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Institutional Pressures and Ethical Reckoning by Business Corporations

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ABSTRACT. Prior studies have provided explanations for the presence, use and dissemination of codes of corporate ethics or codes of corporate conduct of business corporations. Most such explanations are functional in nature, and are descriptive as they are derived from the codes and their associated documents. We search for more underlying explanations using two complementary theories: first, social contract theories explaining the exogenous and endogenous reasons of organizational behavior, and then institutional theory explaining why organizations take similar measures in response to institutional pressures. Based on our explanations, we contend that the codes and their use and dissemination are arising from underlying social and institutional pressures for firms to continuously validate their existence in the face of increasing changes and recurrent uncertainties.

KEY WORDS: corporate code of ethics, code of conduct, institutional theory, endogenous and exogenous pressures, social contract

> An infectious greed seemed to grip much of our business community … It is not that humans have become any more greedy than in generations past. It is that the avenues to express greed have grown so enormously.
>
> Alan Greenspan
>
> Testimony before the [US] Senate Banking Committee, July 16, 2002

Introduction

Ethics is a key ingredient of any well-run society as it ''lubricates'' the social and economic systems of that society (Noreen, 1988). History shows that, from time to time, the pendulum of ethics loses its regular rhythm and creates social and economic turmoil. With every outbreak of major corporate scandals, whether it is financial or otherwise, the ethical pendulum swings irately as public pressure demands a quick fix to return to normalcy. Major corporate scandals, such as Enron, WorldCom, HIH, Parmalat, and the more recent global credit crisis, have highlighted ethical lapses which led to a massive loss of confidence in the integrity of the business community and a very sharp decline in the capital market (Blodget, 2008). Once again, the subject of corporate ethics is under scrutiny, and pressures are on the business community to demonstrate their commitment to improve their ethical conduct. In addition, questions have been raised as to whether the rekindled interest in ethics is an indication of a radical change in public expectations and standards of behavior, or a reflection that business persons are becoming more unethical than their forebears, or the standards governing ethical behavior are becoming more stringent (Hill et al., 1992). Without doubt, public concern about ethical behavior in our institutions, particularly our business institutions, has increased dramatically due to the public becoming more educated and inquiring, institutional activities becoming more transparent, corporate activities becoming more pervasive, and communications channels becoming more far-reaching.

In a society that emphasizes accountability, the public have high expectations of business organizations to have ethical codes specifying the guiding principles and standards of behavior required of their members. In the past, professions were the ones having a code of ethics. The development of codes of ethics in the legal, medical, and accounting professions has histories dating back to centuries. Although the individual provisions are different, all codes generally require that their respective members

maintain a higher standard of conduct than that called for by law (Backof and Martin, 1991). Over the years, these codes have evolved, responding to forces that are exogenous and endogenous to the professions. Specifically, changes in the ethical codes are often due to economic and social events, governmental influence, and growth and change within the profession (Preston et al., 1995). This trend of codes of conduct has also become popular among other profit and non-profit organizations as an indication of good citizenship showing a concern for the public's trust in the institutions and in those who manage them. Over time, codes of ethics have become the norm for public companies (Kaptein and Schwartz, 2008). More recently, corporate entities are experiencing indirect regulatory intervention for having codes of ethics. For example, although the *Sarbanes-Oxley Act* 2002 does not require firms to have a code, it requires public companies to disclose whether they have a code of ethics for their principal executives, and financial and accounting officers (Rockness and Rockness, 2005). They also must disclose amendments and waivers to this code through regulatory filings on a Form 8-K or through their websites.

With the increasing prominence of the corporate code of ethics, numerous authors have attempted to identify the reasons for the existence and disclosure of codes of ethics by corporate entities. We examine these explanations and find that most of the explanations are functional in nature, as they explain what functions codes of ethics serve. These explanations are mainly derived from the codes themselves and their related documents. The explanations are not sufficiently insightful as they are descriptive rather than critical in their evaluations. We go beyond these functional explanations and identify certain underlying reasons for the adoption, use, and exposure of the code by corporations. In particular, we highlight the applicability of institutional theory in understanding the growth in the use of corporate codes of ethics. The rapidly changing and uncertain nature of the institutional context faced by modern corporations provides a fertile ground to explore the role of institutional processes in the creation of corporate codes of ethics.

Likewise, the aim of this article is to identify and explain the underlying reasons as to why modern corporations[1] are producing codes of ethics and reporting their use to the wider public. After critically examining the literature on corporate codes of ethics, we establish that these codes are a means of ensuring the corporations' existence in an environment filled with exogenous and endogenous pressures. We believe that the new insights that we provide will add to the existing knowledge about this increasingly important corporate instrument.

While our purpose is to search for explanations regarding why firms are producing codes of corporate ethics, we also contribute to the literatures in contractualist business ethics and institutional theory. The literatures in these areas have provided robust explanations for corporate activities. We draw from these literatures to provide alternative explanations for the establishment of corporate codes of ethics. Both contractualist business ethics and institutional theory help in identifying the underlying reasons for codes of ethics. They are complementary in nature. An application of the two theoretical strands provides a broader and deeper understanding of the evolution of codes of corporate ethics.

The remaining sections of this article are structured as follows. The second section highlights the growing use of ethics in economic systems by stressing the fact that capitalistic endeavors cannot prosper without ethics. The third section identifies the use of functional explanations for the adoption of codes of ethics by firms. The fourth section identifies some un-stated underlying motives of code adoption based on social contract viewpoints (Dunfee and Donaldson, 1995; Heugens et al., 2006; Pajunen, 2006). The fifth section uses the concepts of isomorphism and legitimation, popularized by institutional theorists such as DiMaggio and Powell (1983), Scott (1995), and Suchman (1995), to explain why firms choose to adopt similar instruments even though they are separate entities. Finally, conclusions are drawn in the last section.

The growth in the use of ethics in economic systems

A corporate code of ethics is a formal document consisting of moral standards used to guide employee or corporate behavior (Kaptein, 2004; Sacconi, 1999; Schwartz, 2001, 2004, 2005). The *Sarbanes-Oxley Act*

2002 defines a corporate code of ethics as a codification of standards that is reasonably necessary to deter wrongdoing and to promote[2]:

1. honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
2. avoidance of conflicts of interest, including disclosure to an appropriate person or persons identified in the code of any material transaction or relationship that reasonably could be expected to give rise to such a conflict;
3. full, fair, accurate, timely, and understandable disclosure in reports and documents that a company files with, or submits to, the (Securities Exchange) Commission and in other public communications made by the company;
4. compliance with applicable governmental laws, rules and regulations;
5. the prompt internal reporting of code violations to an appropriate person or persons identified in the code; and
6. accountability for adherence to the code (SEC, 2002).

Capitalism is a socio-economic system characterized institutionally by the predominance of the market, private property, the profit motive, and competition (Hartwell, 1987; Shaw, 1991). In capitalist societies, there is a strong ideological and intellectual respect for the individual and a strong legal protection for person and property. However, there also exists the individual's will and desire to seek and maximize his/her entrepreneurial pursuits (Sacconi, 1999). A stable economy is a reflection of the cooperativeness of these self-interested individuals. This state will only be attainable in "a suitable institutional and ideological environment, an environment in which the prevailing values and opportunities allow the individual to pursue his own idea of a good life with some chance of success" (Hartwell, 1987, p. 1). For cooperation to be achieved and conflicting interests to be reconciled, compromises have to be made and self-seeking acts have to be subdued. Laws are enforced to ensure a civilized society; in a same vein, moral/ethical standards in the form of codes of ethics are also necessary to supplement the law to ensure a moral society reflecting the general mores of that particular group or institution. In other words, any kind of good, settled economic life requires a certain degree of ethical behavior with some underlying element of trust and confidence.

