

Recognising Value Based Approach In Corporate Governance : Institutionalization Of Ethics

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Corporate governance is the structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability. However, for decade argument on the inadequacy of corporate governance mechanism to cope with the modern corporation seem to hit the business agenda. Several views indicate that the principle based governance designed to direct and manage business could not cope with the globalization era of business. The purpose of this paper is to propose fundamental element to fill the inadequacy - incorporating value based approach into corporate governance practices. This paper argues that value based approach form of corporate governance practices need to be introduced to support the present corporate governance practices framework. Hence, this paper will discuss the ethics aspects of governance focusing on formalization of ethics in organization as a mechanism to improve governance practices. A single case study was conducted to explore the ethical mechanisms that have been institutionalized in order to enhance corporate governance practices. Interview was performed with relevant key person in the company. Based on the interview conducted several ethical mechanism were discovered in order to enhance better governance in the corporation. This paper contributes towards new perspective of governance whereby the ethical aspects is integrated into the governance practices.

Field of research: ethics, corporate governance

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1. Introduction

Corporate governance is a topic which is often discussed and debated upon in recent years. Although the issue of corporate governance has been discussed since the early days of corporations, the interest on corporate governance seems to take the attention of the media and the public after the giant corporate scandals such as *Enron*, *Worldcom* etc. Due to its economic impact, these corporate malpractices spark the crisis of trust among the stakeholders. Subsequently, realising the important of governance issues, regulators in various countries including Malaysia provides various perspectives for governance reforms. As a moved to rebuild the trust on the governance systems initiative on improving the corporate governance systems has been formulated world wide. Proactive measures have been taken by the regulators to put forward recommendations and regulations on corporate governance. Continuous efforts developed simply to guide corporations into achieving necessary high standards of corporate behavior.

However, the trend of corporate scandals keep emerging which questions the credibility of our corporate governance system. Some claims that the present corporate governance mechanism neglect fundamental element (Coffee, 2003). Reviewing the literatures, it is also noted that the current corporate governance mechanism has its limitation. The purpose of this paper is to propose fundamental element to fill the limitation - incorporating value based approach into corporate governance practices. This paper argues that value based approach form of corporate governance practices need to be introduced to support the present corporate governance practices framework. Value based approach is necessary to cope with the advancement of business conduct in this era. Hence, this paper will discuss the ethics aspects of governance focusing on formalization of ethics in organization as a mechanism to improve governance practices. A single case study was conducted to explore the ethical instrument that have been institutionalized in order to enhance corporate governance practices. Hence, this paper will discussed on the various ethical instrument present in the company selected. In essence, this paper contribute towards advancement of knowledge in governance as it put forward the important element (that is ethics), which is recognized as fundamental to circumvent corporate governance flaws by several researchers (Arjon, 2005; MacKenzie, 2004, Oon, 2004)

2. Literature Review

Concentration on corporate governance mainly dealt in the decision making of board. Implementation of the decision making is indeed important as the decision by the board involves the strategic planning of the whole corporations. Hence, accomplishing the four pillar of corporate governance that is accountability, transparency, fairness and responsibilities are core values in every decision making in a corporations. Good governance as described by Quinsumbing (2007) is formal and informal decision

making and the process of which the decision is made. Therefore, good governance possess characteristic such as participatory, consensus oriented, accountable, transparent, responsive, effective, and efficient, inclusive and follow the rule of law (Quinsumbing, 2007). The key challenges of modern corporations, however is to accomplish these values at the same time maintain the sustainability of the corporations.

Compliance based approach of governance structure have been claim insufficient in coping with the challenges of modern business (Arjoon, 2005), hence companies find themselves pressured to satisfy stakeholders demand for accountability and transparency. Typified by the agency theory where the wealth of stakeholders is made priority has somewhat incapacitated the compliance based approach of corporate governance. Profit driven motivation of achieving the wealth for stakeholders is no more relevant in sustaining the growth of business in the globalization era. Globalization has forced corporations to act ethically or confront with the consequences of losing their support from stakeholders.

Bring to the fore, integrating ethics as a new approach towards better governance has been viewed important. This is due to the many suggestions made by governance scholars that ethics is the core concept in corporate governance (e.g Cladwell & Karri, 2005; Sullivan & Shkolnikov, 2007). Businesses have responsibility towards the society, therefore answerable to the society. As emphasised by the social institution theory, a corporation is not merely a private association created for the purpose of personal enrichment but also a public enterprise that is intended to serve some larger social good (McEwan, 2001). Hence, ethical behavior is the social responsibility of a corporations to protect the society in which they operate (Fisher, 2004). Fisher (2004) further adds that the responsibility of corporation is a set of obligations the corporations has to protect in a society in which they function.

