The role of integrity in individual and effective corporate leadership

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Abstract

This paper focuses on the issues of the integrity of the individual and its importance at the corporate level in creating a culture of integrity. Individuals that have integrity build trusting relationships with others. At the corporate level it takes individuals of integrity to develop a consensus around shared values. As this consensus builds, the corporation develops a culture of integrity. A culture of integrity creates a highly valued work environment; it impacts the quality of corporate governance; and it provides a foundation for solid long-term financial performance.

Keywords: integrity, corporate culture of integrity, great places to work, partnerships, long-term financial performance

Introduction

There is a great deal of lip service paid to the role of integrity in leadership circles; however, integrity means different things to different people and varies based upon circumstances. This paper focuses on the issue of the integrity of the individual and its importance at the corporate level in creating a culture of integrity. With an individual of integrity, we talk about the character of the person and our trust and belief in this individual. At the corporate level, we talk about leaders that have created a corporate culture of integrity that provides consistency, trust, and predictable results.

This paper maintains that integrity, both in individuals as leaders and in the corporate culture, is necessary for long term success and corporate sustainability.

Individual Integrity

At the individual level, integrity is more than ethics; it is all about the character of the individual. It is those characteristics of an individual that are consistently considerate, compassionate, transparent, honest, and ethical. The characteristic of trust is closely associated with integrity. While the definition may seem vague, we characterize individuals with integrity as individuals that we can count on to do consistently what is "right" and what is expected of them. They are reliable and predictable in dealing with others and with issues, and they are defenders of what is fair, just, and acceptable.

In the Turknett Leadership Character Model, developed by psychologist Dr. Robert Turknett, integrity is the foundation of the model, and without integrity, no leader can be successful. The Turknett Leadership Group notes that individuals of integrity will not twist facts for personal advantage; they are willing to stand up for and defend what is right; they will be careful to keep promises; and they can be counted on to tell the truth. In their model, integrity is the foundation of leadership and it involves a careful balance between respect and responsibility (Turknett, n.d.).

In his discussion of individual and corporate values, James H. Quigley, Global CEO of Deloitte Touche Tohmatsu, emphasizes the critical role of trust in the professional success of an individual. He states: "Simply put, those who bend rules are not considered trustworthy, and without trust an individual's value is severely diminished. Without trust and confidence, markets do not function, and value is destroyed." (Quigley, 2007, p.9). Quigley goes on to note the critical importance of integrity and character in the workplace. Lacking trust, competencies are meaningless. Individuals who are not trustworthy will not be given opportunities or responsibilities, and they will not be wanted as team members by clients or other employees (Quigley, 2007).

Professionals who have worked with personnel who lacked integrity talk about the inability to count on individuals to do what they have said they would do, environments where the focus has gone from customers to protecting oneself, and where leaders are unwilling to live by the values that they publicly espouse.

Corporate Culture of Integrity

At the corporate level, integrity refers to the culture, policies, and leadership philosophy. A culture of integrity has to start at the top and be seen in the conduct and activities of the executives. The leadership of the corporation must develop a consensus around shared values. As Kouzes and Posner (2002, pp. 79-80) point out, the development of shared values improves the work environment and productivity:

- It strengthens personal effectiveness, corporate loyalty, and ethical behavior
- It fosters team work, corporate pride and consensus

Corporations that have these values outperform other firms by a wide margin in terms of revenue growth, job creation, stock price and profitability (Kouzes and Posner, pp.80-81).

It is important for an individual to search for an employer with similar values. This match will be a key factor in one's ability to grow professionally and gain experience. As Quigley (2007) has pointed out, the culture of integrity may be far more important than the starting salary in one's quest for personal and professional fulfillment. He notes that corporations with a culture of integrity:

- Offer support to employees through colleagues and processes in place; consultation with other is seen as a strength rather than a weakness, and
- Supports a work-life balance as it reduces job stress, balances one's perspective, and contributes to job satisfaction (Quigley, 2007, p. 15).