Good ethics is synonymous with good business (Collins, 1994). The reason why business and ethics are perceived to be in conflict is the agency problems in business whereby managers are seen to be occupied in the pursuit of their own self-interests at the expense of others. Such an impression illustrates that participants in business activities often lose sight of the fact that they are interdependent on each other for success as they need to cooperate with one another to achieve their objectives. For example, a company cannot succeed without the help of its capital providers, employees, suppliers, customers, and external regulatory agencies. Managers cannot succeed without the cooperation of internal participants such as superiors and subordinates. Obviously, Adam Smith's concept of the "invisible hand" to promote the general good in capitalistic activities is both an economic and a moral concept because economic agents cannot operate in an ethical vacuum (Dobson, 1990; Shaw, 1991). Both social and economic theories share an assumption that human being is strictly motivated by self-interest (Pfeffer, 1997) suggesting that individuals act rationally to maximize their own utilities or preferences. Since all market participants have their individual goals and expectations, it is unreasonable to blame business leaders alone as the architect of all business failings because of their so-called unrestrained self-interests. Undoubtedly, the capitalist system produces some "opportunistic" managers who focus exclusively on profit maximization with guile and deceit. It is easy to lay the blame on these managers for financial failures. As the stewards of financial investments, they have to bear the bulk of the responsibility. However, the responsibility also lies with shareholders and the whole model of private ownership and profit maximization (Blodget, 2008; Noreen, 1988).

The erosion of ethics

Commercial history is filled with financial crises caused by governance problems in both the

shareholder model and the stakeholder model. Critics of capitalism are always concerned about its negative impacts on society as there are limits to what the law can do. Rapid social change has created many new issues while removing the strictures associated with ethics. The rise in commercialism and competitiveness, and the trends in deregulation and privatization have witnessed the emergence of some ''myopic'' business measures with the fixation on short-term performance at the expense of long-term strategies. The practices of selective disclosure, unusual trading, and earnings management are ''games'' played by the market participants such as corporate managers, accountants, auditors, and financial analysts to meet earnings expectations (Levitt, 1998). Commercial standards of integrity slip as the ''chase for the dollar'' pushes ethics and morality into second place for business activities. The changing times have given rise to leaders with different priorities, whose principles have much to do with expediency, who imbibe the concept that the end justifies the means. Corruption, fraud, bogus companies, and corporate mismanagement are but some of the unethical acts of businessmen. Exposure of such unscrupulous activities have not only severely shaken the trust that is the basis of capitalism, it has also lessened public respect for business. Ethical standards are steadily being eroded with the dividing line between smart business practice and sharp practice becoming blurred to such an extent that ethical and moral principles become elastic (Finlay, 1990). It is an indication that businesses are neglecting their social responsibility and moral duty toward stakeholders (Kolk and Pinkse, 2006). These faults within the corporate system run much deeper than what is visible from a few scandals and crises (Bakan, 2004; Blodget, 2008).

The pursuit of self-interest is not new; so are the excesses in corporate life. What is significant is that these help to build up a ''catalog'' of corporate casualties. What these ''casualties'' have in common, apart from their shared fate, is that the demise of prominent corporations is accompanied by serious questions about the ethical conduct of management, directors, auditors, and accountants, the very people who are supposed to create value and build trust for the organizations. Materialism in the light of management greed, and excessive executive remuneration packages, focus on short-term gains, employee exploitation, and the like have led to the loss of public trust in business leaders and institutions. All these have contributed to an environment of declining business ethics and weak corporate governance controls (Cooper and Leung, 2004; Ferrell et al., 2008).

Unethical behavior is not unique to present-day corporate culture. Economic history provides many examples of unethical behavior in the business community, aptly described by Conroy and Emerson (2008) as the ''ethical cycles and trends.'' For example, the South-Sea Bubble, an incident in the early-eighteenth century in which unscrupulous promoters sold shares in a fictitious company (South Sea Company) to unsuspecting investors, is an early example of a scam (contractual failure between stakeholders) in a diversely held company. Similar frauds took place in the nineteenth-century England, which resulted in a large number of corporate bankruptcies. This was followed by the Great Crash of 1929 caused by the unethically excessive use of margin lending by brokerage houses (Bakan, 2004; Dobson, 1990). The 1960s and 1970s had witnessed many fraudulent commercial practices, environmental degradation, price fixing, the decline in the quality of products, and many employee-related issues such as gifts and entertainment, and discriminatory hiring and promotion practices. All these led to an increasing mistrust in not only the business sector but also government and politicians, with the consequential rise of the notions of environmental, consumer, public and civil rights, and increasing calls to redress the abuses of social responsibilities in business (Bakan, 2004; Ferrell et al., 2008; Finlay, 1990).

The same ethical issues persisted in the 1980s and 1990s, with the addition of sexual harassment, environmental protection, and product safety. In addition, during these periods, corporate greed and excesses led to the demise or disgrace of some of the oldest and most important corporations. For instance, well-known company failures include the savings and loan banks in the U.S., while other debacles include the Maxwell Group's raid on the pension fund of the Mirror Group of newspapers, the collapses of the Bank of Credit and Commerce International and Barings Bank in the U.K. (Bakan, 2004; Finlay, 1990), and, in the late 1980s, the imprisonment of some Australian ''high flyers'' for fraud and embezzlement (Clarke et al., 2003).

With reference to Alan Greenspan's statement at the outset of the article, the 1990s and the early years of the twenty-first century had seen an outbreak of "infectious greed" among prominent business leaders from mega-nationals engaging in "earnings management" practices. Obsessed with the drive for ever-increasing profit performance to meet market expectations, these greedy high flyers had forsaken ethics and turned a blind eye to blatant financial discrepancies in both external reporting practices and internal reporting (Carson, 2003; Copeland, 2005). A review of the key features of the spate of corporate collapses in the international business community illustrates a number of commonalities – "a dominating leader, a culture of outputs over prudence, a series of earnings management practices seemingly encouraged by senior management, and a willful blindness about discrepancies" (Cooper and Leung, 2004).

With every bout of well-publicized scandals, there is public outrage about the deception and fraud in business, public demand for improved business ethics and greater corporate responsibility, and increased debate about the highly visible legal and ethical lapses at well-known corporations (Ferrell et al., 2008; Rockness and Rockness, 2005). The distrust of business runs high, so does the intensity of public scrutiny. Although there is a tendency to blame the destruction of ethical consensus on institutions, it must be acknowledged that these ethical failures were caused by the individuals in the institutions (Copeland, 2005). This section has only alluded to the severity of ethical lapses – how badly the ethics of market participants has tainted the reputation of organizations and betrayed the trust of the public. Such unsavory behavior provides ample justifications for calls for measures to bring the economic systems back to equilibrium.

The prevalence of corporate codes

Historically, companies have been reactive when confronted with criticisms and accusations about their ethical standards. While there are regulatory measures to institutionalize ethics, many companies have chosen to produce codes of ethics long before regulatory intervention was proposed (Kaptein and Schwartz, 2008; Long and Driscoll, 2008; Sims, 1991). Ethical concepts in the form of motto, credo or mission statement have been around for a long time. In the U.S., the existence of such concepts could be traced back to earlier periods, for example, J.C. Penney Company started "Penney Idea" from 1913 and Johnson & Johnson's credo (a one-page statement that contained a broad set of values that the organization embodies) was published in 1943. In the 1950s, between 15 and 40% of large companies had a code of ethics and by 1992, the proportion had increased almost twofold, with 93% of the U.S. firms and 83% of North American and European firms reported to have written codes of ethics or conduct (Adams et al., 2001). In most cases, formulating codes was a response to scandals of one sort or another. For instance, in the 1980s, after the pricing scandals that shocked the U.S. defense industry, General Electric embarked on an image overhaul. This was further accelerated by the enactment of the U.S. Sentencing Guidelines in 1991, which provided potential monetary incentives for corporations to institute ethics or compliance programs (Adams et al., 2001; Ferrell et al., 2008; Schwartz, 2004, 2005). Surveys conducted in the period indicated that 90% of Fortune 500 firms and nearly 50% of all companies instituted some form of corporate ethics code (Hill et al., 1992).

