

**Signing Ceremony of Business Ethics**

**Pact with Public Corporations**

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# **Ethics Management and National Development**

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*July, 2004*

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## **I . Adverse Impacts of Corruption on National and Social Development**

Corruption in the public sector starts with the abuse of power or position by public officials to obtain private gains. Such wrongful acts hamper the public interest by lowering quality of administrative service while raising the cost for the service, and ultimately undermine credibility and authority of a government.

Corruption hinders business activities of companies which are in full compliance with the market principles and furthermore distorts market's reasonable distribution of resources.

It is a common sense that if a company resorts to wrongful management practices such as window dressing, stock price manipulation, slush funds, collusive ties with the politics, it would be difficult to engage in the desirable business activities like technology development and facility investment.

This, in turn, leads to the decline in the savings and investment of corporations and makes foreign transactions dwindle, thereby not only weakening national competitiveness in the short-term but also eroding growth potential of the national economy over the long-term. Moreover, such illicit acts become an impediment to the consistency and predictability of government policies and increase uncertainties.

Undemocratic and non-transparent management of corrupt companies along with the absence of internal and external checks brings about conflicts between labor and management and increases anti-corporate sentiment.

If corruption in one area leaves unchecked it could spread to other areas, becoming a social and cultural evil that inflicts the entire society. For example, corrupt practices in public administration have been easily led to corruption in such areas as education, military service, legal and medical sectors.

Furthermore, the rampant corruption weakens “self-purification ability” of the society, demoralizes hard-working people, and undermines the core values of society by giving rise to conflicts among social strata, opportunism and cynicism.

Mistrust and bad reputation for public officials and businessmen as a whole make Gresham’s Law – “Bad money drives out good money.” - come into play. As a result, the both public and private sectors are swamped with corrupt people.

In a nutshell, corruption is a social evil that blocks development of not only individuals and companies but also a nation, and finally gives rise to the collapse of the entire society.

## **II. Necessity of Ethical Management**

### **1. What is Ethical Management?**

Business ethics refers to the value that must be uphold and honored by all stakeholders such as shareholders, customers, partners, employees and communities surrounding a company.

Ethics management means that a company runs business in a way that gains trust of all stakeholders by complying with market orders and acting consistently with its rights and duties as a social entity. To be more specific, it refers to transparent and fair management in such areas as accounting, tax payment, working conditions, and environmental protection, etc.

Therefore, it is a narrow understanding that ethical management is just a means to control corrupt conducts of executives and employees and a tool to innovate management.

### **2. Why Is Ethical Management Needed?**

Some say that managing business in an ethical way costs too high and accordingly, it is contrary to the goal of profit maximization. However, it is designed to enhance corporate competitiveness, and maximize economic

value added by correcting wrongful and high-cost practices to meet ethics standard rather than just preaching that a company should be more moral and ethical.

The necessity of ethics management is manifested by the fact that growing number of companies are driven out of the market or having difficulties in running business due to unethical behaviors or decision-making.

The ethically behaved companies gain the trust from investors, customers and business partners, which, in turn, leads to the higher brand value and profits. This means that ethical management becomes an indispensable component of a very survival of corporations.

Corporations create employment and are source of value-added of a nation. Therefore, integrity and trustworthiness of companies are directly related to the development of the entire society.

In the global age where an economic boundary no longer exists, investment decision and capital movement are based on how competent companies are. Non-transparent corporate governance and management practices stymie investment and distort an efficient allocation of resources, thereby weakening the both corporate and national competitive edge.

As the market economy is built upon the trust and order, the rampant unethical and anti-social practices will prevent the market economy as well as individual companies from growing. Therefore ethics management is critical to maintaining free market economy.

### **3. Examples of Ethical Management in Korea**

We have witnessed a series of scandals where unethically managed companies go into bankruptcy or are put into a big trouble such as Daewoo, Donga Construction, SK Global and Good Morning City. All of them have one thing in common: they

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These cases demonstrate that “too big to fail” is no longer available in Korea, and made us realize that even best-performing companies can collapse if they disregard corporate ethics.