Several opinion has been gathered to claim that integrating ethics value in an organization could prevent corporate mishap and thus safeguard the individual and corporate reputations (Drennan, 2004). Infusion of ethics principles and values into corporate culture often been emerged in the boardroom discussion. Fombrun and Foss (2004) highlight the three principles which has often emerged in the discussion among the board are: infusion of ethic principles and values into corporate culture, appointment of chief ethics officers, adoption of stricter ethical guidelines and codes of conduct.

2.1 Institutionalized Of Ethics

One of the views of infusing value based approach of governance is through instiutionalisation of ethics. Several ethic researcher claims that institutionalization of ethics is a formal initiatives to guide the member of an organization in making ethical decision (Weber, 1981; Hoffman, Moore & Fedo, 1983). Empirical evidence in the 1980's and 1990's has proven on the point that institutionalization of ethics is a form that have been incorporate in organization to direct corporations towards ethical decision making. (i.e Stevens, 1994; Vitell and Hidalgo, 2006). But what is

institutionalization of ethics? There are several views on the understanding of institutionalization of ethics. Andrew (1989), for example, defined institutionalization of ethics as the action that are needed to map a high road to economic and ethical performance and to mount guardrails to keep corporate wayfarers on track' (p.99 as cited in Soutar, McNeil & Molster, 1995). Purcell and Weber (1976: 6), on the other hand, defined it as

'... institutionalizing ethics may sound ponderous, but its meaning is straightforward. It means getting ethics formally and explicitly into daily business life. It means getting ethics into company policy formation at the board and top management levels and through a formal code, getting ethics into all daily decision making and work practices down the line, at all levels of employment. It means grafting a new branch on the corporate decision tree- a branch that reads "right/ wrong' .

Purcell and Weber (1979) suggested that companies should adopted institutionalization of ethics to impose good strategy in companies. Recent opinion on institutionalization of ethics has been viewed in Vitell and Hidalgo (2006) where, it has been identify as an important route to control the problem of ethical issues in an organizations. Institutionalization of ethics explores how organization structure and action are molded by cultural, political and social forces that surround the entity (Fogarty, 1995). This organization structure and action are important as the action which does not instill with values, may lose the support of the institutions actors. This is because, the environment surrounded the organizations dictate that organizational survival is predicated upon some form of conformity to prevailing values or standards for appropriate behavior. As pointed by Fogarty (1995), institutional theory provides an ability to allow for the separation of the rhetoric of ethics and ethical action.

Soutar et al. (1995) explained that institutionalization of ethics keeps the employees of an organization guided by formal ethics element to matters relate with ethical concerns. This formal guidelines is indeed important as has been noted in McEwan (2001) that ethics is an important element in decision making process in an organization. Institutionalization of ethics would helped in decision making in an organization because it is a form of consistent set of value that would guide employees in their conduct of doing business. Soutar et al. (1995) in their study reveal that there are three factors to institutionalized ethics in an organization which are: internalization of ethical values, compliance with rules, and external perceptions. In their study of institutionalization of ethics in Western Australia Stock Exchange companies listed in main and second board, Soutar et al. (1995) found that forty eight percent of these listed companies have institutionalize ethics in their workplace. As for the factor contribute to companies taken formal step to incorporate ethics values, it is reveal in their study that size is a factor that explain the interest to institutionalize ethics in these public listed companies. Larger companies (with employees between 1000-5000) have formally incorporate ethics however, the smaller companies (less than 100 employees) had undertaken the initiatives. Soutar et al. (1995) also found that there are several reasons for companies not taken initiatives to institutionalized ethics in their organization process, which are company is ethical enough, company too small to need it, lack of time to plan such efforts, and lack of financial resources. It is also discovered that the major pushing

factors are more of external purposes as the main reason was to provide direction to employees and to be seen as socially responsible and to improve corporate image. Nevertheless, the internal pushing factor describes are improving management behavior and corporate culture, compliance with law and the reduction of criminal activity in the workplace.

Sims (1991) in his suggestion described several elements which could be institutionalized within organizations. Permanent board-level committee, code of ethics, ethics training are some of the ways to institutionalized ethics in an organization apart from managing the psychological contract between its employees and the organizations, reinforcing the employee's organizational commitment, and encouraging an ethically-oriented organizational culture. In addition, Jose and Thibodeaux (1999) conducted a study of 86 corporate level marketing and human resources managers of American multi-national corporations. It found that the implicit forms of institutionalizing ethics is more effective than the explicit forms in shaping the ethical behavior.

