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### Birth of the Ethics Industry

By James C. Hyatt

A lot of companies are singing the compliance blues these days, as they struggle to cope with the complexities of Sarbanes-Oxley legislation, passed in 2002 in the wake of financial scandal. Complaints about the cost and time involved are common, but there's another effect of Sarbanes-Oxley less remarked upon. Corporations are rushing to learn ethics virtually overnight, and so, a vast new industry of consultants and suppliers has emerged. The ethics industry has

Consider a few examples of recent mushrooming attention to ethics. At **Goldman Sachs**, Paulson will moderate 20 forums this year on ethics, for the bank's entire staff of managers. **Citigroup** is adding annual ethics training for all 300,000 employees, and **The New York Times** is doing likewise.

Where do such firms turn for help? The New York Times signed a multi-year agreement with a 11-year-old Los Angeles-based firm that helped advise the **U.S. Sentencing Commission** on compliance programs. LRN will provide a legal and ethics education program, including a course on the company's business ethics policy. LRN CEO Dov Seidman says his business has at least doubled in the last two years. Growth is also rapid at **EthicsPoint**, a five-year-old PC firm that is one of three leading providers of ethics hotline services. Section 301 of Sarbanes-Oxley (SOX, as it's often called) requires board audit committees to create a reporting system to handle complaints and tips. In the past, nearly two out of three companies used internal systems, EthicsPoint CEO David Childers. "But in the last year, there has been a dramatic wave of outsourcing," he adds. Studies have found employees are 50 percent more likely to report a problem managed out of house. "People are afraid of retaliation and that anonymity can be breached." Among EthicsPoint's clients are **Ceridian**, **First Federal Bankshares Inc.**, and **Syracuse**

The faces behind these ethics services include people like Kevin Kelton, 48, who spent 24 years writing TV scripts for *Saturday Night Live* and *Night Court*, and now is a "content author" for LRN. Kelton directs six in-house writers to prepare lessons on a variety of ethical and legal issues. LRN, which offers a web-based education platform with more than 200 modules.

Kelton's new job isn't that different from his old one, he insists. The challenge is to engage the user "not so much as entertainment as to keep the user emotionally involved." Thus, the ethics writers prepare a script on how an executive ran afoul of conflict-of-interest rules, illustrating how the behavior didn't square with ethics rules.

Julie, 24, a recent college graduate, works in a West Coast call center for EthicsPoint, fielding inquiries over the phone and the web, on issues ranging from suspected fraud to sexual harassment. (Her last name remains confidential due to the nature of her job.) "My boss describes it as a hot dispatch," Julie said. Most calls aren't ethics related, and only 9 to 10 percent are SOX-related. More than half involve human resource issues such as complaints about harassment or workplace conditions.

Callers, she finds, are often upset or angry, not able to tell the full story. It may take her two weeks to elicit enough information to forward to a client (while protecting the caller's identity). The hardest part of her job: "Not giving advice."

Recruiting for the ethics army is vigorous. **Craigslist** — the free community search engine — listed 64 jobs in San Francisco and 50 in Boston that included the word "Sarbanes." **Monster.com**, a broader job search engine — tallies more than 1,000 and, on a recent check, 158 posted jobs.

Not all new “Sarbanes” jobs are directly tied to ethics, since the legislation focuses on accounting systems, creating a boom in accounting positions. **The Public Company Accounting Oversight Board**, created by SOX, has a \$136 million budget and should have 450 employees by the end of this year.

At major firms, there has been a boom in new ethics officer positions, with such positions recently at the **New York Stock Exchange**, **Marsh & McLennan**, **Nortel Networks**, and **Associates International**, among many others.

Kerry D. Moynihan, a managing partner at recruiting firm **Christian & Timbers**, reports “more work” helping companies find executives to handle compliance issues, with job titles chief compliance officer or general counsel to vice president of human relations. At financial companies, in particular, such officials are called upon to be “much more accountable to federal regulators.” And more companies “are creating offices around things like corporate responsibility officer.”

There was a time, he says, when compliance duties landed in the lap of “the green eyes; you didn’t want as front men. Now they are much more front of the house, three doors down from the chief executive.” Wall Street compliance officers that used to make \$350,000 to \$450,000 can now command \$750,000 or a million dollars in salary, he reports. And he expects demand for compliance officers to increase. He predicts hedge funds, for instance, will be subject to SEC regulations by 2006. And many companies will need help “coming up to speed.”

Ethics officers often wear more than one hat. At **Lubrizol Corp.**, in Wickliffe, Oh., Mark M. Hambrick has been vice president for human relations as well as chief ethics officer since 1994. He finds that the number of ethics officers have expanded substantially over the years. Currently, two people work with him on ethics, helping with tasks like posting ethics guidelines in seven languages, and overseeing 27 regional leaders around the world whom employees can contact with questions. The company is currently rolling out its ethics program to 3,000 new employees who’ve joined Lubrizol, a specialty chemical company, through an acquisition.

To convince employees it’s serious about ethics, Lubrizol frequently notes the experience of James Hambrick. When he oversaw business in the former Soviet Union, “he came back and said basically we can have our business plan or our ethics policy, but not both. We walked away with the business as a result,” Meister says. The story “lets people know you can make ethical decisions and be successful in this organization.” Venture capital money is flowing into the ethics industry as a result of the boom. The training business **Midi Corp.** of Princeton, N.J., was acquired with \$7 million in venture capital and “more money has been guaranteed when we need it,” says Bette Tomaszewicz. In one year, company employees have grown from 20 to nearly 70.