It was difficult to measure accurately the number of codes as there are different types – industrial, trade association, professional, and international – and forms, such as code of ethics, code of conduct, operating principles, company objectives, credos (Cassell et al., 1997; Schwartz, 2004), business principles, corporate philosophy, corporate ethics statement, and code of practice (Kaptein and Schwartz, 2008); however, there is sufficient evidence to suggest that codes are now prevalent around the world, at least among large corporations (Kaptein and Schwartz, 2008; Schwartz, 2001). In the U.S., by 1992 over 90% of large corporations had codes of ethics (Center for Business Ethics, 1992) and in Canada, 86% of large corporations had similar codes in 2000 (KPMG, 2000). In Europe, 56% of U.K. large companies have a code, 51% German companies and 30% French companies have a code. O'Dwyer and Madden (2006) also report that the usage of codes of conduct amongst indigenous Irish companies increased significantly between 1995 and 2000 as a reaction to emerging business and political

scandals in that country. The numbers are increasing with the continual calls from governments and other stakeholder groups for the establishment of corporate codes of ethics (see Schwartz, 2001, 2004). This prevalence is also supported by Kaptein (2004) who found that of the two hundred largest corporations in the world, 52.5% have some sort of ethical code. A recent survey by the Business Roundtable Institute for Corporate Ethics also reports the continual rise of corporate ethical standards (Copeland, 2005) as a part of corporations' broader strategy to promote self-regulation and deter government intervention and regulatory action.

There are two implications in this renewed interest in ethics. The first is that an ethical code is important in business dealings. The second is that a general perception that whatever ethical code may have existed in the past is no longer adhered to and new codes may need to be formulated (Dobson, 1990).

Functional explanations for the existence of the corporate codes of ethics

A review of the business ethics literature shows that there are various interpretations of the stated objectives of the codes of ethics. Some authors call them "functions" (see Frankel, 1989) while others label them "reasons" or "purposes" (Kaptein and Schwartz, 2008; Schwartz, 2001). To operate effectively, a firm maintains a balance between its *raison d'être* and the various interests in its own organization and in the larger community, namely, its employees, customers, suppliers, the government, regulatory agencies, and the public at large. As a visible enunciation of norms and values, the code of ethics defines the ethical boundaries of the firm in its business dealings as an ethical corporate citizen. In this section, we explain the functional approach using the eight broad functions of a code of ethics identified by Frankel (1989, pp. 111–112).

An enabling document

A code of ethics is an enabling document because it aims to offer guidance or moral anchor to members when they encounter novel and confusing situations in their workplace. Such a framework acts like a compass, providing the direction – more informed choices or alternative courses of action – but not the ultimate destination (Frankel, 1989). Statements relating to this function permeate the literature. They include the following:

- The provision of consistent normative standards for employees (Ethics Resource Center, 1980, 1990) – a vehicle to provide a benchmark, a stable foundation or core of a corporate identity or culture.
- The guiding principles and standards of behavior required for their members (Collett, 1998; Kaptein, 2004).
- Part of an important communication system (Collett, 1998). It allows management to emphasize to the employees of the company the standards of behavior with which they are expected to conform. It offers guidance to employees who are confronted with difficult choices while performing their duties, and in doing so it contributes to the establishment of an appropriate moral tone within the company.
- A self-regulatory instrument for organizations … public documents … a particular normative stance (Kaptein, 2008).

Source of public evaluation

A code, as a visible pronouncement of a firm's self-proclaimed role and values, can function as a basis for the public's expectations and evaluation of firm performance. In this way, it can serve as a mechanism for holding the firm and individual members accountable. Such a provision is an indication that management places some value on ethical behavior; that moral considerations have a place in the organization's functioning (Frankel, 1989). The following are a selection of points from the literature on the subject:

- To provide a visible and public statement of ostensible organizational values, duties and obligations (Cassell et al., 1997).
- To establish business as a profession similar to medicine and law; codes are a marker of professions (Adams et al., 2001).

- The avoidance of legal consequences (Ethics Resource Center, 1980, 1990).
- As symbols to both internal and external stakeholders the organization's commitment to ethical practice (Murphy, 1995; Pfeffer, 1981; Weaver, 1993).

Socialization

Corporate power and prestige are derived not only from the quality goods and services the firm provides, but also from the sense of group solidarity and common purpose that is expressed and reinforced in codes of ethics. This is what the process of socialization aims to achieve. The codes help to foster pride in the organization and strengthen corporate identity and allegiance among its members (Frankel, 1989). The following are some views from the researchers in this particular area.

- To shape change; to improve the organizational climate so that individuals can behave ethically (Adams et al., 2001).
- To articulate the moral climate that is part of the organization's culture (Adams et al., 2001).
- To play a valuable role in the induction of new members into the philosophy of the company (Collett, 1998; Pfeffer, 1997).
- To institutionalize the morals and values of the company founders such that they become part of the corporate culture and help socialize new individuals into the culture (Weiss, 1994).

Enhancing corporate reputation and public trust

A firm's reputation is closely linked to public perceptions about its motives and the quality of its performance. Having a code of ethics can help a firm to gain trust. The code can be seen as a tool to influence public impressions. From this perspective, the strategic value of codes lies in their capacity to function as a political device "designed to privatize conflict or to restrict the scope or to limit the use of public authority" (Frankel, 1989, p. 112), thereby insulating the firm from threats to its autonomy (i.e., self-regulatory mechanism). In this regard, the code is a

- Means of promoting public image (Ethics Resource Center, 1980, 1990).
- Part of a strategy (Farrell and Farrell, 1998) for social recognition and credibility.
- Public relations device – communication device to external stakeholders about the standards of conduct they could expect from the company (Collett, 1998).
- Vehicle to assure stakeholders that members are competent, have integrity and intend to maintain and enforce high standards (Higgs-Kleyn and Kapelianis, 1999).
- Means of enhancing public confidence (Adams et al., 2001).
- Strategic device to maintain or acquire a positive reputation within the institutional environment (Wright and Rwabizambuga, 2006).

Preserving entrenched biases

At the lowest level of the social contract principle, firms are expected to advance the values that define their social role. Society expects such a commitment in return for the firm's power and privilege. Corporate biases do exist and they may be both normative and tangible. In case of unresolved ethical issues, there is a tendency on the part of the firm to appeal to the code as a "mask" for preserving the firm's perspective of the world. A code may also be used to censor "deviant" ideas from within the firm, thereby ensuring that entrenched biases prevail over potential innovation (Frankel, 1989). Therefore, corporate codes have been perceived by business ethics researchers as

- Legal self-defense mechanisms and managerial tools: Since organizations can be held legally responsible for the actions of employees, managers enact codes to guide individual behavior and to protect the organization from the illegal and unethical behavior of employees (Adams et al., 2001);

- Mechanisms to insulate an organization from significant exposure to criminal fines (Laufer and Robertson, 1997); and
- Strategic device to extend legitimacy to the self-interested wants of organizations (Long and Driscoll, 2008).

Deterring unethical behavior

In addition to promoting ethical conduct, a code may function as a deterrent to unethical behavior by (1) linking the code to a threat of sanctions, and (2) making it an affirmative duty for corporate members to report errant colleagues, thereby creating a monitoring system in which each member assumes a responsibility for upholding the group's integrity (Frankel, 1989). What follows is a selection of views on this subject matter:

- To legitimize the good soldiers' behavior and teach the loose cannons what behavior is appropriate in the organization and warns the grenade of sanctions for unethical behavior (Trevino and Nelson, 1995).
- To exert control in the workplace such as environmental controls, organizational controls, and personal controls (Laufer and Robertson, 1997).
- To influence decisions of employees so that the resulting behavior is acceptable to the organization (Farrell and Farrell, 1998).
- To provide incentives for ethics compliance (Sacconi, 1999).

Support system

A code may also be a source of support for members against unwarranted erosion of their power or improper demands on their skills by outsiders. It can be used as a vehicle to strengthen the firm's collective front and that of its individual members in resisting, for example, vexatious claims by clients, unreasonable demands from employers, or unduly intrusive incursions into corporate affairs by ambitious bureaucrats (Frankel, 1989). The following contains the views of ethics researchers on the matter:

- To emphasize to employees the standards of behavior with which they are expected to conform (Collett, 1998).
- To provide messages to all employees (Stevens, 1994); to direct attention to personal accountability and ease fears about consequences for certain actions.
- To influence and regulate; to act as a form of control – according to emerging sets of norms, beliefs and values (Cassell et al., 1997).
- To encourage employees to exercise sound judgment when faced with ethical and other dilemmas (Collett, 1998).
- To provide ethical controls because the legal system and markets do not necessarily lead to organizational behavior that takes into consideration moral impacts of business decisions (Adams et al., 2001).