It is also revealed that institutionalization of ethics such as ethical program could provide difference in governance practices in a corporation. Felo (2001), for example, although found that there is no significant relation between the potential conflict corporate governance structures in firms with ethics program and without ethic programs, however firms in which board are actively involved in the oversight of the programs have more independent boards than firms which the board are not involved in the programs. As a matter of fact, recent study conducted by integrity interactive Europe concluded that robust ethics and compliance program are the major concern for business across Europe. Implementing ethics and compliance programs are among the top reason chosen by the heads of legal and chief compliance offices of 500 largest companies for doing the right thing and building common company culture. Needless to say, the trend of institutionalization of ethics continues as companies realize the benefits of infusing ethics in business activities. Companies take initiatives to include and improvise the ethical mechanism to attract particular interest group towards the companies as it is belief being a responsible member is rewarding. Following section of the paper explains the outcome of a case study conducted by the researcher to investigate the mechanism used for institutionalizing of ethics in enhancing corporate governance practices.

3. Research Method

A single exploratory case study was conducted for the purpose of exploring the ethics mechanism institutionalization in company to enhance the practices of good governance. The case was selected based on certain criteria such as suitability of company being listed in the public listed companies. Also, it is listed among the best ten companies which are ranked to obtain high corporate governance score in 2006, hence appropriate to be selected as sample for the study. As stated by Ritchie and Lewis (2003), unit for sample chosen due to the characteristic that is expected or known to have salience to the subject matter under study, in other words, 'symbolic representation' due to its relevant to the investigation of the study.

3.1 Description Of The Case

The description of the case is restricted for the purpose of confidentiality. Hence, the name of the company would not be disclosed. However, basic information of the study will be described. The study was conducted in one of the leading communication corporations in Malaysia. It started as a private company but has been listed in the Bursa Malaysia for several years. The company is well established for its innovative service provider and has received several domestic and international awards. This company grew rapidly due to the demand of communication technology. The selection of the company was based on the criteria that the company is among the top ten (out of 350 companies listed on the Main Board) that had been accounted as companies practicing the highest level of corporate governance compliance in accordance with the Bursa Malaysia Securities Berhad corporate governance and best principle. The rank on the level of compliance was based a joint study by the University of Nottingham and the Malaysian Shareholder Watchdog Group (2007) related with corporate governance.

3.2 Design Of Research

An exploratory case study is appropriate to describe the research strategy. The exploratory fits in the design because at this stage, this study mainly focus on 'what' questions which as described by (Yin, 1994) justify the rationale for conducting an exploratory study. In this sense, the present study aims at exploring 'what' and 'how' the company use ethical mechanism that could enhance its corporate governance practices. In order to answer the inquiry: what are the instrument used to incalculate ethical conduct in improving corporate governance practices, the research procedure follow the inquiry method. Discovering what is the 'truth' out there is the key issue of the research design. Hence, based on the nature of the study (i.e exploration of ethics), face to face interview is appropriate technique. Interview was conducted with the head of internal auditor. The head of internal auditor was selected due to his scope of work where any ethical issue and concerns is the responsibility in his unit. The interview was recorded on tape, but in some cases notes were taken. The tape was subsequently transcribed. Documents such as the annual report was also observe to investigate the aim of the study. Themes were then identified from the transcription, document analysis and a summary of result drafted.

4. Findings and Discussion

Based on the interview transcribed, several themes related with institutionalization of ethics as being possibly influencing the corporate governance practices were discovered. Some of the themes are directly concerned with the formal structure of the company whilst others are more of views of the respondent. Based on the data gathered, the data were later broken into themes. These themes are:

4.1 Committees And Committee Members

The respondent pointed several ethics structure that is practiced in the company. One of the main initiatives towards good governance practices is that the company form “Defalcation Committee”. It is a committee that set up to deliberate all conflict cases related with ethical issues. The members of “Defalcation Committee” are the Chief Finance Officer, Director of Human Resource, General Council and Chief Operating Officer. The purpose of forming this committee is to listen and make decision upon any individual who had violate the ethical conduct based on the report made by the Internal Audit Department. Disciplinary act will be taken upon the individual based of severity of the cases which has been brought on by the Internal Audit investigation and report. This committee will meet once in every six weeks to update on the cases reported by the Internal Audit Department. The decision of ‘Defalcation Committee” is taken seriously by the company.