Recently, the FKI (Federation of Korean Industries) released the report titled “Analysis on Relationship between Corporate Ethics and Corporate Value.” The report shows that ethically managed companies enjoy much higher rate of foreign investment, share price growth rate, ratio of operating profit to sales than less-ethical ones.

In recent times, domestic companies are paying greater attention to ethical management. For instance, Shinsegae, Posco and Yuhan-Kimberly are spearheading the efforts in adopting ethical management. The Institute for Industrial Policy Studies (IPS) opened the Business Ethics Center and runs the BEST Forum (Business Ethics is the Source of Top Performance) and the Ethics Officer Program (EOP).

The FKI has developed various ways to supports companies in implementing ethics management – Korean council for business ethics; business ethics support center; and business ethics school.

Nonetheless, there is a long way to go to catch up with developed nations. As TI Korea pointed out many firms have not made enough efforts in setting up an implementing system and putting the code of ethics into practice after they adopted the code. It is required to have an internal oversight system that controls and monitors the actual implementation.

### **III. Government's Efforts to Prevent Corruption**

#### **1. Anti-Corruption Policies Since 1990's**

The Kim Young-sam and Kim Dae-jung administrations undertook comprehensive and systematic actions to fight corruption. It laid the foundation for combating large-scale administrative corruption and corporate corruption. The level of petty corruption in public administration was

significantly lowered.

The Kim Young-sam government laid a framework for corruption prevention by introducing the Real Name Financial Transaction System (1993), set up the Regulatory Reform Committee (RRC) (1998) pertinent to the Basic Law on Administrative Regulations (1997).

Building upon what had achieved in the preceding administration, the Kim Dae-jung government put in place a legal framework such as enactment of the Anti-Corruption Act (ACA) (2001), the Prevention of Money Laundering Act (2001), and the Foreign Bribery Prevention Act in International Business Transactions (FBPA) (1998), and launched the Korea Independent Commission Against Corruption (KICAC) (2002).

The incumbent government selected the creation of “corruption-free society” as one of the 12 major administrative goals. To do that, it has revised economy-related laws and tried to improve systems.

For example, the Securities and Exchange Act was amended to prevent formation of illicit funds. The amended act stipulates that a person in charge will be required to take civil liability if false information is stated in a corporate disclosure document, and the disclosure document must be certified by a CEO of a company.

The Act on External Audit of Joint-Stock Companies and the Certified Public Account Act were revised to prohibit a CPA who has audited a company for a long time from providing consulting service for the same company.

The newly enacted Collective Action Act states that minority investors who suffer loss because of unlawful acts like window dressing, inappropriate audit, false disclosure, stock price manipulation and inside trading are allowed to file a collective action.

Not only that, the government revised the Enforcement Decree of the Specific Financial Transactions Reporting Act to curb illegal financial transactions. In a bid to control money laundering, the amount of suspected financial transaction that a financial institution must reported to the Financial Intelligence Unit (FIU) was lowered from KRW 50 million or more to KRW 20 million or more.

To prevent those who are under the influence of major shareholders from being selected, the government is pursuing the amendment of the Securities and Exchange Act to oblige a company to appoint outside directors among those recommended by a neutral “committee on recommendation of candidate for outside directors.”

The cumulative voting became mandatory under the to-be-revised Securities and Exchange Act and the Fair Trade Act in order to protect interests and rights of minority shareholders from abusive acts of controlling shareholders

and the management.

To take steps further, the Rho Moo-hyun government is trying to strengthen the FIU's power to trace financial information, and make it mandatory for financial institutions to report large-amount cash transactions to the authorities even if they are not suspected transactions. Furthermore, it will make it obligatory for lawyers and accountants as well as financial institutions to report suspected transactions.

