

# Does Business Ethics Pay? Ethics and Financial Performance

*Institute of Business Ethics, Simon Webley and Elise More*  
2003

## Objectives:

- To explore measures of commitment to ethics/corporate responsibility and compare against financial performance measures.
- To investigate whether a commitment to business ethics does pay.

## Methods:

- Sample taken from FTSE 350 (UK) of between 41 and 86 companies for the years 1997-2001.
- Companies divided into two groups: those with codes ethics for at least five years and those without.
- Indicators used for measurement
  - Corporate Financial Performance
    - Market Value Added (MVA)
    - Economic Value Added (EVA)
    - Price/Earnings Ratio (P/E)
    - Return on Capital Employed (ROCE)
  - Corporate Responsibility
    - Code of ethics
    - Ratings for socio/ethical risks
    - Cited in Britain's Most Admired Companies
- Basis for methodology
  - Verschoor, Curtis C. "Corporate Performance is Closely Linked to a Strong Ethical Commitment," *Business and Society Review*, Winter 1999, pp. 407-415.
    - Conclusion: Superior MVA for US companies who referred to their ethics programs in their annual reports compared with companies who did not.

## Findings:

- Presence of a code of ethics is a good indicator of a genuine commitment to ethics.
- Using EVA, MVA, and P/E as measures, companies with a code of ethics outperformed similar companies without.
- Companies with a code of ethics generated significantly more EVA and MVA than those without.
- Companies with a code of ethics experienced less P/E volatility than those without.
  - Indicates more secure investment and consistent management.
- Companies with a code showed increased average ROCE of 50% while those without showed decrease during 1999-2001.
- Companies with an explicit commitment to doing business ethically produced profit/turnover ratios at 18% higher than those without.

## Conclusion:

There is strong evidence to indicate that larger UK companies with codes of ethics, e.g. those who are explicit about business ethics, out-perform in financial and other indicators those companies who say they do not have a code. Having a code of business ethics might, therefore, be said to be one hallmark of a well managed company.

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