When we have "trust" in our dealings with a corporation it is usually because the leadership of the company has created a culture of integrity. We believe that our relationship with the corporation will be predictable, reliable, and consistent in meeting our needs and requirements. The corporation has a leadership and governance system that successfully identifies and manages risk so that corporate activities can be transparent and predictable/reliable. It also means that if things are not going well, information will be shared so that employees can understand the situation and have the opportunity to contribute to the solution.

CoveyLink Worldwide (2006) speaks of the importance of trust because trust always affects the outcomes in terms of speed and cost. If there is a lack of trust, the speed on the transaction will go down and the cost will go up. In short, trust has a favorable impact on the economics of the relationship; trust pays a dividend in terms of speed and reduced cost. Establishing a culture of integrity engenders trust and increases efficiency.

In contrast, the characteristics of low integrity organizations are:

- High employee turnover rates,
- Lack of trust (suspicion and paranoia), honesty, and transparency,
- Broken promises,
- Disrespect - officers disparage colleagues or a category of employees,
- Buck-passing - others are blamed for problems,
- Unexpected financial events occur,
- Reluctance to put policies and procedures into written format,
- Exaggeration of leadership accomplishments, and
- Limited board access to information, officers, and employees.

High integrity organizations are characterized as organizations that are collaborative, constructive, innovative, transparent, with high employee morale, valued customer loyalty, and strong partnerships. They build teams and create value.

Studies have shown that corporations with a culture of integrity tend to have governance systems with higher external ratings and higher quality of earnings. They tend to be good places to work, competitive in their markets, and provide higher, more predictable returns to investors.

Integrity and Performance

The integrity hypothesis assumes that individual leaders of integrity can create a consensus around a culture of integrity within a corporation. This culture of integrity, in turn, will create a highly-valued work environment; the corporation will operate with its focus on the long-run good of its customers, employees and investors; and, as a result of this focus, the corporation will excel in terms of financial performance when compared to its peers.

The Evidence

Great Places to Work.

The Great Place to Work Institute, Inc. produces various lists of companies that are considered the most desirable places for employment. These lists are compiled from survey data collected from employees. The Institute uses a proprietary "Trust Index" survey and "Culture Audit" questionnaire in compiling its list of the best places to work (GPWI, n.d.).

The "Trust Index" focuses on corporate levels of respect and credibility. It consists of 57 statements that cover five areas: credibility, respect, fairness, pride, and camaraderie. The "Culture Audit" collects information on the employee demographics, benefits, and perks. It also asks management to describe aspects of corporate culture (GPWI, n.p.).

The Great Place to Work Institute, Inc. maintains that great workplace practices contribute positively to the bottom-line. The Institute maintains that these companies have lower turnover rates, are able to recruit qualified applicants, and have better employee morale, all characteristics of firms that have a culture of integrity. As a result, the Institute maintains, companies that are good places to work generate higher earnings and, over time, strong share prices. The Institute advances the belief that corporations with these characteristics have, in the long run, outperformed the S & P 500 and the Russell 3000 (GPWI, n.p.).

Governance Ratings.

There is a lot of controversy surrounding corporate governance ratings. The rating entities use multiple criteria and weights. As a result, a company that gets a relatively high score by one source may get a low score from another. The use of multiple criteria tends to weaken correlation with financial performance. Nevertheless, at least one criteria, director ownership of equity, exhibits a consistently strong correlation with financial performance (Bhagat, 2007).

Governance Studies.

A number of studies have shown that good governance may indicate less expropriation of corporate resources by management. These corporations are able to attract investors who are willing to invest more in the firm, thereby lowering the cost of capital. Also employees and suppliers are more loyal believing their relationships will be more prosperous; they will be treated fairly; and the relationship will be long term (ADBI, p. 1).

In the Gompers et al. (2003) study, it was shown that corporations with stronger shareholder rights had higher firm value, higher profits, higher sales growth, and lower capital expenditures than firms with weaker shareholder rights. This study constructed its own index of shareholder rights and compared the corporations with the highest ratings to the corporations with the lowest ratings.

