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# Collusion, reputation damage and interest in code of conduct

## The case of a Dutch construction company

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### **Biography Johan J. Graafland**

Johan Graafland (1960) studied economics at the Erasmus University Rotterdam. From 1986 he worked at the Central Planning Bureau as an economist. In 1990 he published a dissertation in economics at Erasmus University Rotterdam: 'Persistent Unemployment, wages and hysteresis'. From 1993 to 2000 he was head of the division Applied General Equilibrium Models of the Central Planning Bureau. From 1991 to 1998 he studied theology at Utrecht University. In 2000 he was appointed professor in 'Economics, business and ethics' at Tilburg University. In 2002 he became Director of the Centre for Corporate Social Responsibility at the faculty of Philosophy of Tilburg University. Besides, he worked part-time in the business sector, including family companies in the textile and construction sectors.

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# Collusion, reputation damage and interest in code of conduct

## The case of a Dutch construction company

### **Abstract**

In November 2001, a TV program showed that many large Dutch construction companies participated in price fixing. We analyze how one such company, Heijmans, reacted to the reputation crises after the TV program by introducing a code of conduct. We present the outcomes of a questionnaire survey conducted among 140 managers just after the TV program with respect to the relevance of such a code and discuss the change in attitude of the CEO of Heijmans following after the negative publicity.

### Keywords

Corporate social responsibility, code of conduct, collusion, construction sector, reputation, parliamentary investigation, regulation

## Introduction

The construction sector in the Netherlands was in the center of publicity during 2002. After a TV program by Zembla on 9 November 2001 exposing a clearing system for construction companies that colluded in price offers for public works, the Dutch parliament installed in 2002 an investigation committee to research these practices. The TV program indicated that the well-known large Dutch construction companies regularly met in secret just before an offer procedure in order to determine which company was cheapest and to increase its price offer. The winning company shared the increase in profitability by reserving a compensation for the other companies.<sup>1</sup>

This practice goes back to the fifties when the Dutch government stimulated a system of collusion in the construction sector. One of the reasons for this was the danger that the competition on the construction market may become too fierce without such regulation because of the large market power of the government, which was by far the largest customer. In 1953, the so-called *Wegenbouw Aannemers Combinatie* (road construction building contractors combination, WAC) was founded. According to rules approved by the Dutch government, the WAC organized pre-consultations between the construction companies, in which companies communicated their prices. The cheapest company was elected and received the order and compensated the other companies for the calculation costs involved in their offers (NCR, 2002a). The firm that received the order was also allowed to raise its price in order to reduce the high financial risks (Priemus, 2002). This inspired many other construction companies in market segments other than road construction to form cartels. In 1963, an organization was founded for the entire construction sector (the union of cooperating price-regulating organizations in the construction sector, SPO) covering 28 cartels and 4,000 companies in the construction sector. The Dutch government also approved of this organization.

Because companies regularly met each other, this procedure led to other contacts that were not in accordance with the rules of the WAC and SPO. Representatives of the companies started to meet each other before the WAC consultations to distribute the market. These market allocation activities were illegal. Moreover, companies often also succeeded in obtaining information from individual government officials about the maximum price that the government was prepared to pay for the order. During the illegal pre-consultations, the price of the cheapest company was raised accordingly and the difference between the price and the costs was distributed among the companies that participated in these illegal pre-consults. The Dutch experience also inspired construction companies in other countries, for example, Germany and Belgium to form illegal cartels (NRC, 2002a; NRC, 2003).

In 1992, the European Commission prohibited the practice of pre-consulting. In 1998, the Dutch government implemented this EU regulation and forbade the practice of ex-ante consultations (Priemus, 2002). But, as the TV program showed, the practice still continued. During this program, Mr. A. Bos, a former director of *Koop Tjuchem* (one of the large Dutch

construction companies), blew the whistle by presenting a hand-written clearing book reporting many secret transactions between the large construction companies. The amounts were substantial. In addition, Mr. Bos told that several government officials had accepted bribes from construction companies for communicating strategic information. On the basis of a small sample, the parliamentary investigation committee estimated in its final report that, owing to this practice and other forbidden practices (like using false invoices), the costs of public works were about 8,8% higher than they would normally have been, implying a substantial burden to the Dutch taxpayer.<sup>2</sup>

As a result of this negative publicity, the stock values of large Dutch construction companies dropped. This enforced the awareness that a good reputation is of vital importance for the financial success of a company. For this paper, we describe the efforts to upgrade ethical procedures made by one of the most profitable large Dutch construction companies, Heijmans, which was also mentioned in the TV program by Zembla on 9 November 2001. We investigated how top and middle managers of this company perceived the usefulness of introducing a code of conduct and the kind of code of conduct they would prefer. Our findings highlight the processes that take place when companies change their procedures in reaction to negative publicity.