Adjudications

Finally, codes may also serve as a basis for adjudicating disputes among members of the firm or between members and outsiders. The firms may act to arbitrate disputes, or legislators, administrators, and judges may accord codes considerable significance in assessing corporate practice and adjudicating claims by or against members involving outsiders (Frankel, 1989). Thus, codes can

- offer support to employees should their actions ever be questioned; they have an effective defense if they can prove compliance to the code (Collett, 1998);
- resolve abuse of authority problems (Sacconi, 1999);
- send messages about expectations of standards that go beyond behavior required by law (Adams et al., 2001); and
- provide an avenue to influence behavior by creating dialogue among the affected parties (Adams et al., 2001).

In light of the multiple interests a code serves, it must be recognized that no single function mentioned above can fully account for its existence and impact. However, findings of research into corporate codes of ethics have provided evidence that the

existence of a code has a significant influence on not only public perceptions but also the perceptions of corporate members about the ethics of organizations (Adams et al., 2001).

Some unstated reasons for the corporate code of ethics – a social contract account

Corporations exist in an environment that is filled with dependence, threat, uncertainty, complexity, and volatility (Scott, 2003). Their survival depends very much on their ability to avoid, buffer, or change the environment. Increasingly, there are more environmental forces bearing upon corporations to perform ethically. It can be deduced from the semantics of the codes that there are two interrelated forces influencing firm behavior. These forces are often not given sufficient recognition. We label them as *exogenous* (external) forces and *endogenous* (internal) forces and explain in this section that the literature also rationalizes the existence of the code of ethics from these perspectives. *Exogenous* forces manifest in "external shocks" such as major corporate scandals, the change in social expectations, the dependence of businesses on powerful stakeholders such as governments, regulatory agencies, special interest groups, the media, and consumers. Individually or in unison, these groups exert pressure on businesses to behave ethically and responsibly through their products and services, contractual relations, employee health and safety, environmental protection, use of natural resources and general posture in the community (Nicholson, 1994; Shepard et al., 1997). *Endogenous* forces are internally generated through introspection and interaction. The two forces are closely interrelated because the "internal forces, such as employee values or intergroup conflicts, may derive their impetus from wider social structures and norms, and to the degree that external forces, such as regulatory frameworks and institutional practices, reflect the felt concerns of organizational members" (Nicholson, 1994, p. 584). To survive in an environment that is increasingly complex, uncertain and volatile, it is essential for companies to employ a variety of legitimating mechanisms to enhance their reputation as ethical enterprises.

In deducing the unstated reasons for code adoption, the discussion of this section employs a social contract perspective to explain the two streams of institutional pressures promoting corporate ethical behavior. A social contract perspective is used to reflect the tacit understanding within society that corporations, in the process of serving their own business interests, are obliged to take actions that also protect and enhance society's interests. Figure 1 illustrates how the exogenous and endogenous forces are embedded in the social contract framework.

In its simplistic form, the social contract depicts that firms are expected to meet many expectations of society – both implicit and explicit – and, in return, society grants them the right to use resources and to operate within the community. It is an implicit contract based on custom and accepted without dissent. In other words, the contract allows for "the generation of binding ethical obligations through the recognition of actual norms created in real social and economic communities" (Dunfee, 2006, p. 304). Heugens et al. (2006, p. 214) characterize ethical contractual schemes as "a set of norms, rules, practices or institutions that specify a system of cooperation, ratified and sustained by consent or voluntary re-enactment, and designed to advance the good of those taking part in it." Sacconi (1999) defines the social contract as a hypothetical model of an ideal agreement that can constitute the criterion for assessing real economic institutions since the world of economic institutions (firms and markets) is imperfect and the firm is made up of incomplete

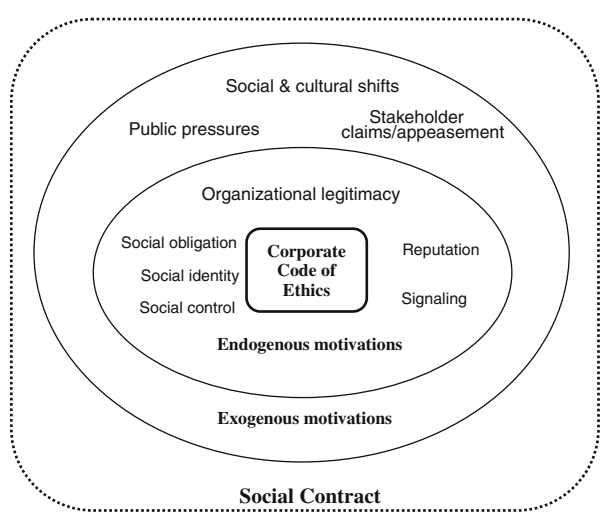

Figure 1. The unstated motives for code adoption – a social contract account.

contracts. It is a rational agreement that comprises two interrelated components – justification (the *ex ante* perspective of the hypothetical agreement on the fair constitution of the firm) and implementation (the *ex post* perspective signifying the implementation of the agreement). The former represents the "state of nature," some sort of pre-institutional strategic interaction forming the basis of the normative force for change while the latter provides the motivations/incentives for compliance and as such, self-enforcing in nature (Sacconi, 2006, 2007). In short, the social contract is the "constitution" of the firm and the code of ethics the "constitutional chart" making the implicit social contract explicit.

When codes of ethics are looked upon as the firm's "constitution chart" used to establish the rules with the "rational expectation by each party that others will comply with those commitments" (Sacconi, 1999, p. 193), then they are there to resolve the problem of trust through abstract strategic bargaining interaction, and the cooperative game theory popularized by Aoki (1984) can be used to explain the demand for and disclosure of corporate codes of ethics as voluntary cooperation.

There may be considerable variability in corporate motives to code adoption as the nature and structure that make up the institutional environment of firms are different. Both exogenous and endogenous motivations for code adoption are found to be a good fit in the social contract framework where they complement each other with the endogenous variables adjusting as exogenous circumstances change. The emergence of exogenous forces such as socio-cultural shifts and public pressures suggests that existing corporate behavioral patterns are no longer sustainable. Endogenous motivations to change will pursue self-enforceable incentives such as organizational legitimacy, reputation, social control, and signaling with the voluntary adoption of codes of ethics as a means to achieving better corporate governance (Sacconi, 1999, 2006, 2007). We discuss the exogenous and endogenous motivations below.

Exogenous motivations

Social and cultural shifts

To appreciate the call for ethics betterment, it is necessary to examine the societal and cultural changes that have taken place in the latter part of the twentieth century. In this period, there was a shift from a producer culture to a culture comprising three themes, liberal individualism, a calculative/technical rationalism, and a consumer culture (Preston et al., 1995). With the rise in educational level, there emerged a more inquiring public in search for a better quality of life. There was also an increase in political, economic, and social problems. All these led to an increasing distrust of government, politicians, and business leaders; a call for more power sharing in public and organizational life; and the rise of environmental, consumer, public interest, and civil rights groups.

With the growth of the market economy, the societal shift has leaned toward a view of the economy as a social institution embedded in communities resulting in the larger society changing the existing social structures (Shepard et al., 1997). This "social embeddedness" of the economy highlights the rising importance of institutional or collective responsibilities (Jeurissen, 2004; Kaptein, 2008), which requires the cooperation of all stakeholders to find solutions for social problems. The market system in which corporations operate is an important part of this institutional environment. The current trend has witnessed a shift from legally based compliance initiatives in organizations to cultural initiatives that make ethics a part of core organizational values (Ferrell et al., 2008).

Public pressures

While the notion of accountability is taking hold, the organizational features have changed. The traditional, hierarchical model of the organization is disappearing. In addition, virtually all members of the public are regarded as stakeholders, and the number of activist stakeholder organizations such as minority groups, women, environmental lobbyists, and grassroots neighborhood groups is growing (Shepard et al., 1997). These diverse, interlocked groups all vie to maintain their autonomy and advance their interests within a social framework that governs their relationship with the external environment (Kaptein, 2008; Kolk and Pinkse, 2006). With increasing concerns about corporate accountability, they started to make extensive social demands on institutions (Ferrell et al., 2008; Finlay, 1990; Jeurissen, 2004; Phillips and Johnson-Cramer,

2006). Exogenous forces bearing on a corporation's ethics reside in its dependence on powerful external stakeholders such as the government and influential special interest groups (Verbos et al., 2007). The impact of these groups on corporations is both direct and indirect. Direct effects arise from such activities as boycotts, demonstrations, lawsuits, and sponsored shareholder resolutions on various issues. Indirect effects come from stakeholders' influence on public policy in the form of regulations in a wide range of areas such as fair trading, equal employment, environmental protection, and product safety. Increasingly, special interest groups employ political tactics such as lobbying, litigation, policy research, and coalition building to press for their causes (Shepard et al., 1997).