Midi has developed more than 50 different courses on legal and ethical topics, and is adding more courses a year. The material, available as online videos, is designed to “have a long shelf life,” said Jeffrey M. Kaplan, a Midi vice president. “Nobody ever asks an employee to commit to anything 30 days after training,” he says. “The devil on your shoulder is always pretty big; your boss is always looking over your shoulder. The question is, what is your little angel going to say? We want our training to help you resist the devil a run for his money.” Kaplan says what’s driving the ethics boom is not so much the legislation, as the increased tendency of prosecutors and regulators to take ethics programs into account when considering charges. Midi also sees demand for training on the Foreign Corrupt Practices Act, antitrust issues, and harassment.

One Sarbanes-related script Midi produced depicts a sales executive persuading a customer to inflate sales numbers by accepting goods that can be returned later. The sales person, in another employee to help cover up the arrangement. The second employee considers reporting the problem, but doesn’t, lies to an FBI agent, threatens a whistleblower, and eventually goes through a chain of events “you’re likely to remember for a long time,” Kaplan says. Midi’s sales, about \$5 million last year, are projected to balloon to \$8 to \$10 million this year, possibly \$20 million next year. A new era of growth, established ethics-related businesses are re-creating themselves. **Glo Compliance Services**, in Charlotte, N.C. — the largest hotline provider — traces its business to AlertLine, set up in 1981 to help defense contractors identify fraud. The business eventually became part of the **Pinkerton** security company, and it now provides services to half of the Fortune

2003, two Pinkerton businesses were purchased in a management buyout, and the new company embarked on a drive to expand in the current receptive climate. CEO Dennis Muse says \$25,000 calls a month, with topics ranging from ethics charges to a manager's behavior.

Reaching out beyond ethics, Pinkerton recently launched a service called "Stakeholder," a way for stakeholders like shareholders, customers, or contractors to voice concerns.

Software companies have found a bonanza in Sarbanes-Oxley. "Last year (2004), we met our revenue," declares Ed Thomas, product marketing manager for **OpenPages**, Waltham maker of governance, risk, and compliance management software. He expects similar growth this year.

The company's SOX Express software helps companies automate the compliance process by documenting internal financial controls, a SOX requirement. Next on the horizon: expanding risk management issues such as manufacturing and human resources. "Sarbanes is risk management for your financial department," he says.

**EMC Corp.**, the \$8 billion-revenue information storage company in Hopkinton, Mass., is a leader in what a spokesman calls the "emerging trend of records management." In 2004, it spent nearly \$3 billion to acquire two software companies serving that market. Fueled in part by Sarbanes-related demands, revenues at those two companies rose more than 20 percent in first quarter 2005. The Sarbanes-related activity ended up being about protection and management of information. Andrew Cohen, director and senior counsel at EMC.

At **Iron Mountain Inc.**, the big Boston record management company, the impact of the current era "has been profound," says Ken Rubin, executive vice president for corporate marketing. The collapse of **Arthur Andersen** and **Enron** moved records management "from the back room to the boardroom," he says. "How companies manage records became linked to corporate ethics; ultimately, to brand reputation and share price." In the new atmosphere, clients "began to view records as information assets, as footprints of action or inaction."

The price of all this new activity is enormous. **AMR Research** estimates that organizations will spend \$6.1 billion on Sarbanes-Oxley; others estimate twice that amount. Large companies with one of the big four accounting firms have seen their annual fees double. Technology firm **Aberdeen Group** of Boston reported earlier this year that "for many mid-tier firms, the cost of complying with SOX is temporarily spelling the difference between profit and loss."

At its best, though, the ethics evolution underway is about more than complying with expected detailed rules. It's about shifting how firms are managed, to incorporate an ethics focus. David L. Rubin, founder and CEO of **LRN**, likes to say he was in the ethics business "BE—Before Enron." In 1994, LRN was 10 years ago doing legal research for Fortune 500 companies, "putting out fires through crisis analysis." But he soon developed a notion of "ethical capitalism as a long-term driver of business success," and launched training programs to establish "do it right cultures." LRN has worked with companies like **Johnson & Johnson**, **Pfizer**, and **DuPont** for years. "Ethics isn't about good or bad," Seidman says. "Integrity is either there or it's not." David Gebler, president of **Working Values**, a decade-old Boston-based business ethics consulting firm, says in the new climate, "it's up to organizations to make the leap to an ethical culture because they are unsure of where to go."

He adds: "It is not enough to merely ask whether controls are in place or if everyone has signed a code. The organization has to understand what the drivers of behavior are and how those align with integrity goals."

Brian Gontarski, director of business development at Working Values, says an organization's culture, its values, and its business goals may be created by separate units. "We strive to find the point where they all intersect," so ethics is seen "as a way of doing business, not just following the company line."

Over time, as boards get more involved, the new focus on ethical behavior will only expand. Ann Jorgenson, a partner in Cleveland-based **Squire, Sanders & Dempsey LLP**. "What's

dramatically is that CEOs are moving away from the inclination to control board discussion becoming willing to hear other points of view, she says. Her job as an advisor is to “make comfortable with the exercise of independent judgment and to understand what constructi is.”

It may all be working. There are indications that the focus on ethics is bearing fruit.

The National Benchmark Study by the **University of Michigan** and research firm **Employ Motivation & Performance Assessment** looks at a variety of working condition measure found that among 1,000 major companies, the only statistically significant change in 2004 in companies’ scores for “ethics and fairness.”

Surveying financial executives, **Oversight Systems Inc.**, Atlanta found that most have se line benefits from SOX compliance. Nearly half, 49 percent, say SOX compliance reducec fraud and errors, and 48 percent say it made financial operations more efficient.

There are always critics, of course, and they’re making a buck as well. **CafePress**, selling merchandise online, is offering mugs priced at \$15.99 that are emblazoned with the words “Stinks!”

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