The content of this paper is as follows. In section 2, we describe the perception of Heijmans managers about the ethical standards of Heijmans with respect to the competition in the months before the TV program. For this purpose, 12 directors and members of the board of Heijmans were interviewed using a scorecard. Section 3 discusses the ethics of collusion and why it is seen as harmful. Section 4 discusses the importance of a good reputation as a strategic intangible asset and how ethical behaviour impacts upon it. Section 5 deals with the usefulness of a written code of conduct for Heijmans as a means of improving the implementation of values and its reputation. First, we present the opinion of the CEO before the TV program. Next, we describe the results of a questionnaire distributed among 140 managers on a managers' meeting in the week after the TV program. Finally, we describe the CEO's reaction to the negative publicity and the measures taken to restore the company's reputation, including the introduction of a code of conduct. In section 6 we mention some lessons from this case study.

### **Relationship with competitors: interviews with Heijmans' top managers**

The construction sector has very specific characteristics. In the view of the general public, ethical standards are relatively low in the construction sector. Transparency is low, especially for the many small companies in this sector. Together with some other labor-intensive sectors (like hotels and restaurants, and the repair of consumer goods), the construction sector is associated with the avoidance of taxes and social premiums (Graafland, 1990). Furthermore, the Dutch construction sector is known for its high absence rates owing to sickness and disability (EIB, 2001c). In 1998, for every 100 workers, there were 32 disabled persons in the construction sector receiving a disability benefit (EIB, 2001a). The work pressure is high and has risen in the last ten

years, whereas it declined in other sectors (EIB, 2001b).

Heijmans is one of the largest Dutch construction companies. In 2001, Heijmans belonged to the five largest Dutch construction companies, whereas its profitability ranked among the top three (PriceWaterhouseCoopers, 2001). The company started as a family company in 1923 (Van Empel, 2002). In contrast to other large construction companies in the Netherlands, Heijmans has a rather informal culture. The managers of Heijmans dislike formal procedures and, in 2001, many had worked for a long time already at Heijmans. Although the company had grown to 2,000 employees in 1990 and to almost 10,000 in 2001 (Heijmans, 2002), the managers felt that Heijmans gave much personal attention to its employees. They thought that Heijmans differed from other large Dutch construction companies that had a more bureaucratic and impersonal culture.

In order to investigate how the managers of Heijmans perceived the ethical quality of Heijmans, 12 top managers were interviewed, using a scorecard for about hundred concrete ethical aspects, distinguishing six stakeholder groups (employees, suppliers, shareholders, competitors, customers and society at large). The advantage of interviews is that this method offers the flexibility to ask additional questions in response to the answers of the respondents, including questions about opinions and motives. Thus, it provides much insight into the perceptions of managers. A disadvantage of interviews is that they are very time consuming. Hence, the sample is often limited and not representative for the total group of managers. For this reason, we also used a questionnaire, which was distributed among all top and middle management (see below).

The appendix presents an overview of the scores for 37 aspects of corporate social responsibility that comprise the hundred more detailed aspects. For this article especially the managers' perceptions with respect to competitors (no price fixing, no trade barriers, no bribes), customers (transparent cost calculation), and society at large (compliance with laws, honest dealings with politicians) are relevant. During the period just before the negative publicity about the secret price agreements, the top managers of Heijmans judged these aspects as rather favorable. In particular, the managers of Heijmans reported a relatively high score for market-conform price setting. Price fixing seemed to be absent. Also, trade barriers seemed to be no major problem. More problematic was the transparency of the cost calculations in offers. Price fixing by collusion is only possible if customers are not able to check the reliability of price offers. The greater the lack of transparency of the cost calculations, the more room there is for demanding more than the actual costs. This might indicate that the top managers of Heijmans were already aware of some problems with regard to fair pricing before the public attention following the TV program in November 2001. Finally, the managers also judged the relationship with government officials as good. They reported that compliance with the law was good and that the dealings with politicians were honest. Bribes also seemed to be rare.