The large number of corporate scandals in the last few decades indicates that there is an abuse of trust and an erosion of ethics in business. Regulatory measures have been introduced creating pressures for organizational adaptation and change. For instance, in the U.S., the *Federal Sentencing Guidelines for Organizations* (1991) and the *Sarbanes-Oxley Act* 2002 set out guidelines encouraging corporations to improve their ethics as a means to protect the public interest.

Endogenous motivations

Organizational legitimacy

From the previous section, it can be seen that the survival of corporations depends upon many factors including the consent and support, not just of its internal stakeholders, but society at large. If they are indifferent to public demands, they will suffer from the withdrawal of community support which would have an adverse impact on their operations, for example, restrictions on resources, boycotts, and increased political interference in the form of more restricted legislation. To attain public consent or organizational legitimacy, they have to conform to social values and the norms of acceptable behavior in the larger social system of which they are a part. Codes of ethics are cultural symbols used to legitimize an organization's actions; they are also the most concrete form of acknowledging social obligations (Pajunen, 2006; Preston et al., 1995). Through code adoption, corporations can make claims to organizational legitimacy by affirming their responsiveness to social expectations with the hope of changing public perceptions for the better.

Suchman (1995) explains that many dynamics in the organizational environment stem not from technological or material imperatives but from cultural norms, symbols, beliefs, and rituals. As such, corporate activities such as ethics codes initiatives represent one important means by which management can influence external perceptions about their organization. Producing a code of ethics constitutes a strategy to influence the organization's relationships with the parties with which it interacts. Through this enlarged accountability in acquiring social support, the corporation enhances the chance of its continued existence. Wright and Rwabizambuga (2006) observe that organizations normally change their structures or policies as a response to formal pressure from other organizations or by conforming to standards established by external institutions. These institutions specify rules, procedures, and structures for organizations as a condition of conferring organizational legitimacy, which can be defined as "a generalized perception or assumption that the actions of an entity [the firm] are desirable, proper, and appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Wright and Rwabizambuga, 2006, p. 90). In return, the organizations initiating the changes are rewarded with enhanced legitimacy for acting in accordance with social expectations.

Reputational effects

Closely related to organizational legitimacy is a corporation's reputation, which, according to Wright and Rwabizambuga (2006, p. 94), reflects the corporation's "ability to simultaneously respond to the demands of multiple stakeholders with different normative perspectives, interests, and objectives, basing their judgments on different signals and informational cues." Corporations are known by the perceptions they generate, that is, by their reputations (Mitnick and Mahon, 2007). Reputation is one of the most valuable assets of the corporation; it is this asset that induces stakeholders to trust the corporation. As such, there is an incentive to safeguard and enhance reputation (Sacconi, 2007). One of the strategies to construct reputation is to formulate codes of ethics as a means to establish the reputation

of ethical corporate citizenship. This will help us to address the cognitive problem highlighted by Sacconi (2007). When stakeholders judge corporate reputation, they base it on the perceived consequences of corporate actions, or on perceptions of the moral principles that appear to guide corporate conduct. In other words, reputation is a social construction that can be based on observations of the consequences of actions as well as on observations of the guides used to generate the actions. Corporations accrue reputation when observers see good effects flow from actions, and when they see the members acting on good principles. Society rewards reputation based on moral grounds more than it does those that are based on receiving or distributing benefits (Mitnick and Mahon, 2007).

However, the stability of corporate reputation can be affected by many factors for example, reinforcement of views among observers and strength of commitment of the firm to the moral directive. Reputation can be transitory. For instance, where markets are competitive, the attainment of reputation represents significant market advantages. Similarly, in boom times, when firms are perceived to be on course economically and ethically, good business reputation is maintained. With every outbreak of business failures, this good reputation is tarnished and calls for ethics become imperative. Thus, firms need to maintain good reputation and defend against threats that can damage their reputation (Mitnick and Mahon, 2007). The long-run cost of a tarnished reputation normally outweighs the short-run benefit of opportunistic behavior (Dobson, 1990). However, some cynics tend to regard reputation-building behavior as different from ethical behavior in terms of the underlying motivation for the action with the former being purely economically motivated and the latter strictly non-economically, socially oriented. However, the two are not mutually exclusive as good reputation, similar to good ethics, is vital to business. The benefits of projecting an ethical image with an active code of ethics will maintain reputation far beyond the organization, into the community, and even the country (Finlay, 1990).

Social control

Social control is important not only in broader society but also in organizations. Business ethics initiatives can exert social control through the creation and maintenance of moral and social order by formalizing norms of acceptable business practice and behavior (Laufer and Robertson, 1997). The codification of ethical standards reflects internal and external norms, customs, and etiquette not necessarily required by law. It assumes the role of a self-regulatory and self-enforcing mechanism requiring members, individually and collectively, to act or engage in behavior that conforms to agreed-upon expectations.

In response to exogenous forces, corporations would have the endogenous motivations to adopt codes of ethics to attain legitimacy and maintain corporate reputation. However, a corporate code of ethics is also a collection of good intentions to pacify external demands and insulate the corporation from censure if it is not addressed in a deliberate and coherent manner on either a strategic or an operational basis within the organization. What this means is that a code has to be internalized to be useful. In other words, corporations can develop values and norms, but they must communicate them to members, and enforce them with appropriate rewards and sanctions. To be effective, these ethics initiatives must be driven by top management to ensure workforce commitment and trust (Pfeffer, 1997).

"Internalization" is an integral part of socialization. Socialization is the process of learning one's culture and how to live within it. It is highly complex and interactive, it can be either formal or informal, and it takes place at organization, group, and individual levels. Individuals and groups learn the cultural elements (including important values, beliefs, attitudes, social roles, norms, language, and symbols) of their own society to perform appropriate roles. This is what some of the social scientists call "cognitive patterning." The main task is to induct all individual members into its cultural elements to achieve social and cultural continuity (Clausen, 1968). Socialization is achievable only when the individuals or groups have "internalized" the relevant cultural elements. This refers to their having gone through the process of learning, understanding and finally accepting the specific social rules and expectations. This internalization process will be much enhanced if there are good role models available. As such, the power of the process will very much depend on new members' proactive

socialization behaviors, as well as their leaders' active engagement (Nicholson, 1994; Verbos et al., 2007).

In an ethical organization, socialization is expected to prime ethical identification and is vital to imparting the internal values (for example, code of ethics) to new members (Verbos et al., 2007). The induction of moral order to shape members' understanding of the organization's ethical directives conveys shared values and beliefs of the organization and facilitates interaction between more experienced and less experienced members. It also helps to inculcate ethical commitments and create a strong ethical climate. In addition to regulating and monitoring the behavior of its members through the code, corporations can reassure public policy makers that this self-regulatory mechanism helps to promote the best interest of society.

Looking at it from a social contract perspective, Thompson and Hart (2006) call these arrangements psychological contracts (social contracts at the nano level) while de Graaf (2006) label them as "heuristic devices." Thompson and Hart (2006) provide some insight into the cognitive implications of contracting at the individual level by explaining that individuals cognitively construct a set of reciprocal obligations between themselves and their institutions. These perceived obligations help to shape an individual's behavior and evaluate the ethics of his or her institutional context. de Graaf (2006), on the other hand, is of the view that people bind themselves to contracts for the sake of the Good rather than as utility maximizers. They internalize local norms and values that fit their identity in the institutional setting and assume their assigned roles. Social contracts are therefore heuristic devices helping to determine the content of existing moral norms.

Signaling

The role of corporation, in the view of social contractarians, is to provide an ethical environment to serve the needs of stakeholders. As such, a dialogue between the parties concerned must be put in place to foster cooperation. Codes of ethics, expressing the basic social contract of the firm, are legitimating mechanisms corporations use to promote trust and to enhance their reputation as ethical organizations. Codes of ethics are therefore enunciations by corporations communicating to external stakeholders their commitment to conform to recognized business practice. These are tools employed for pragmatic and prudent reasons – for maintaining or enhancing corporate reputation in institutional environments where it is threatened. The aim is to add value to their brands (products or services), increase competitiveness, enjoy greater access to capital markets, and be exposed to less public scrutiny (Wright and Rwabizambuga, 2006).

