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Facilitating Business in South Africa

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The Corporate Report

Facilitating Business in South Africa

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CONTENTS

About the Editors

Articles

The case for recognition of ethical capital as part of the six capitals model

Cynthia Schoeman

We define ethical capital as the collective value that derives from the organisation's commitment to ethics, governance and good corporate citizenship. The lack of a defined, separate identity for ethics in the form of ethical capital erodes the benefits that can be gained from ethics being a dominant feature of the organisation.

An organisation that can claim ethical leadership and an ethical culture encompassing ethical conduct within the company and relative to its external stakeholder has clearly created something of great value. And that value warrants being accurately identified, not least because the benefits of clarification and focus support the pursuit of ethics. This value can best be described as *ethical capital*. Yet this is neither a widely adopted concept within organisations nor is it recognised in the six capitals model. Consider instead that ethical capital should be recognised as an *asset* that serves as a source of value for the organisation and its stakeholders.

In favour of ethical capital as a distinct capital

The six capitals model, comprising financial, manufactured, intellectual, human, social and relationship, and natural capital, is core to the International Integrated Reporting (<IR>) Framework ('*the Framework*'). There are three factors that support ethics being recognised as a distinct capital.

1. The capitals influence the organisation's ability to add value over time

The six capitals model directly addresses the purpose of an integrated report which includes explaining to financial capital providers how an organisation creates value over time. The capitals are viewed as stocks of value on which the organisation depends for its success and are intended as a guideline for ensuring that the organisation considers all the forms of capital it uses or affects. The Integrated Reporting Committee of South Africa (IRC of SA) accordingly acknowledges, relative to the capitals, that 'changes in their availability, quality and affordability can affect the organisation's ability to create value over time'.

This clearly applies to ethics. An organisation definitely depends on its ethical status for its success, as is well illustrated by the negative consequences of ethical failures. The recent announcement that Bosasa (now known as Africa Global Operations) has gone into voluntary liquidation is exactly such a case in point. Conversely, a sound ethical culture and reputation can create value over time for the organisation and its stakeholders, including its financial capital providers.

2. Customising the capitals

The Framework and the IRC of SA explicitly state that organisations do not need to adopt the exact definitions of the capitals as set out in the Framework, and are free to use their own definitions:

> *Organisations may categorize the capitals differently. For example, relationships with external stakeholders and the intangibles associated with brand and reputation (both identified as part of social and relationship capital in paragraph 2.15), might be considered by some organisations to be separate capitals, part of other capitals or cutting across a number of individual capitals. Similarly, some organisations define intellectual capital as*

An organisation depends on its ethical status for its success.

comprising what they identify as human, 'structural' and 'relational' capitals.

This flexibility allows the six capitals model to be extended to include ethical capital as a separate, defined source of value which would give greater clarity to the value ethics can, and does, add to the organisation and its stakeholders.

3. The spread of ethics across the six capitals model dilutes its value

The Framework's definition of three sources of capital, namely human capital, social and relationship capital, and intellectual capital, include some aspects of ethics and ethics-related concepts and issues:

Human capital – People's competencies, capabilities and experience, and their motivations to innovate, including their:

- *alignment with and support for an organisation's governance framework, risk management approach, and ethical values*
- *ability to understand, develop and implement an organisation's strategy*
- *loyalties and motivations for improving processes, goods and services, including their ability to lead, manage and collaborate.*

Social and relationship capital – The institutions and the relationships within and between communities, groups of stakeholders and other networks, and the ability to share information to enhance individual and collective well-being. Social and relationship capital includes:

- *shared norms, and common values and behaviours*
- *key stakeholder relationships, and the trust and willingness to engage that an organisation has developed and strives to build and protect with external stakeholders*
- *intangibles associated with the brand and reputation that an organisation has developed*
- *an organisation's social licence to operate.*

Intellectual capital – Organisational, knowledge-based intangibles, including:

- *intellectual property, such as patents, copyrights, software, rights and licences*
- *organisational capital such as tacit knowledge, systems, procedures and protocols*

Human capital and social and relationship capital clearly represent facets of ethics. Although intellectual capital does not obviously address ethics, organisational capital is occasionally defined elsewhere as encompassing culture, which would entrain ethics. Ethics is thus spread across two or three sources of capital. The result of this diffusion is that the collective or total value of ethics is not necessarily recognised or, for example, factored into the organisation's value creation strategy.

Defining ethical capital separately to highlight its value

We define ethical capital as the collective value that derives from the organisation's commitment to ethics, governance and good corporate citizenship. It therefore includes the following:

- The board and leaders' commitment to being effective, ethical role models
- The board and leaders' commitment to upholding and advancing corporate governance principles
- An ethical organisational culture where ethics and values shape conduct, decisions and strategy, and where compliance with laws, rules and regulations is coupled to fair and consistently enforcement
- An inclusive approach to stakeholders that is focused on building trust-based relationships and mutual value
- A commitment to good corporate citizenship, encompassing the organisation's social and environmental responsibilities.

The lack of a defined, separate identity for ethics in the form of ethical capital erodes the benefits that can be gained from ethics being a dominant feature of the organisation. It is therefore recommended that organisations expand their ethical vocabulary and adopt this concept. For organisations that utilise the six capitals model, this should be expanded to include ethical capital to highlight the centrality of ethics for the organisation. If further justification is required for this change, it is worth remembering that the opposite of ethical capital is ethical bankruptcy.

This article was first published in *Setting the Example, Issue 31, February 2018*.

Cynthia Schoeman is the managing director of Ethics Monitoring & Management Services Proprietary Ltd. She is a founding director of the Ethics Practitioners' Association (EPA), and is a member of the investigating committee of the Independent Regulatory Board for Auditors (IRBA).

Cynthia has over 15 years' experience in the field of workplace ethics and governance. She has developed practical tools and services to support the effective and proactive management of workplace ethics within organisations and consults private and public sector organisations in this regard.

Cynthia is a published author in the area of workplace ethics, namely *Ethics Can: Managing Workplace Ethics* (2014), *Ethics: Giving a Damn, Making a Difference* (2012) and *An Employee's Guide to Workplace Ethics* (2011). Her articles are widely published in business journals and the press.

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