical components involved in these situations may not always be obvious (Sims and Felton 2006). It is important, therefore, for participants to understand that reflection about ethics is not limited to predefined course topics. Awareness of ethics and dealing with ethical aspects are continuing endeavors throughout one's career; they do not stop at the end of the classroom sessions.
- *Provide participants with practical frameworks*. Ethics training should not only provide participants with theoretical knowledge but also help them develop practical ethics problem-solving skills. This aspect is important not only for managers but for all employees (Knouse and Giacalone 1997). The goal of this part of successful ethics training is to provide employees with a hands-on conceptual framework that supports ethics in the professional decisions that employees face every day (McDonald 2000).

  A simple example of such a practical framework is a "decision tree" that helps decision makers steer a course through ethics-relevant business decisions. The decision tree starts with the question of whether a planned action is legal; only if it is legal may the decision maker proceed to the next step. Here, the question is whether the action maximizes shareholder value. If it does, then the decision maker proceeds to Step 3, where the question is whether the behavior is also ethical. If the decision maker answers at Step 2 that the action does *not* maximize shareholder value, the decision maker is asked whether it would be unethical to *not* take the action. If so, the leader is advised to proceed with the action and to simultaneously inform shareholders of its effect (Bagley 2003).

- *Create a climate conducive to learning*. To ensure that the ethics training provides a meaningful learning experience, the learning environment must allow participants to feel comfortable about expressing their opinions and concerns (McWilliams and Nahavandi 2006). A core aspect of such a learning environment is a climate of open discussion and reciprocity that is based on giving and receiving by all participants and that is not merely about the trainer's or supervisor's contributions. Education research shows that training programs for adult learners should leave room for input and choice as well as provide opportunities for discussion and reflection on personal experience (LeClair and Ferrell 2000).

  Thus, ethics courses should focus on creating an interactive climate that actively encourages participation. Experience-based learning approaches that provide real-life applications are especially appealing to participants and effective (Sims and Felton 2006).

  Live instruction is an important component of a climate conducive to learning. Face-to-face discussions in small-class settings stimulate participants' sensitivity. The focus of these discussions should be on active decision making rather than on passive lectures (Ponemon and Felo 1996).

- *Focus on concrete, relevant issues*. To be perceived as relevant and to encourage meaningful discussion among finance and investment practitioners, ethics training programs should focus on problems specific to the investment industry, not on general principles of business ethics. Material that covers realistic scenarios relevant to the finance industry (for example, insider trading, fraud, breach of fiduciary duty) and to the specific organization is most effective (Knouse and Giacalone 1997). Participants should, for example, be asked to determine key areas of ethical issues in their work and decide which underlying ethical principles should govern the handling of these issues.

- *Establish clear links to the firm's ethical guidelines and codes of conduct*. The discussion of concrete issues should be integrated with and should spell out links to relevant documents and regulations established by the participant's firm, such as existing ethics guidelines and a corporate code of conduct. In this way, established ethical guidelines are likely to be understood and can actually be implemented by employees on a daily basis. Often, this aspect of ethics training is considered particularly relevant by participants: Linking the training contents to the firm's ethical guidelines and codes of conduct satisfies finance professionals' desire to make ethical guidelines applicable (LeClair and Ferrell 2000).

- *Include a follow-up to the training sessions.* Follow-up sessions deepen the learning process that is initiated in the training sessions, no matter which training approach is used. Follow-up programs (and allowing some time to elapse between training and the follow-up program) allow employees the possibility of digesting and refreshing what they learned in the initial training (Knouse and Giacalone 1997). Many approaches to such a follow-up after the training sessions are possible. Firms may, for example, circulate newsletters to draw attention to key ethical messages, discuss postseminar case studies, highlight the behavior of ethical employees, and/or establish work groups or networking circles (Ponemon and Felo 1996).

Although all of these facets are important ingredients of successful ethics training programs, the programs cannot work without authentic support from firms' top management. For ethics programs to be effective, the following organizational preconditions need to be met. First, the firm's senior managers need to send clear messages about their full support of the training program and about an ethical vision for the firm. Second, the top management needs to ensure that the firm's code of conduct is written in an understandable and concrete manner, rather than being written in abstract legal language. Third, the code must include a statement of specific commitment of the organization to the ethical behavior of its employees (McDonald 2000; Ponemon and Felo 1996). Not even the best ethics training program can work if real commitment to a culture of ethics is missing among the firm's leaders.

## Training Methods

Finance and investment firms that wish to provide ethics education for their employees face a wide spectrum of available training programs and educational methods. Contemporary possibilities range from on-site training to distance learning and involve participation in philosophical lectures and experiential simulations. The following paragraphs discuss some of the possibilities.