Internal codes of conduct are there to guide business practices within the organization. They are also a signal from management to the workforce conveying the former's expectations on an acceptable mode of behavior. The codes offer guidance and support to the workforce when they are confronted with ethical dilemmas in performing their duties. An effective code, therefore, may result in a range of benefits including better communication and organization learning, improved employee morale and productivity, and better business reputation (Collett, 1998).

Wright and Rwabizambuga (2006) regard the adoption of corporate codes as grounded in a number of strategic motivations to appease stakeholders while at the same time to boost corporate profits. First, corporations can accrue reputation and brand benefits by assuring stakeholders that they operate ethically and responsibly. Second, they can differentiate themselves from the malpractices of competitors to boost their credibility since stakeholders have a tendency to assign reputational status based on a comparison of corporate practices. Third, being perceived as an ethical business may allow them to operate in a more favorable political and regulatory environment and enjoy the freedom of self-regulation.

In sum, in publishing codes of ethics, corporations have accepted that they do operate in a society via a social contract, expressed or implied, and that their survival and growth are based on whether they are seen to be moral arbiters and agents of social improvement. As highlighted by Shocker and Sethi (1973, p. 97),

> In a dynamic society, neither the sources of institutional power nor the need for its services are permanent. Therefore, an institution must constantly meet the twin tests of legitimacy and relevance by demonstrating that society requires its services and that the

groups benefiting from its rewards have society's approval.

The above discussion has shown that the environmental forces and the semantics of the stated functions of corporate codes have provided some "food for thought" in deducing the underlying motives of code formulation. Apart from pressures emanating from a firm's external environment, there is also a variety of firm-specific endogenous incentives for adopting a voluntary code of conduct. These exogenous and endogenous motivations, however, are not mutually exclusive, as shown in Figure 1.

An institutionalist interpretation of the existence of the corporate codes of ethics

Thus far, this article has traced the factors leading to the prevalence of corporate codes of ethics, compiled a list of the functions of corporate codes, and speculated on the unstated motives of code adoption by alluding to the "exogenous" and "endogenous" forces that might have prompted the adoption. A careful examination of the semantics of the functions of the code reveals two traits: (1) they tend to be concerned with behavior in areas protective of the corporations; and (2) they appear to be a reiteration of obligations of corporation members. The ultimate goal of code adoption, it seems, is for survival in a rapidly changing institutional environment.

We now explain why firms have resorted to take up a similar instrument to deal with their various endogenous and exogenous ethical demands even though they are separate entities. It is fitting to use the institutional theory framework to explain the motives of corporate code adoption. Institutional theory explains why so many businesses have similar organizational structures and cultural elements even though they are separate entities, and how organizations as institutions, shape the behavior of individual members. It has called attention to the importance of social and cultural environment, emphasizing that many dynamics in the organizational environment stem not from technological or material imperatives but from cultural norms, symbols, beliefs, and rituals (Pfeffer, 1997; Scott, 1995, 2003; Suchman, 1995). In short, institutional theory emphasizes how cultural understandings shape the evolution of organizations. At the core of the organizational change is the concept of legitimacy (see DiMaggio and Powell, 1983; Meyer and Rowan, 1977; Scott, 1995; Suchman, 1995).

DiMaggio and Powell (1983) use the concept of "isomorphism" to explain why organizations within a field tend to become more similar to one another. They believe that the concept is a vivid description of the process of structural homogeneity. Isomorphism is a channeling process that moulds organizational units within a field to become more similar when coping with a common set of environmental circumstances. Institutional theory highlights the choices organizations have to make in response to or in compliance with their institutional environment, which comprises: (1) powerful institutional constituents such as influential stakeholder groups, and (2) the rules and requirements with which they must comply to gain desired rewards of support and legitimacy. Isomorphism, or compliance with expectations, is essential for organizational success. Institutional theory helps to explain why organizations deploy resources to increase their legitimacy to obtain favorable institutional resources and how these organizations select strategies and tactics based on possessing institutional resources.

Owing to the process of isomorphism, organizational features change in similar ways in order for units within a field to adapt to environmental conditions. Building on Meyer and Rowan's (1977) social myth–bureaucratization hypothesis which stresses that social rules are important legitimizing structures in organizational survival, DiMaggio and Powell (1983) posit three institutional processes underlying bureaucratization and other types of organizational change, namely, coercive isomorphism, mimetic processes, and normative pressures. Scott (1995) also proposes a similar framework but he calls them the three pillars of institutions: regulative, cognitive, and normative pillars. Subsumed in both frameworks is the notion of legitimacy, which, according to Suchman (1995), can be further refined into subsets to match the two frameworks. We focus on three broad subsets: pragmatic, cognitive, and moral legitimacy. The following discussion uses these frameworks to explain the pervasiveness of code adoption.

The regulative pillar – coercive isomorphism

Institutional theorists give much emphasis to the regulative aspects of institutional change. Organizations (inclusive of their members) are assumed to be rational, self-interested beings. However, it is inevitable that these interests will conflict, and the differences have to be resolved. An important role of institution is, therefore, to constrain and regulate behavior by mitigating the self-interests of both individuals and organizations with a view to preserving a stable societal environment. This process is manifest in explicit rule-setting, monitoring, and sanctioning activities (Scott, 1995, p. 35). In DiMaggio and Powell's (1983) typology, this is coercive isomorphism, and in Scott's phraseology, the regulative pillar. Suchman (1995) also shares the same logic of instrumentality and describes such self-interested choices as a pragmatic means to attain legitimacy.

Coercive-based change occurs when organizations consciously adopt new practices in response to formal or informal pressures exerted either by external actors upon which the organizations are dependent or by cultural expectations. These pressures may emerge in the form of force, persuasion, or invitations to join in collusion (DiMaggio and Powell, 1983). In highly institutional environments, organizational changes are shaped by responses to formal pressure from other organizations or by conforming to normative standards established by external institutions (Wright and Rwabizambuga, 2006). Shepard et al. (1997) observe that the coerciveness in this form of isomorphism comes from two sources. First, there are formal and informal pressures brought to bear by competing organizations and on organizations that depend upon them. Second, there are pressures created by the societal and cultural expectations in the institutional environment within which organizations must operate. Such pressures have prompted many modern organizations to take both reactive and/or proactive measures to fend off criticisms, regulations or potential litigation. A key characteristic of this initiative is the tendency to homogenization, that is, to attain some common grounds with competing organizations. Another characteristic is that these changes may be largely ceremonial. As summed up by DiMaggio and Powell (1983, p. 150), "organizations are increasingly homogeneous within given domains and increasingly organized around rituals of conformity to wider institutions." This is a strategy that organizations adopt to "increase their legitimacy and their survival prospects" (Meyer and Rowan, 1977, p. 340).

In the corporate world, the cycle of crises and scandals has prompted renewed calls for ethics reform (Conroy and Emerson, 2008). The survival of modern corporations rests not only on their "economic muscle" but on their overall contributions to society. Wider social, political, and economic interdependencies mean that corporate actions have significant impact on the constituents (the stakeholders). Corporate failures due to mismanagement, financial irregularities, sub-standard products and services, etc., can have major economic impact on the organizations concerned, but more importantly, they can have huge flow-on effects on the broader society. In severe cases of scandal, the government intervenes by setting laws and regulations on the specific areas of public concern. For instance, the enactment of the *Sarbanes-Oxley Act* 2002 in the U.S. is a classic example of government mandate in regulating corporate governance with significant emphasis on the ethical responsibilities of corporations and their executives (Rockness and Rockness, 2005). Direct and indirect pressures from stakeholder groups have also created some organizational convergence in the area of ethics reform. Driven by fear and expediency, the prevalence of corporate codes is evidence of corporate response to coercive or regulative pressures. To pursue their self-interests, both corporations and their managers have to behave expediently to conform to social and cultural expectations, and adopting a code of ethics is instrumental to achieving that goal. The decision to appease external (formal and informal) pressure groups is a rational choice to attain legitimacy, albeit pragmatic legitimacy as highlighted by Suchman (1995). This reflects corporations' awareness of the "social embeddedness" of the economy and the power of stakeholder activism (Shepard et al., 1997). In an economy that is increasingly interdependent, modern corporations have to adopt expediency measures to improve public perception, resource flows, and, last but not least, the chance of survival. Adopting codes of ethics may be a genuine desire to acknowledge the validity of the rules and their

functions (social contract principle); it may be a mere shallow acceptance, that is, a ritual, symbol, or ceremony, without believing that the codes are fair, correct, and justified.

