

## 9 Ways to Establish an Ethical Framework: The Importance of Ethics in ESG Investing

*By Cynthia Thyfault, Founder & CEO*

In an exclusive Special to the Digest, Cynthia Thyfault, Global BioFuture Solutions, Founder and CEO shares a 2-Part Series on ESG Investing and the Bioeconomy. In this first part, we look at the importance of ethics in ESG investing and how to establish ethical frameworks.

Environmental, social and governance, or ESG investing, is a form of sustainable investing that considers an investment's financial returns and its overall impact. An investment's ESG score measures the sustainability of an investment in three specific categories: environmental, social and corporate governance.

All investors use a selection of financial data and economic indicators to analyze a company. But ESG investors go further, they also analyze Environmental, Social and Governance (ESG) factors when assessing a company's potential for success. It's a way of analyzing investment risks, while maximizing opportunities others don't see.

Environmental factors include: Climate change, carbon emissions, water management, waste, biodiversity, renewable energy, green building and clean technology.

Social factors include: Human capital, labor standards, product and chemical safety, privacy and data security, controversial sourcing, access to healthcare and finance.

Governance factors include: Ethics, corruption, taxation transparency and anticompetitive behavior, Board and leadership structure, pay equality, and ownership.

To make the best and most consistent decisions, impact investors also spend as much time evaluating the ethics, values, and reputation of a company as much as they think about growth and financial returns. ESG factors are also far more difficult to measure than the clean-cut financial data of earnings, profit and loss.

Business ethics are considered the heart of corporate governance – integrating values such as honesty, trust, transparency, and fairness. A company ethics statement will determine policies, practices, and decision-making processes. Ethical values are the building blocks of any startup. They can be critical in determining how a company deals with certain situations and how it handles internal and external issues. Values help business leaders stay aware of temptations and prevent lapses as the business grows.

A Business Ethics Statement is not something you need to start worrying about when your company reaches a certain size; it is considered the heart of corporate governance and needs to be established from the beginning, and continually refined and adjusted as the business grows. It can also be a critical factor in determining how a company deals with certain situations and how it handles internal and external issues, especially in times of crisis or unforeseen circumstances.

It's worth the time and effort to establish a Business Ethics Statement and implement that with your staff and board of directors. Employees in high-integrity cultures are 67% less likely to observe significant instances of business misconduct compared with employees at companies with low-integrity cultures, according to a 2010 Corporate Executive Board report. And businesses with the best organizational culture earned an average return on assets that was 40% higher than those with the lowest-rated organizational culture, according to a study by Denison Consulting.

Here are nine tangible ways that leaders can establish and instill an ethical framework for their company:

### **1. Define your core values early on**

Core values guide how an organization thinks and behaves; they're the bedrock on which business decisions are made and successful relationships are formed. Once defined, core values should be visible in every aspect of company operation: from sales and marketing to internal reviews to employee check-ins.

Your core values are also the heart and soul of your business, informing things like hiring practices, business operations, company culture, and business strategy.

Your core values already exist, you just have to identify, define and delineate them. By filtering every business decision you make through your core values, you'll create symbiosis between your strategic vision, people, and processes.

### **2. Integrate ethics into your hiring process**

One way to focus on business ethics early on is to integrate it into your hiring process. By being selective about who you choose to hire, you can save time, money, and conflict over tough choices later on.

Determine the specific attitudes, values, and attributes you're looking for in employees, and keep looking until you find them. When you have promising candidates, involve some of your best employees as interviewers. They will want colleagues who share their beliefs and will be able to help you determine whether or not a certain prospect holds the same values.

During the interview process, ask candidates questions that help reveal their character. Ask candidates to respond to hypothetical scenarios to gain insight into how they would behave when faced with ethical challenges. Inquire about previous experiences as well — e.g., "Did you

ever have a boss who asked you to do something that made you uncomfortable? How did you handle it?”

Above all, don't waver from your commitment to hiring ethical employees. Be specific about what ethical behavior looks like at your company and keep looking until you find candidates who fit the bill. Integrity is neither a top-down nor a bottom-up proposition; every single employee contributes to a company's ethical profile. Your responsibility is to recruit and retain the people who will act with integrity, even when no one else is watching.

### **3. Create a culture of openness and welcome dissent**

Having different points of view and internal constructive critics are a leader's best friends. Too often, founders are blinded by their own enthusiasm for their creative vision and surround themselves with “yes-man” employees who don't challenge their practices.

When this happens, founders can quickly fall out of touch with reality and lose their ethical bearings. Creating a culture of openness is a good way to establish internal checks and balances.

Staffing an organization with ethical employees will also reduce rates of fraud, prevent discrimination and harassment, increase customer satisfaction, and build the company's positive reputation. In my own business I have experienced that when times get tough or work is more challenging than usual, the ethical employee tends to work harder and persevere instead of making morally questionable decisions under pressure.

### **4. Lead by example**

As we all know, actions speak louder than words. Similarly, leadership behaviors demonstrate company culture. A leader needs to show the face his team needs to see by demonstrating an ethical attitude and consistency is key. Your team will demonstrate these values because they have seen you do it.

