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CODES OF CONDUCT FOR SMALL AND MEDIUM-SIZED ENTERPRISES (SMES)

QUERY

Can you provide good practice examples of codes of conduct for SMEs?

PURPOSE

We are planning to start a new research on codes of conduct for SMEs. As Hungarian SMEs are lacking good examples, we would like to compile international best practices and offer the companies paths and codes to follow.

CONTENT

1. Overview of underlying principles
2. Examples of codes of conduct for SMEs
3. References

SUMMARY

As the bulk of business in most economies is conducted by SMEs, there are major potential benefits associated with implementing ethics management programmes within small and middle sized firms. Codes of conduct constitute a central element of business ethics programmes to ensure that the company's activities comply with relevant laws and regulations and provide adequate guidance to employees and other key stakeholders on what behaviours and business conduct are expected of them. This answer provides a few examples of codes of conduct specifically developed for SMEs as well as examples of business ethics related activities conducted by TI national chapters that specifically target SMEs.

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1. OVERVIEW OF UNDERLYING PRINCIPLES

CODE OF CONDUCTS FOR PRIVATE COMPANIES

A code of conduct is a central component of an ethics management programme, ensuring that the company's activities comply with adequate laws and regulations and providing guidance to employees and other key stakeholders on what behaviours and business conduct are expected of them. Codes of conduct organise the company's ethical framework in one single and comprehensive document providing specific guidance for key stakeholders on how to deal with difficult situations and ethical dilemmas and spelling out mechanisms on addressing and preventing conflicts of interest. As such, when confronted with corruption challenges, the code provides employees with specific guidance on how to recognise and react appropriately to corrupt and unethical business practices.

Codes of conduct are based on the core values of the company, which can be broadly categorised as "business values" (customer service, quality, efficiency, value for money, etc) and "ethical values" (integrity, transparency, honesty, openness, respect, responsibility, etc) (Institute of Business Ethics, 2007). The code typically translates these core values into expected behaviours in relation to the company's key stakeholders (e.g. employees, supervisors, customers, suppliers and contractors, shareholders, business partners, competitors, etc). In addition, codes can also set a general policy of complying with industry standards, laws and regulations (local, foreign and international) governing the specific area of commerce as well as environmental laws.

Codes of Conduct often differ in their structure and content, but usually include:

- *Introduction/preamble:* This part of the code typically states the purpose of the code, of the company and the core beliefs of the enterprise;
- *Commitment to ethical values:* The code outlines the core values the company wishes to abide
- *Commitment to anti-corruption:* The code articulates the stance of the company's management regarding corruption and the involvement and role of its employees. This can include a corruption "zero tolerance" statement ;
- *Specific guidance provisions,* covering the basic principles of the company's relations to third parties (agents, clients, and suppliers), typically organised by relationship or responsibilities to stakeholders (i.e. employees and supervisors, shareholders, customers and consumers, business partners, suppliers and service providers, competitors, environment and the communities);
- *Fundamental prohibitions/guidance* covering issues such as acceptance of gifts, entertainment or advantage, bribery, facilitation payment, charitable contribution and sponsorship, political contributions, conflicts of interest, protection of company property and information, etc.
- *Compliance with the code:* The code can include a description of implementation mechanisms, including roles and responsibilities, procedures, sanctions, training monitoring and reporting mechanisms, and should generally encourage employees to report misconduct and provide guidance on how to do so.

In terms of structure, there are different options for organising the code. They can be organised according to 1) the formulation of statements and principles of the company that provide an overview of the ethical principles the company and its "insiders" abide to; 2) a division of the insiders and outsiders associated to the daily operations of the company. The Lebanon Anti-Corruption Network who has just finalised a code of ethics for SMEs recommends the second option as the simpler alternative (see example below).

CODE OF CONDUCTS FOR SMES

Why develop a code of conduct for SMEs?

It is estimated that the vast majority of the world businesses consist of SMEs, carrying out the bulk of business in most economies, especially in emerging and transition economies. Some estimate that their contribution to the world business could be up to 97 %¹.