This favorable response contrasts with the information provided by the TV program. This contrast may be explained in two ways. First, the top managers might have willingly given a too-

favorable view and may not have been prepared to share sensitive information in the interviews. Another plausible explanation is that the judgments of the top managers of Heijmans reflect their true opinions and must be interpreted in the context of the business culture in Heijmans and the Dutch construction sector. For example, one manager told that he knew of illegal price agreements in the Dutch construction sector (without indicating whether Heijmans actually cooperated in these agreements), but he did not judge them as unethical. The managers of other construction companies also expressed this opinion. For example, Mr. Burggraaf, one of the contractors that publicly admitted to the illegal practices, did not perceive the illegal pre-consultations and the resulting distribution of the market as wrong (NRC, 2002a). This indicates that, even if Heijmans had been involved in secret price agreements and if the top managers had been aware of this, they would probably have regarded these patterns as normal and would not have judged them as unethical. As described above, the price agreements had a long and legal history and provided a solution to the problem of the large market power of the government as main customer of construction products. Moreover, as came out during the public hearings of the parliamentary investigation committee, individual companies felt that they had no choice but to continue their cooperation in the secret price agreements. Individual construction companies that tried to stop this practice by not attending these secret meetings soon learned that their orders greatly diminished and were, therefore, forced to continue their cooperation. Several large construction companies tried to stop the illegal practices, but failed because too many companies were involved (NRC, 2002b). This apparent inability to withdraw gives another reason why managers might feel that they cannot be blamed for their cooperation in illegal price agreements. This notion can be defended by the argument that, if there are circumstances that make it difficult although not impossible for a company to perform a certain act, such mitigating factors lessen its responsibility (Velasquez, 1998). Because of the prisoner's dilemma that individual companies faced and in the light of the historical background of these practices, it can be argued that it is especially the responsibility of the government and branch organizations at the meso level of the construction sector to provide procedures that allow compliance with the EU regulations for fair and transparent conditions (the so-called principle of displacement, see Jeurissen (2000), chapter 5).

### **Harmful consequences of collusion**

If construction companies regarded their price agreements as normal, why did the TV program of Zembla damage the reputation of construction companies? There are several moral reasons for the public indignation about the secret price agreements.

First, according to economic welfare theory the perfect market should be the ideal of economic policy because it is efficient. Kath and Rosen (1994, p. 410) formulate the first welfare theorem as follows: 'As long as producers and consumers act as price takers and there is a market for every commodity, the equilibrium allocation of resources is Pareto-efficient.' This theorem

reflects the idea of Adam Smith of the 'invisible hand' that in pursuing one's own interest in a perfectly competitive market, one automatically attains an optimal social outcome. Price agreements between companies reduce the efficiency of the market and are therefore, from a utilitarian point of view, objectionable. By price agreements, the companies can function much like a giant firm and raise the price above what Smith calls '*The Natural price*', thus reducing consumer surplus and aggregate welfare (Velasques, 1998). The parliamentary investigation estimated the price difference at 8,8 %. As prices do not reflect production costs, price agreement will also distort the efficient allocation of the resources of the economy (capital and labour) among the various industries of a society. Moreover, also the incentive for companies to improve the productivity by innovations will decline (dynamic inefficiency). Companies with a low productivity can still obtain an income by obtaining compensation from the construction company that receives the order.

It should be noted that this argument is only partially valid, because the construction market is not only distorted by the collusion of the companies, but also by the great market power of the government as the main customer of infrastructures. Moreover, as construction companies anticipated the price increase agreed upon during the pre-consultations, they often started with very competitive and loss-making price offers in order to obtain the order. Still, as noted above, the formal pre-consultations induced to other informal contacts that were not in accordance with the government regulation and it is highly probable that the net effect of this practice on prices has been positive, in particular if informal pre-consultations were combined with other illegal actions like using false invoices and paying bribes to obtain information of the available budget for government projects.