The Klapper and Love (2002) study showed that better corporate governance is highly correlated with better operating performance and market valuation. The Klapper and Love study classified good governance into seven categories: discipline, transparency, independence, accountability, responsibility, fairness, and social awareness. These are the characteristics closely associated with a corporate culture of integrity.

In the study by Black et al. (2002, p. 16) of Korean firms, an improvement of ten percent in their corporate governance index led to an increase of 40 percent of the company's book value of common equity.

In the ADBI study (p.12) the rate of return on assets (ROA) was also positively impacted by the quality of corporate governance.

In contrast to these studies, the Rock Center for Corporate Governance at Stanford University using different commercial governance measures has shown little relationship between the governance ratings from four rating services (RiskMetrics Group, Audit Integrity, Governance Metrics International, and the Corporate Library) and corporate performance. The Center's study used five measures of performance: restatement of financial results, shareholder lawsuits, return on assets, the Tobin "q" ratio, and Alpha, a risk-adjusted measure of stock performance. The Tobin "q" ratio was the only measure in the Center's study to show a significant correlation (Daines, 2007).

Earnings Quality.

Corporations that have developed a culture of integrity tend to have high-quality earnings. That is, the governance policies around accounting policies, disclosure, and reporting favor transparency and conservative treatment of accounting issues. These policies lead to high-quality earnings; earnings that are repeatable, controllable, and bankable.

RateFinancials (2006) has repeatedly found that the poorest quality of earnings is associated with weak corporate governance, and companies with poor-quality earnings underperform the market. These firms with poor governance standards and aggressive accounting practices have lower equity returns and more volatility than companies with strong governance and earnings quality.

To test the premise that firms with greater agency problems perform worse, Sivaramakrishnan and Yu (2008, pp. 23-24) used past industry-adjusted performance as a measure of the adequacy of corporate governance in place. They found that firms with greater agency problems perform less effectively. Firms that outperform their rivals consistently had high-quality earnings where quality of earnings was defined as high accrual quality, high earnings persistence, and high earnings predictability. While their study did not find a direct link between high-quality governance and high-quality earnings, they did find that adequacy of governance was associated with high-quality earnings. In a study of Canadian firms, it was found that return-earnings were positively related to the strength of shareholder rights and quality of governance practices (Niu, 2005). The results of this study suggest that good corporate governance mechanisms provide greater oversight of the financial reporting process and ensure higher-quality earnings (Niu, 2005, p28).

In the Jordan et al (2008) study of 42 software firms, the authors found a correlation between high quality earnings and good governance ratings. Firms with high quality earnings had higher corporate governance ratings, higher stock prices, and higher earnings per share than software firms with low quality earnings. When the top three firms were compared with the bottom three firms in terms of quality of earnings, the top firms had high governance ratings, stock performance, and earnings per share while the bottom firms had poor governance ratings, poor stock price performance, and negative earnings per share (Jordan, 2008, pp.16-17).

Implications

Integrity is a prerequisite to personal success and for developing leadership skills. Individuals that have integrity build trust in their relations with others; they become valued as friends, colleagues, mentors, and supervisors. They are respected and counted on to do what is right. They are able to balance respect and responsibility, and they are able to share their values with others.

At the corporate level, it takes individuals of integrity to develop a consensus around shared values. They must be able to discuss these values openly as well as live the values they espouse. As this consensus builds, the corporation develops a culture of integrity. This culture impacts the interpersonal relationships within the company and creates a highly valued work environment. Employees are motivated and creative, take pride in their work, and enjoy their co-workers. The culture of integrity also impacts the actions and policies of the leadership team and the quality of the corporate governance system.

In a great place to work, turnover declines, employees have high morale, and productivity rises. As the culture of integrity permeates the relationships with customers, vendors, and suppliers, trust paves the way for transaction time and cost to diminish and for partnerships to develop. The corporate boards are able to give value and direction to executive officers, thereby assuring that the culture of integrity spans all stakeholders' interest.

Corporations with a culture of integrity tend to be leaders in their industries; they tend to outperform other firms and turn in solid long-term financial performance. They are good firms to work for, to work with, and to own.

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