To maintain accountability, you also need to ensure employees have ways to report unethical behavior, and that your organization takes those reports seriously. To that end, provide a safe, anonymous channel for employees to report ethics violations, such as an employee hotline or an anonymous document. Investigate every report and be sure to hold C-suite execs to the same standards as any other employee. If employees see executives getting away with bad behavior, the good employees may leave, and the less ethical ones may try to see what they can get away with.

### **5. Craft values everyone can own**

Defining core values is not enough. It's critical that startups craft values that everyone can own. Not only can this help attract good employees early on, but it encourages your team to really own and practice the company values on a daily basis. A common mistake that companies make when drafting a code of ethics is not to consult employees. Even if you think you're in

tune with the daily trials and tribulations of your staff, you should solicit broader participation in the crafting of the code. Employees need to have a say in it but they also need to know why the code is important and why it ultimately contains the tenets that it does. Soliciting anonymous input from your staff on a situation they were in during the past year that made them uncomfortable is also a good starting point.

The key in drafting a Business Ethics Statement is to hit the right level of specificity. It should address both the particular nuances of the company's industry as well as its broader goals for social responsibility and should also be concrete enough to serve as a guide for employees in a quandary without laying out rules for every situation that could arise.

When you define ethical behavior for your employees, make sure that these expectations are clear throughout your organization. When you come across employees doing good things for others, share those stories. Consider nominating employees for awards, highlighting them on social media, or writing posts about them on your company's blog. This also encourages an ethical culture and lets everyone know that your company values integrity.

#### **6. Learn from immediate peers or distant models**

Many founders make the mistake in thinking that the unique quality of their business means that their leadership values are also unique. In doing so, they fail to grow.

Pattern yourself after other brilliant founders or leaders you admire. Taking online courses, reading books, and listening to podcasts and TEDX talks can quickly expand your leadership knowledge regarding ethics development and the process and value of implementing them in your own company.

#### **7. Know your limits and build a strong foundation for when it's time to pass the torch**

While it can be difficult to imagine the day you're succeeded as the leader of your startup, if you have plans for large growth in the future, it's important to prepare for the day when you'll no longer be the lone day-to-day internal boss and primary external ambassador.

Create an Ethics Standard that is able to embed authentic, ethical and emotionally intelligent behaviors into the DNA of the organization, build strong, collaborative relationships, and create a performance enhancing culture that is ethical, caring and sustainable.

#### **8. Remember that workplace culture is fragile**

Workplace culture is the tacit social order of an organization: It shapes attitudes and behaviors in wide-ranging and durable ways. Cultural norms define what is encouraged, discouraged, accepted, or rejected within a group. When properly aligned with ethical values, drives, and needs, culture can unleash tremendous amounts of energy toward a shared purpose and foster an organization's capacity to thrive.

Culture can also evolve flexibly and autonomously in response to changing opportunities and demands. Whereas strategy is typically determined by the C-suite, culture can fluidly blend the intentions of top leaders with the knowledge and experiences of frontline employees.

As someone once said, culture eats strategy for breakfast.

Egomaniacal moves, personal grandiosity, greed, and deception create impressions that are hard to erase. Once you cross that line it can be nearly impossible to regain good standing in the public eye.

## **9. Consistent ethics oversight by the Board of Directors**

Research over the past 20 years has continued to underscore that integrity drives performance. Corporate culture and tone at the top are considered key drivers of ethical behavior, but boards of directors often devote little time to the topic.

It's important that during executive sessions, board committee members ask broad questions. The AICPA Audit Committee Toolkit for Public Companies advises asking questions such as:

- Are you aware of any issues that could cause embarrassment to the company? Have you ever been told anything in confidence or otherwise that would embarrass the company if it were known publicly?
- Are there any items that you have discussed with the CEO, CFO, other officers, or outside counsel of which the audit committee is not already aware?
- Is there any activity in the organization with which you are uncomfortable, consider unusual, or that you believe warrants further investigation?
- Are you aware of any current or past fraud occurrence or any kind of fraud in the organization? Do you know of any situations in which fraud could occur?
- Do you feel comfortable raising issues without fear of retribution?
- Are there any questions we have not asked that we should have asked? If so, what are those questions?

Companies have more and more of an incentive to be ethical as the area of socially responsible and ethical investing keeps growing. However, it is the challenge and responsibility of every bioeconomy leader to create a strong ethical workplace culture and grow a successful business that can operate ethically in both good times and downturns.

It is also a good idea to read other company's ethics statements to get a feel for what you would like to include. Our company recently completed our ethics statement, and it can be found [here](#). The Aemetis Ethics Statement is found [here](#). The REGI Code of Business Conduct and Ethics is found [here](#). The Novozymes Sustainability Report 2020 ties their company ethics with the United Nations Guiding Principles on Business and Human Rights and can be found [here](#).

The importance of business ethics reaches far beyond employee loyalty and morale or the strength of a management team bond. As with all business initiatives, the ethical operation of a company is directly related to profitability in both the short and long term.

The reputation of a business in the surrounding community, other businesses, and individual investors is also paramount in determining whether a company is a worthwhile investment.

The increasing number of investors seeking out ethically operating companies to invest in is driving more firms to take this issue more seriously, and the direct benefits will reap continuing rewards now and into the future in many ways.

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