The cognitive pillar – mimetic processes

Cognitive elements of institutions consist of rules that constitute the nature of reality and the frames through which meaning is derived (Scott, 1995, p. 40). Such a collection of ''internalized symbolic representations of the world'' is the result of the institution's mediations with the external world of stimuli (pressures and others). Through the interaction process, the institution is able to make sense of the ongoing events, provide meanings to these happenings and formulate rules for institutional members. Some of these may be formal written rules; some may be unwritten rules of conduct that underlie and supplement formal rules. Together, they form the ''constitutional rules'' of the organization, projecting an ''organizational template'' and cultural (symbolic) framework as the basis of behavioral commitment. The template is a ''social construct'' subject to modification and adjustment with ongoing interaction. The cognitive view insists that much of the coherence of organizations lies in those that have the power to reproduce and transform this template to portray a certain social identity (Scott, 1995; Suchman, 1995) that reflects collectivist (shared) interests rather than individual intentions. DiMaggio and Powell (1983) call the mechanism that captures the cognitive dimension of isomorphic processes ''mimetic processes.'' They observe that organizations grappling with uncertainties tend to employ mimetic processes by imitating or modeling themselves on counterparts that are perceived to be successful and more superior. In Scott's (1995) view, the underlying logic of the cognitive pillar is often one of orthodoxy, that is, the cultural framework allows members to behave in conventional ways, in ways that will not cause them to stand out or be noticed as different. A principal indicator of this imitation is prevalence as there are a large number of similar organizations exhibiting the same form or practice. Suchman (1995) observes that this is the manner organizations seek ''cognitive legitimacy'' in a chaotic social world by employing cultural models to provide plausible explanations for the organization and its endeavors. On the surface, organizations within similar fields perform similar tasks as they confront strong but similar pressures for structural isomorphism. However, no two organizations are exactly the same. Adopting the mimetic process may produce similar forms and practices, but beneath this veneer, there may be evidence of an innovation of different ''cognitive maps'' suited to the organization's mission. This system is different from the regulative process, which highlights rules/regulations to control the self-interests of actors and institutions (as discussed above), and the normative system, which emphasizes social obligation as the basis of compliance (to be discussed in the next section). The cognitive system stresses the importance of social identity, taking for granted that the constitutional rules or cultural patterns are but ''routines'' that institutional members follow.

This system of shared premises, rules, and performance programs can be used to explain the pervasiveness of corporate codes of ethics. Over the years, with the widespread publicity of corporate transgressions and the increased concerns for the erosion of business ethics, there is a ''sea change'' in corporations' attitude towards ethics. Business ethics literature has provided ample evidence that there has been a steady increase in code adoption, supporting DiMaggio and Powell's (1983) theory that there is great pressure on organizations to become isomorphic (see the previous section), and particularly so for organizations engaged in the same type of activities to look or act alike. Indeed, both external and internal pressures may encourage mimetic isomorphism. In this perspective, companies produce ethics codes because all other companies, particularly the large and successful ones, are doing so. Since those companies that comply successfully with social and cultural expectations appear to gain legitimacy and thereby critical resources (for example, increase in investment through improved investor confidence), there is no harm in employing the same ''organizational template.'' Such mimicry also supports Meyer and Rowan's theory that organizations that devise structures that conform closely to institutional requirements ''maximize their legitimacy and increase their resources and survival capabilities'' (Meyer and Rowan, 1977, p. 352). The phrase ''organizational template'' is used generally and categorically to depict

the structure of codes whose adoption by organizations becomes successively replicated. Whether it is an exact replica or not, companies do have their unique traits and structures reflecting on the contexts of their codes.

Although it is difficult to differentiate whether some companies produce codes solely for fulfilling the social contract principle or merely for pragmatic and expediency reasons (pragmatic legitimacy as discussed earlier), there is definitely some recognition of the codes in terms of the social responsibility mandate they assume. Among these companies, many can be described as imitators modeling themselves upon the early adopters. In a world that increasingly acknowledges the importance of an ''invisible ethical hand'' in capitalist pursuits, corporations that are perceived to be not ''doing the right thing,'' that is, not producing codes of ethics, will be ostracized. It is beyond the scope of this article to determine whether code adoption is borne out of a genuine desire of good corporate citizenship (that is, social contract), or purely a ritualistic gesture. What is apparent is that cognitive legitimacy in the form of code adoption affirms the social status of the organization and lays the cognitive base for an ethical culture where shared meanings, assumptions, norms, and values are used to govern work-related behavior. In the presence of such a model, organizational activity will prove ''predictable, meaningful, and inviting'' (Suchman, 1995, p. 582).

Codes of ethics are highly observable as they are public documents. Their presence can act as signals that the companies are social conformists responding to institutional pressures. They are also powerful messages for the modelers, particularly when the early adopters are looked upon as good ethical corporate citizens. In today's business environment where pressures for competitive efficiency is intense, ''public recognition may give these organizations legitimacy and visibility and lead competing firms to copy aspects of their structure or operating procedures in the hope of obtaining similar rewards'' (DiMaggio and Powell, 1983, p. 153). For companies that have suffered huge reputation damages during crises or other incidents, producing a code of ethics or updating one helps to generate positive reputational effects as it can project a more favorable corporate and social image. In short, companies are rewarded with enhanced legitimacy and reputation if they develop internal structures with external institutional pressures.

The normative pillar – normative pressures

Normative isomorphic organizational change, according to DiMaggio and Powell (1983), originated from professionalization. An important aspect of professionalization highlights the collective struggle of members of an occupation to define the conditions and methods of their work, and to establish a cognitive base and legitimation for their occupational autonomy (DiMaggio and Powell, 1983). It takes the form of socialization, which involves normative processes, to facilitate the creation of normative rules concerning organizational practices. Normative rules ''introduce a prescriptive, evaluative, and obligatory dimension into social life'' (Scott, 1995, p. 37). Included in these rules are values, norms, roles, and beliefs that are both internalized and imposed by external forces. Some normative rules are there to constrain social behavior while others are to empower and enable social action. Together, they confer rights, responsibilities, privileges, duties, licenses, and mandates on members of the organization (Scott, 1995, p. 38). The focus of normative process is to ensure, through a process of internalization, that members of organizations are aware of their role(s) in a social situation and to behave appropriately in accordance with the specified standards of conduct. The emphasis is on social obligation, which means that members conform not because it serves their individual interests but because they are obligated to do so. In this conception, behavior is not guided by self-interests and expediency as discussed previously under coercive or regulative processes. Rational choice is somewhat restricted as it is usually guided by the normative framework, which is grounded in a particular social context. The promulgation of normative rules about organizational behavior aims to create a pool of almost interchangeable individuals. The process of socialization acts as an isomorphic force. Although normative rules can be internalized and imposed by others, moral legitimacy is attained ''not on judgments about whether a given activity benefits the evaluator, but rather on judgments about whether the activity is 'the right thing to do'" (Suchman, 1995, p. 579).