4.2 Criteria Of Director Appointment

Another means of enhancing good governance is setting criteria for appointment of directors. The respondent pointed to additional criteria for selection of directors where the criteria for appointment of director should be beyond their qualification. He strongly believed that directors of a corporation should not be restricted to skills and knowledge. Malaysian Code of Corporate Governance (Report on Malaysia Code of Corporate Governance, 1999) recommended that board should make up of combination of directors who has intimate knowledge of the business. However, the Code does not emphasis that the credibility of board members in terms of their recognized integrity and credibility. The company however, emphasize additional criteria which he find important in enhancing standard of corporate governance practices. Apart from directors skills and knowledge, the persons appointment should be of high reputation and integrity. As mentioned by him, this criterion is applied in the company understudy. Selection of directors for the said company is based on their reputation and integrity stand point. He explained the credibility of all twelve members of the board. Majority of the board members had experience in prestigious international companies with high business reputation. The board of director line up are mainly persons with high integrity and re-known business person. He also states that Malaysia has long way to go in terms of the board members reputation and contribution towards the governance practices as Malaysian environment may be dominated by the founder and family which probably not in the position to contribute the best to the business. He stress that shareholders should be more vocal in terms of selection of directors.

4.3 Promotion Of Ethics

There are various ways that are practiced in the company in order to promote ethical conduct among the staff, board members and employees of the company. Below are several ethical instrument that are gathered based on the interview.

4.3.1 Code of conduct and business practices

“Ethics is core value of the company, on top of company satisfaction and culture”; statement pointed by the respondent. Ethics is one value that is considered as a core practiced in promoting and communicating good behavior in the company. He voiced that the company do not tolerate unethical behavior with any parties related to the company. The key manifesto of the company is to operate its business fairly, ethically and in full compliance with all laws and regulations. In order to make belief the manifesto, the company has created a detailed Code of Business Practices guideline for all the relevant internal and external parties. This Code of Business stipulates how each relevant individual should react and behave in line with the expectation of the company good governance practices. For example, every employee of the company must reach understand and sign the code of business practice every year, this more than 10 pages document that lay down precisely what company standard for, regard to principle of ethics, down to the detail of what given or gift, that they can receive and not receive or procurement and delivery with contractor or member of the staff. Those are being sign once a year to remind people of values. The practices in not restricted to employee, as a matter of fact, other relevant parties involved in the company are also bound by their ethics instrument. The company also formulated a vendors code of business practices. The vendor codes consist of practices that are expected from vendors and the guidelines that are formulate by the company in order to main certain standard of integrity from both parties (the company and the vendor). “All company doing business must also signed on code of business practice, where they seek to communicate our principal of doing business and they are written reading and acknowledging they are being understand. Vendor who found to be working against this ethics, would be discontinued from doing business with us”. This explained by the respondent is the entry point code of business proactive.

In regards to the implementation and effectiveness of the code, the company has specially established office of Business Practices to provide policy guidance and facilitate compliance with the code. Continuously efforts are taken by the office of Business Practice to look into ways to enhance high standard of business conduct and ethics in the company such as benchmark for best practices is observed to further improvise the company business practices.

4.3.2 Ethics Hot line

Further instrument disclosed by the respondent in promoting ethics is that the company created ethics hotline. In order to maintain the integrity of the hotline and the confidentiality of the subject, an independent unit is mandated to hold the trust of the hotline. Hence, internal audit, being the internal independent department is the custodian of the hotline. The purpose of appointing internal audit unit as custodian is because the staff would have higher confident to report through email or letter of any wrong doing instead of directly report to the top

management. Staff in this company normally have full confidence to report to the internal audit without fear.

4.3.3 Other sources

We have an internal control web whereby all employees can get access. It is a program on internal control, case study and part of ethics. There is a section called "ask or control" where the employee can ask any enquiry related to internal control, risk management and any ethics issue. That is one training using virtual reality that is easily accessible and provides quick answers for the employee to resolve their conflict or query related to an ethical issue. In addition, on entry point, every new staff is given training related to ethical conflict. Thus, it would guide them to deal with ethical problems or issues in the future. Some of the staff such as the management manager and the engineer were given training in a management attachment program where they are trained from six to twelve months. This attachment program nurtures them to be ethical managers and be better in internal control.

4.4 Behavioral Development

Employees are constantly encouraged to attend programmes such as 'effective people program'. Such programmes are developed to enhance their management skills. The company provides change programme initiatives to facilitate the mindset and behavioral change to realize the company's long-term vision target. The aim of establishing the change programme is to establish the company's reputation and to sustain the company's value proposition. The company also revamped their performance appraisal system to incorporate performance indicators on behavioral mindset change. This is a good move made by the company to instill good behavior among employees in ensuring continuous permeation of the culture across all aspects of the company's business.