- *Philosophical approaches.* The discussion of philosophical approaches to ethics is a possible starting point for ethics training. Philosophical ideas may help individuals in the financial industry understand and analyze ethical problems as they arise in people's daily work and serve as a first basis for codes of conduct and ethical guidelines. A purely normative or philosophical approach to ethics training misses out, however, on factors that are of crucial importance in the work of investment professionals. For example, this approach fails to pay adequate attention to the corporate and social surroundings in which investment professionals operate (Brady and Logsdon 1988).
- *Case study.* Cases studies are commonly used in business ethics training programs. Research on finance students' ethical perceptions before and after case studies were presented to and discussed by the students supports the effectiveness of this method (Cagle and Baucus 2006). A traditional case study approach,

however, may easily result in a purely academic, and thus insulated, discussion that neglects aspects that are critical to real-life ethical behavior of investment professionals. In other words, case discussions run the danger of preparing participants only for abstract ethical decision making, not for concrete ethical behavior. Moreover, investment professionals should be able to act ethically not only in specific scenarios but also in many different settings and situations (Brady and Logsdon 1988). Finally, although case studies help raise awareness of the complexity of ethical dilemmas and improve analytical skills (McWilliams and Nahavandi 2006), they may not promote engagement and emotional involvement on the part of program participants.

- *Critical Incident Technique.* The Critical Incident Technique requires more active involvement from participants than do philosophical approaches and traditional case studies. This technique aims at facilitating effective ethical decision making in highly relevant areas of professional behavior. For this technique, employees familiar with a problem area (for example, with churning or unauthorized trading) are asked to identify what is ethical behavior and what is unethical behavior for a professional facing specific situations that may arise in this area (Dean 1992).

  The Critical Incident Technique encourages independent thinking and invites participants to distinguish between average ethics on the job and outstanding ethical behavior in ethics-relevant areas. It involves participants in identifying such areas, in formulating specific situations that may arise, and in defining outstanding ethical performance. In doing so, the Critical Incident Technique ensures authentic observations and highly specific solutions.

- *Game-based and simulation methods.* Such companies as Lockheed Martin and Sony have developed game-based ethics programs.

  In an early game-based approach at Citicorp, small teams of employees were presented with a sequence of ethical dilemmas related to conflicts of interest, sexual harassment, reporting ethical concerns, and confidentiality issues. The teams discussed these issues and selected one action from among four predefined action alternatives. After the teams had presented their solutions, their answers were discussed, often heatedly, by all seminar participants and were scored according to scales predetermined by the company's senior managers. The senior managers were also present at the seminar to explain their reasons and expectations, to react to appeals from the teams, and even to change a game's score if the team presented convincing solutions (Trevino and Nelson 2007). This approach facilitates teamwork and cooperation; it also provides timely feedback to participants. Most importantly, such games are stimulating and encourage active engagement with ethical issues (LeClair and Ferrell 2000).

Another interactive ethics training approach is represented by simulation programs. In the simulations, participants familiarize themselves with the character of specific roles they take on and with the values and goals of simulated organizations. Simulation programs can allow a high degree of interaction among the participants and can function as a practice stage in ethical decision making in workplace situations (LeClair and Ferrell 2000).

## Effectiveness of Ethics Training Programs

Corporate ethics training programs provide encouraging results in terms of their impact and effectiveness. In fact, employees in organizations offering ethics training programs have a more positive perception of their organization's ethical culture than do employees in other organizations (Valentine and Fleischman 2004). Moreover, a survey that has been distributed for decades among graduates of Columbia Business School shows that ethics education programs encourage ethical behavior. Specifically, individuals who had encountered ethics training were less likely to engage in unethical actions (Delaney and Sockell 1992).

Naturally, not all methods of ethics training are equally successful. Many textbooks cover ethics in insufficient depth (Baetz and Sharp 2004). Lectures and self-study alone are unlikely to make a difference in how finance professionals understand and approach ethical issues (Izzo, Langford, and Vitell 2006). Other passive forms of learning, such as listening to lectures and watching videotapes, also do not have a great impact on the ethics of decisions and behavior. Only interactive and personally engaging methods will lead to tangible outcomes among participants (LeClair and Ferrell 2000).

The most effective ethics training programs are well thought out and embedded in the context of the organization. To create long-term effects, finance and investment firms need to thoroughly plan and implement ethics training programs. The most frequent mistakes made by organizations are failure to set clear and reasonable goals for the program, lack of support for the program from senior management, and unsuitability of the program for average employees because, for example, the code of conduct is written in purely legal language (Martens and Day 1999).

To conclude, ethics training may not be able to turn morally corrupt individuals into saintly finance and investment professionals, but effective ethics education raises awareness of ethical concerns in investment professionals. Moreover, it improves ethical decision making by increasing professionals' skill and comfort in addressing ethical issues. Acquiring sound psychological knowledge about the ethical interplay of personal, situational, and organizational factors and developing and implementing a genuine ethical commitment by the organization offer investment professionals a solid basis for this new comfort with ethical dimensions of their work.