For SMEs, there are several potential benefits of implementing an ethics management programme, including the development of a code of conduct (Transparency International, 2008). As their bigger counterparts, SMEs are frequently confronted by corruption challenges but have limited resources and

¹ <http://www.tbl.com.pk/the-global-economys-backbone-sme-inclusive-tools-for-achieving-a-sustainable-world/>

bargaining power to resist bribery pressures. At the same time, they increasingly need to demonstrate that they have adequate anti-corruption policies in place, for example to be selected as a supplier to large multinationals in their supply chain, or when they participate in tendering processes with large corporations.

A reputation of integrity is also likely to increase opportunities to acquire government business, attract financial organisations or provide better access to international markets. It can be an effective protection against reputational damages as well as legal risks associated with corruption. In addition, corruption tends to create a company culture of unethical behaviours and attitudes, exposing companies failing to prevent bribery to higher risks of theft, fraud, and financial statement manipulation (PwC, 2008).

Yet very often, SMEs' values and ethical standards are implicit, based on an informal understanding of expected practices and behaviours (Institute of Business Ethics, 2007). The manager/owner often acts as a role model in this regard, influencing the company's ethical culture by his/her attitude and behaviour.

Against this backdrop, SMEs have many incentives for developing a more formal and explicit set of ethical values through a code of conduct, including (Institute of Business Ethics, 2007):

- Communication to stakeholders;
- Reputational benefits;
- Guidance to staff on expected behaviours;
- Increased employee's loyalty and staff morale;
- Attraction of "high quality staff";
- Decreased costs of borrowing and insurance;
- Legal risks management;

What SME specificities need to be considered?

SMEs can generally benefit from the long standing experience of larger companies in designing business ethics infrastructure and codes of conduct. Those can in principle be adapted and tailored to the specific needs of SMEs relatively easily. However, there are a few specific features of SMEs that need to be taken into account in this process such as for example (please see: <http://www.transparenciacolombia.org.co/NOTICIAS/tabid/134/ctl/Details/mid/755/ItemID/7/Default.aspx>):

- *SMEs are often family-owned enterprises* managed by family members, which can hamper

reporting unethical conduct or managing conflicts of interest.

- *SMEs can operate in a relative informal manner*, including a relative lack of discipline, and a certain reluctance in setting articulated business practices and procedures
- *SMEs have fewer organisational structures than large enterprises* and tend to operate in a more informal manner, based on an implicit understanding of the company's values and ethical culture;
- *SMEs are heterogeneous* in size, sectors, ways of operating, etc.
- *SMEs have limited resources* to invest in supporting business ethics activities such as training, communication or awareness raising.

As a result, the process of developing codes of conduct for SMEs can be based on a set of key underlying principles, including the following (Mahmood, S., 2007). In principle, codes should be:

- Self-regulatory;
- Tailored to the specific needs of SMEs
- Flexible so that they can be adapted to the wide variety of SMEs;
- User-friendly, easily accessible, easy to understand by both business owners, staff and stakeholders;
- Incentives based;
- Compatible with other regulations to avoid regulatory burden and duplication.

DESIGN AND IMPLEMENTATION PROCESS

The process for developing a code of conduct is key to the success of the initiative and provides a good opportunity to engage stakeholders, demonstrate the management's commitment and promote the company's core values.

As the target audiences need to fully embrace the standards which the code of conduct promotes, it is recommended to develop the code through a participatory process with the active involvement of the various stakeholders, either directly or through representatives. As such, the development process of the code provides a unique opportunity for the company to discuss common values, mission and obligations with staff and stakeholders, and promote a better acceptance and understanding of the company's underlying values

The document should be approved at the highest level of the organisation - ideally endorsed by the Board and top management - to give it credibility and

demonstrate the leadership's commitment to ethical standards.

Employees and external stakeholders also need to be made aware of the ethical commitments of the company and the code needs to be communicated throughout the company as well as to external stakeholders.