4.5 Leadership Extract The Culture

The respondent viewed that the company is run professionally as the leaders are professional managers. He explained each individual senior board member with great admiration. Observing the members' description, the quality of board members is disputable as their various backgrounds, cultures and nationalities of the board members indicate the professionalism of the company. This is an advantage of the company to possess mixed talent from outside and within Malaysia. As mentioned by the respondent, all of the board members have a good track record. They are highly regarded individuals in the business society. Majorities are from reputable multinational corporations. As stressed by him, "*basically we get the best people around. Their background is strong so when they go to board meetings they can contribute*". The respondent voiced that the corporate governance survey on disclosure of best practices, although good, has its limitations. This is because the measurement does not measure the internal part of the company, for example, the reputation of the leaders. He foresees that the missing element which is very important for investors is not disclosed in the Annual Report. The missing

element could not be prescribed in the statement of corporate governance but culturally cultivate by the leaders in the company. It has strong business fundamental and culture of innovation. Highly qualified individual are trusted to carry out this culture of innovation. What they stand for? Who represent the leadership? Who are they? Observing the annual report, the company provides quite an extensive description of each individual board members including their experience. The board shows good example to the employee by themselves attending training programmes such as in-house to develop their leadership qualities and managerial capabilities.

4.6 Internal Ethics Policy

The procedure related to ethical concerns especially business conduct such as receiving gifts are well documented in the company. For example, they have a declaration form to be filled in for anyone who received gift worth more than RM200. The application will be approved by an ethics officers who will decide on whether the gift should be returned or otherwise.

4.7 Formalised Communication

The company also believe in communicating ethics values from top to bottom. This is done through program where the code in business practice is communicated to the staff. How this is done? Every new recruits to this company spend first week in orientation program where the code in business practice is explained. The objective of the program is to ensure new recruits understand the practices of business conduct in the company and respect the expectation of the company towards ethical behavior. In order to bind their responsibility, accountability and duties, the recruits have to sign code of business practice in their first week of employment.

Another form of communicating ethics is through means of disclosure of cases of wrong doing occurred in the company. In order to maintain ethic as core value practice in the company, the company communicate formally to the employee by verbally or formally inform them of the misconduct that has happened in the company.

“Every years I summarie all the investigation and communicated this with the staff verbally and in the Internal audit control bulletin. I publish this and tell the staff during the year and investigation 14 cases in a year. These cases are like falsification of documents, breach of document practices. As a result of the investigation 10 people has left while 6 dismissed the discipline letter”.

Punishment for those who violate the ethical stance of the company is a message to the others that the company practice high standard of ethical conduct.

4.8 Internal Audit Involvement

Internal audit department in the company plays a key role in the institutionalization of ethics towards good governance. The internal audit department educate through

various means in order to teach the staff with several tips of wrong doing such as recognizing red flag. Unlike other internal audit department in other company, the board recognized the important role of internal audit in enhancing ethical behavior among employees and enhancing governance practices in the company. Internal audit department in the company is very active not only in investigation but managing corporate governance and internal control issue. As a matter of fact, the head of audit is the member of the senior management team to ensure good corporate.

4.9 Enforcement

Implementation is an important aspect in ensuring best practices. 'Walk the talk' is a motto that should be practice in any organization. Essential to maintain the business reputation, the company formatted several strategies to ensure that good governance practices. Defalcation Committee is one initiate taken by the company deal with regulatory on matters pertaining to fraud and unethical practices. The Committee works with Internal Audit Department and Management to act upon any cases of wrong doing. Hence, appropriate action are taken up by the committee upon the findings of the investigation. A fraud management function is also formed to safeguard the interest of the customers. Fraud management function is a monitoring unit that monitor the daily subscriber call pattern to recognize suspected call fraud which uses the industry development system to detect such wrong doing activities. Remedial action are taken proposed to the management to ensure enforcement are taken seriously regarding any unethical behavior to protect the interest in this case the stakeholders.

5. Conclusion

It is about time that corporate governance framework consider to include reference to business ethics. For two decades the present corporate governance framework has guide businesses towards compliance based approach. However, the present corporate governance framework has over time shows its limitation towards the business in this era. Empirical evidence gathered based on a single case study explored found that institutionalization of ethics in the corporate governance practices structure would contribute towards different spectrum of governance. The study which explored how ethics concerns can be integrated in the corporate governance structure in an organization provide new insight of governance. Ethics instruments that have been formalized would help to implement high standards of governance in a corporation. Such approach provides evidence of the corporation commitment to good corporate governance practices. Further study need to be undertaken using a different approach to establish the relationship between the ethical variables and corporate governance practices.

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