## **2. Future Plans of the KICAC**

Up to now, the Commission has focused its efforts on revising or improving laws and systems. In the future, we will also allocate our attention to the establishment of ethics management.

Breaking away from the past when the government made the law and gave instruction in a top-down way, we will more resort to consultation and cooperation to encourage you to make self-initiated efforts. I believe, this is more effective way and better befitting the nature of ethics management.

In this regard, the KICAC is signing a business ethics pact with 14 public corporations. Let me briefly mention the significance of the pact.

First, companies can systematically pursue ethics management and anti-corruption efforts by signing the pact with the government, thereby

effectively protecting themselves and their employees.

Second, expertise and information on anti-corruption held by the government can be shared with the parties to the pact, which can improve effectiveness in fighting corruption.

Third, signing the pact would enhance a corporate image by sending a clear message to customers and partners that signing companies are committed to ethical management and corruption elimination.

Major contents of the pact are as follows;

First, the establishment of an ethical management system such as formulation/revision of a business ethics code

After gathering opinions from public service-related organizations, we will first prepare a standard code of ethics. Based on the standard code which presents the core values, each organization will determine the details according to their needs. To encourage them to implement it, the KICAC will also provide information on procedures to establish or revise the code and best examples, etc.

Second, education on business ethics

The Commission will provide quality education materials, program and

consulting service to help the signing companies to adopt and implement ethics management in full force. To increase interest in and awareness of ethics management, we will actively promote best practices.

Third, establishment of a well-functioning compliance system

We are reviewing the improvement of auditor appointment procedures to guarantee only qualified persons equipped with expertise are selected, and independence and expertise of assistants to an auditor should be increased. A compliance officer system which has been put in place in financial institutions since January 2000 will be introduced. More strengthened protection/reward system for whistleblowers and the introduction of Integrity Pact are also under consideration.

The KICAC opened the Business Ethics Center on June 28, 2004 to provide an arena for the exchange of comprehensive information on corporate ethics. Along with the off-line center, an on-line center called Digital Business Ethics Center also started operation.

The Center will perform such duties as study on business ethics, support for education, and exchanges and cooperation.



## **IV. Ethical Management in Public Companies**

It is widely believed that it is very necessary for public corporations to commit to corruption prevention and ethics management since they play an important role in the national economy and have a monopolistic position in the market.

Although public companies stand between the government and the private sector, since they are also corporations, they should be supposed to manage the business in an ethical way.

“Corporate Citizenship” puts an emphasis on the roles of corporations: they should be a good member of society by creating value-added and creating jobs for a nation rather than just serving its own interest of making money. As this concept gains momentum, the greater roles and higher responsibility are placed on corporations.

Accordingly, a growing importance is attached to ethics and transparency of corporations, and their social contribution in many countries around the world. Major global companies are making efforts to gain trust from the society by taking “ethical initiative.”

We have recently seen an increasing momentum in the call for a break away from the chronic evil practices such as collusive ties between politics and business, arbitrary decision-making by owners, disrespect for minority shareholders, window dressing, non-transparent management practices, and fleet-type operations.

In particular, the recent scandals where some unethical companies shook the national economy made the corporate sector realize how important social responsibility of a corporation is. This also means that our society requires corporations to play a more matured role and ethics management becomes an indispensable ingredient of a corporate survival.

With this recognition, major Korean companies are developing various measures including the establishment of a code of ethics, creation of a transparent subcontracting system, setting the ceiling of entertainment expenses, and strengthening an audit function.

So far, public corporations have been regarded as an example of moral hazard, even being called “a company without an owner.” In addition, they have been involved in unfair and corrupt business transactions for they are monopolistic suppliers of basic products or services and have a superior position as a large-scale order-placers and demanders.

I hope you, the management and auditors, will do your best to combat corruption and implement ethics management under the clear understanding of the importance of ethical management for corporate survival in the 21 century.

Thank you for your kind attention!

Source: <http://www.kicac.go.kr/>

Accessed on 11/29/2004