For example, internally, it is good practice for the manager/owner of the company to introduce the code to new employees. It can also be incorporated into the staff handbook, if any, for issue to each employee upon appointment. Regular training and briefing sessions should also be organised for staff.

More generally, the code of conduct should be seen as a living document, evolving overtime to reflect the company's current situation.

Effective implementation of the code in practice also relies on effective oversight mechanisms in place to monitor compliance, detect and investigate breaches of the code. The disciplinary process should be open, fair and transparent. In addition to sanctions, a system of positive incentives can be introduced to reward staff/stakeholders adhering to the code of conduct in an exemplary manner. The regular assessment of the code's impact is a crucial element of the enforcement regime, with regular monitoring and evaluation of enforcement.

2. EXAMPLES OF CODES OF CONDUCT FOR SME

SAMPLES OF CODES OF CONDUCT

Code of ethics and whistleblower procedure for SMEs (Lebanon Anti-bribery Network)

The Lebanon Anti-bribery Network – an initiative of the Lebanese Transparency Association, TI's national chapter in Lebanon- has launched a code of ethics for SMEs in 2011 that also includes a mechanism for enforcing the provisions. It is structured according to the various key stakeholders group of SMEs, including employees and supervisors, shareholders, customers/consumers, business partners and environment/communities and covers the basic principles of the company's relations to third parties. A chapter of the code deals with implementation, and recommends, among other things, that the code be distributed to every employee and made available to the public on internet, that training be organised on the procedures contained in

the code and that an ethics representative be appointed to monitor implementation. The possibility of rewarding employees for compliance can be considered.

The code as well as guidance on how to draft a code of conduct for SMEs can be accessed at: <http://www.transparency-lebanon.org/publications/codeofethicssmesen.pdf> -

Reference guide book on the corporate governance of family owned enterprises (The Lebanese Transparency Association)

In many countries, SMEs are constituted by many family owned enterprises (FOE), which poses specific challenges when it comes to preventing conflicts of interest or reporting unethical practices. An IFC survey has identified several governance related weakness areas, including a relative lack of discipline, and a certain reluctance in setting articulated business practices and procedures. This can lead to lack of adequate financial and operational oversight, succession planning and capacity to attract and retain skilled outside managers. The Lebanese Transparency Association has developed a guidebook to provide guidance on developing a reliable corporate governance system for FOEs.

The guidebook can be accessed at: http://www.transparency-lebanon.org/index.php?option=com_content&view=article&id=79&Itemid=161&lang=en

Code of Conduct of the Global Advice Network

Global Advice Network offers business ethic services in anti-corruption, anti-fraud, sustainability and business development for SMEs. In particular, it operates the Business Anti-Corruption Portal (www.business-anti-corruption.com), which is designed to support small and medium sized enterprises (SMEs) operating in emerging markets and developing countries to avoid and counter corruption in order to produce a better business environment. As part of these efforts, it has developed an Anti-Corruption Code of Conduct which sets out practical, value-based guidelines for employees to follow in order to counter the risks associated with corruption and bribery.

The draft code of conduct can be accessed at: <http://www.business-anti-corruption.com/tools/integrity-system/>

Hong Kong's Best Practice Checklist for use by Small and Medium Enterprise

Hong Kong's Independent Commission Against Corruption, has developed a governance and internal control best practice checklist for small and medium enterprise. The second chapter specifically focuses on codes of conduct for SMEs.

The best practice checklist can be accessed at:
http://www.icac.org.hk/filemanager/en/Content_1031/sme.pdf

Manual for managing a responsible business enterprise in emerging market economies

The US Department of Commerce published a manual for corporate responsibility programmes in emerging economies. Although not specifically focussed on SMEs, most chapters discuss SME related issues, as the bulk of business in most economies consist of SMEs. Chapter five provides specific guidance on developing codes of conduct and presents a sample outline for codes of conduct.