In recent years, a blend of economic, social, legal, and political events has had a profound effect not only on the behavior and performance of corporations, but also on the public's expectations of them. The days of unquestioned trust and respect on the part of customers or the public are over. With increasing frequency, corporations are exploring ways to improve their products and services and to regain public confidence (Finlay, 1990; Frankel, 1989). The company as an institution serves as a normative reference group for individual members, and through a code of ethics clarifies, for both its members and outsiders, the norms that ought to govern corporate behavior. Apart from being some sort of "ethical credentials" in the form of an enabling document to enhance corporate reputation and uphold public trust, the code is there to show a sense of group solidarity and common purpose in terms of the corporation's ethical values, rules and norms. The socialization process is at work to perform the act of "social patterning" by shaping individual beliefs and behavior so that corporate members are able to show ethical consensus on what ought to be in their business dealings. The constraint on choice is also evident as much corporate behavior revolves around code specifications (that is, the do's and don'ts). In terms of legitimacy, the normative conception would stress a deeper moral base as the incentives for conformity would include both intrinsic and extrinsic rewards (Scott, 1995; Suchman, 1995). Undoubtedly, there are different levels of moral legitimacy. At the higher level are the companies that take the altruistic stance (social contract) in producing a code of ethics for their own as well as the public good. At the lower level are those companies that adopt codes to guide business practices for pragmatic reasons. In general, the decision to adopt a corporate code of ethics that establishes the corporation's commitments and responsibilities should be seen as setting up a normative framework that stabilizes social life in two ways. First, the framework relieves society from the need to regulate an activity for which control by law does not appear feasible, and second, it provides the service in a way that satisfies society's needs (Scott, 1995; Wright and Rwabizambuga, 2006).

Table I sums up the common elements of institutional theory and corporate codes of ethics discussed above. It shows the alignment between the three main propositions in the literature for institutional theory, and then identifies the unstated underlying reasons for the creation and propagation

TABLE I

Common elements – institutional theory and corporate codes of ethics

Institutional theories			Corporate codes of ethics	
DiMaggio and Powell (1983) Institutional isomorphic change	Scott (1995) 3 Pillars of institutions	Suchman (1995) Legitimacy	Un-stated reasons of adoption (social contract)	Stated functions of codes
Coercive isomorphism	Regulative pillar	Pragmatic legitimacy	Social and cultural shifts Public pressures Organizational legitimacy (stakeholder appeasement)	Public evaluation Deterrent to unethical behavior Adjudications
Mimetic processes	Cognitive pillar	Cognitive legitimacy	Reputational effect Signaling Organizational legitimacy (social identity)	Reputation and public trust Preserving entrenched biases
Normative pressures	Normative pillar	Moral legitimacy	Social control Organizational legitimacy (social obligation)	Enabling document Support system Socialization

of the codes of ethics. This is followed by the stated reasons that align with the unstated reasons.

In sum, the ideas of legitimation and isomorphism, as espoused by institutional theorists, are compelling explanations for the prevalence of corporate codes of ethics in the current environment. The institutionalization explanation has implications for a better understanding of why corporations adopt codes of ethics. The prevalence of corporate codes appears to evolve in three stages. First, codes emerge and become formalized in response to institutional pressures (problems and opportunities). Second, consensus develops on the value of corporate codes before it crystallizes. Finally, corporate codes are widely adopted, to the extent that, in some instances, it may simply be imitated to align with current practices.

Conclusion

The aim of this article is to provide the underlying reasons to explain why modern corporations are producing codes of ethics and making them known to a wider audience. Previous explanations in the literature focus on the functions the codes and their associated documents state. Therefore, they mainly provide reasons that the firms themselves present. The codes of corporate ethics have gained tremendous prominence in recent years in terms of both use and disclosure, which raises the question of whether or not the stated reasons are the only reasons being served by the corporate codes of ethics.

Our analysis suggests that unethical behavior has become more frequent and visible. This is because the dimensions of large businesses and the nature of their influences have more profound effects on the community. Likewise, the corporations are under greater scrutiny and pressure to function in an acceptable manner within their social contexts. In response, business corporations are showing greater propensity towards having codes of business conduct or corporate ethics and are disclosing them more prominently.

While the functional perspectives proposed by earlier studies expose the stated reasons for the codes, the more underlying reasons require a critical examination of the codes because these reasons are often un-stated. Prior literature shows that ethical behavior in organizations is determined by the environment of the organization; the role of "significant others," such as executives, superiors, and peers; the existence of slack (or the lack of it) in productive resources; the culture of the firm relative to its social linkages; and the intellectual underpinnings of the business system. We first identify these reasons using a set of established theories, especially contractarian theories, on the exogenous and endogenous reasons of corporate behavior. We then move to a complementary theory to explain why firms adopt similar organizational instruments such as the code of ethics. The theory adopted is the institutional theory. Institutional theory regards corporations as institutions operating alongside other institutions. Because of the presence of other institutions, firms are influenced by institutional pressures that can be categorized into coercive, mimetic and normative pressures. Within this context, we argue that codes of ethics are a means of providing the necessary justifications for corporate actions.

In our analysis, we are cognizant of Zucker's (1987) argument that the institutional settings both exogenous and endogenous to the firm interact to provide conditions that are necessary for the creation and disclosure of corporate codes of ethics. We also note that firm-specific practices, such as ethics code adoption, are continuously responding to and are influencing the institutional setting of the firm. The institutionalization of ethics is an important task for all organizations to counteract the scrutiny arising from increasingly frequent occurrences of unethical and often illegal behavior of highly respected entities and individuals managing such entities.

We used two key aspects of institutional theory – legitimation and isomorphism – as the framework to explain the motives of producing corporate codes of ethics. Both these ideas accept that institutional forces stabilize and create strong pressures for change; sometimes institutional entrepreneurs act to create change and sometimes they act to reinforce existing arrangements. The prevalence of corporate codes of ethics signifies the development of stable patterns of behavior and improved understanding of the value of ethics. Through isomorphic change, that is, the adoption of the codes, corporations have taken on the task of producing similar patterns

(corporate codes) to shape the behavior of their members (socialization and internalization) to survive (legitimacy within the world of institutions) in a highly demanding environment.

The code of corporate ethics has a significant role to play in institutional change since it is an equilibrium condition for economic, social and political systems. In the absence of an ''ethical invisible hand,'' corporate actions have to undergo ethical scrutiny (Argandoña, 2004, p. 199). Institutional change implies an attempt to change distribution, thereby creating fairness problems that go beyond mere economic efficiency. However, one must remember that ''[T]he code of ethics is not a cure-all, and it possesses no magic powers by which it can change moral darkness into light, but it is an effective instrument which now contributes much, and which, with proper use, can be made to contribute much more, to the cause of truth and honor in business relationships'' (Graves, 1924, p. 59). Although codes of ethics themselves will not guarantee an ethical corporation, what is important is that it sets out the conceptual framework and establishes the spirit of the ethics policy.

A limitation of our study is that it reinterprets the existing findings rather than providing empirical evidence on what the underlying reasons for the increased use of codes of ethics in corporations are. This limitation arises from the fact that firms do not normally explicitly state the underlying reasons for their actions. Such reasons have to be exposed by critically evaluating the stated reasons, the propensity with which such actions occur and the context of the actions.

Despite the absence of explicit evidence for the underlying reasons of corporate actions, there is a growing literature under the aegis of institutional theory that is providing sociological, political, and behavioral reinterpretations of economic activities of firms. We provide a similar reinterpretation to identify the underlying reasons for the growing prominence of code of ethics of corporations. This reinterpretation complements the prior explanations of the contractarian perspective. The basis of an enterprise's legitimacy is social contract (Sacconi, 2006, 2007). The exogenous/endogenous distinction of pressures is similar to the idea of ''institutional complementarities'' amongst different institutional sub-systems, where different games are played (Aoki, 1984, 2001). A company is one of many concerned stakeholders but is not necessarily the main institutional actor, or the locus of the interactive system, or one of the main players. The players, as discussed under the institutional theory perspective, include the company, its stakeholders, and the regulatory institutions.

Finally, we use institutional theory to complement the contractualist explanations rather than to provide a competing view. Heugens et al. (2006, p. 219) regard institutional theory as a subset of the contractualist view or more precisely, a form of meso-level positive contractualist view of organizational systems. The institutional theory explanation of organizational arrangements also has similarities with the explanation of Aoki (2001) that an organizational phenomenon is an equilibrium state of shared beliefs within a contractual game setting. We provide separate explanations from a contractualist perspective and an institutional perspective to make clearer identifications of the underlying reasons for the existence and use of codes of corporate ethics in business organizations. Our scheme of analysis extends the contractualist views to explain the increasing adoption of codes of ethics by corporate entities.

Notes

[1] In this article, the terms ''corporation,'' ''firm,'' and ''company'' will be used interchangeably.

[2] The *Sarbanes-Oxley Act* 2002 does not require a code of ethics, but a company is required to disclose in its annual report whether it has a code of ethics.

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