The manual and sample outline can be accessed at:
http://ita.doc.gov/goodgovernance/business_ethics/manual.asp

Anti-Corruption manual for SMEs

The Centre for International Private Enterprise (CIPE) has also compiled anti-corruption tools for SMEs. The manual provides some guidance for preparing codes of conduct as well as a few samples of codes of conduct. (Most of these examples are also provided in this answer).

The manual can be accessed at:
http://www.cipe.org/sites/default/files/publication-docs/antiCorruptionManualForSMEs_English.pdf

Corporate Governance Code for SMEs (Dubai)

Some codes have also been developed for SMEs by government bodies. For example, the Department of Economic Development in Dubai² has published a voluntary corporate governance code for small and medium sized enterprises organised around nine pillars or principles. Pillar one provides, for example, "Adopt a formal corporate governance framework

outlining the roles of the key bodies such as partners, shareholders, board of directors and management". The Code is organised into the following sections: policies and procedures; transparency and shareholder relations; board of directors; control environment (internal controls, audit and risk management); stakeholder relations; and family governance.

The code can be accessed at:
<http://www.hawkamah.org/files/Dubai%20SME%20CG%20Code%20En.pdf>

OTHER INITIATIVES TARGETING SMES

SME Edition of TI Business Principles

Although not per se a code of conduct, TI's business principles can be relatively easily adapted and integrated into a code of conduct, as they set the values by which business can be conducted with integrity. An edition of the Business Principles more relevant to small- and medium-sized businesses (SMEs) has been developed in 2008, together with guidelines which give practical advice to those organizations with limited resources of time, money and people, helping them through the process of developing an anti-bribery strategy to suit their size and structure.

The SME edition of the business principles can be accessed at:
http://www.transparency.org/whatwedo/tools/business_principles_for_countering_bribery_sme_edition/1/

Transparencia por Colombia's Rumbo Pymes program

Transparencia por Colombia has developed a methodology for implementing ethics programs in small and medium enterprises (SMEs). The program consists of a self-directed survey methodology for assessing the ethical culture in SMEs and a series of training modules for addressing challenges identified in the assessment. Training modules address topics such as ethical leadership for owners of SMEs, ethical decision-making models, Transparency International's Entrepreneurial Principles for Combating Bribery customized for the SME context and ethical governance in family-owned enterprises.

The modules are essentially "best practices" employed in large organizations, but customized for the needs of SMEs and include:

² More research would be needed to assess whether this code can be considered good practice.

- *Values and Standards of Conduct* – This module facilitates the collaborative development of a statement that presents employees and leaders with a clear standard of expected behaviours.
- *Leadership* – This module focuses on specific tools for fostering culture change through leadership, including tools for leaders to facilitate discussion about the issue in question and to guide staff through ethical decision making models.
- *Communicating standards* and empowering employees to recognize ethical issues – This module helps leadership communicate the organization's standards of behaviour.
- *Seeking advice about ethics and reporting misconduct* - Rumbo Pymes provides SMEs with tools to receive and process confidential reports and requests for advice on matters related to inappropriate behaviors or that give rise to ethical dilemmas.

More information on this programme can be accessed at:

<http://www.transparenciacolombia.org.co/NOTICIAS/tabid/134/ctl/Details/mid/755/ItemID/7/Default.aspx>

TI France's Vade Mecum

TI France has also engaged with SMEs and developed a guide called "Vade Mecum" to raise SMEs' awareness of legal and commercial risks associated with corruption. The guide describes recent development in the legal anti-corruption framework as well as expectations of SMEs' stakeholders in terms of transparency and integrity. It provides a list of organisations that can support SMEs confronted with challenges of corruption and bribery and highlight possible strategies to anticipate and address these risks.

The guide (in French) can be accessed at :
http://www.transparence-france.org/ewb_pages/a/actions-transparence-international-pme.php

TI Malaysia

As part of the TI Malaysia's business integrity work, a number of practical tools have also been developed for implementation in SMEs. Please contact Mark Lovatt for more information at:
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3. REFERENCES