Besides the utilitarian objection that the pre-consultations caused harm to the overall welfare of the Dutch society, the pre-consultations and other illegal activities can also be convicted from other moral points of view. For example, by lying about the real costs of the projects construction companies did not respect the right of freedom and information of their customers. Moreover, the practices violate the capitalistic criterion of justice (i.e. benefits be distributed according to the value of the contribution the company makes) since customers paid too much for their products. Also from a virtue point of view the attempts to seduce government officials to communicate secret information about the maximum government budgets by paying bribes can be condemned.

### **Importance of reputation and how ethical behavior impacts upon it**

Because of its harmful effects, the publicity about collusion in the construction sector has deteriorated the reputation of construction companies. A good reputation is an important intangible asset. In order to get a license to operate from their stakeholders and the society as a whole, firms have to meet the triple P bottom line expressing the expectations of stakeholders



with respect to the company's contribution to profit, planet and people. Firms that do not meet these expectations may see their market shares and profitability go down (McIntosh et al, 1998).

Evidence shows that customers indeed punish companies if they damage customer's interests. Archer and Wesolowsky (1996) find that owners of durable goods tend to have a tolerance towards single negative incidents with regard to product or manufacturer loyalty, but are not tolerant towards more than one such incident. Another research shows that a one-point increase in the consumer satisfaction index of a Business Week 1000 firm has been calculated to be worth about \$94 million or 11.4% of the average return on investments (Anderson et al, 1994). This indicates that the consumers will reward more reliable companies.

There is also substantial evidence that companies are penalized in the financial markets for unethical behaviour (Gunthorpe, 1997; Rao and Hamilton, 1996). A possible explanation for this penalizing is that the profitability may decline due to huge fines or compensation payments. However, there also seems to be an additional reputational penalty, because the loss in investor returns is normally much bigger than expected on the basis of the expected fines and compensations (Soppe, 2000). The explanation for a lower share price could be that investors perceive more risk of the stock (Badrinath and Bolster, 1996). Most well known are the cases of unethical behavior of companies because of illegal activities, like the current gulf of companies that violated financial reporting rules. Davidson III et al (1994) find that their shareholders will punish companies when they engage in illegal activities. Specific types of crime such as bribery, tax evasion, theft of trade secrets, financial reporting violations and violation of government contracts were associated with abnormal negative stock market returns. Also illegal price agreements belong to this category as illustrated in our case. The stock values of the companies mentioned in the TV program fell by more than 10%.

One way to improve the reputation after a scandal is integrating corporate social responsibility (CSR) policies in the company's strategy. The literature gives several examples of companies that successfully adapted a policy of corporate social responsibility after negative publicity. For example, after the negative publicity about the Brent Spar and Shell's operations in Nigeria, in which Shell did not succeed in convincing the public of the moral legitimacy of its strategy, remarkable changes were adopted in the Shell strategy. From a rather closed organisation, it developed into an open organisation using all kinds of instruments to improve its relationship with the society (including the publication of a social report audited by external accountants and an active dialogue with NGOs like Pax Christi (Gruiters, 2000)). Shell is now at the leading edge of business ethics. Another example is C&A, which introduced a code of conduct for the supply of merchandise in 1996, after the publication of a report about the use of child labor in the Mail on Sunday (8 January 1995). This was the start of an ongoing process of professionalization. Being aware that a code of conduct can also damage a company's reputation if the actual situation does not improve, C&A set up in the same year an organization that would audit compliance with the code and promote awareness of the code. As shown by Graafland (2002a), this organization has been very effective in detecting infringements and improving the

labor conditions of C&A's suppliers. This contributed to the reputation of C&A among NGOs (Robbins and Humphrey, 2000).

These examples show that ethical behavior can improve a company's reputation. More generally, there is much evidence that the reputation of a company is positively related to the quality of the CSR policy of a company (Fombrun and Shanley, 1990; Williams and Barrett, 2000). Several other studies that investigated the relationship between CSR and profitability without explicitly considering the role of reputation, also found that CSR really pays off for companies (Burke and Logsdon, 1996; Waddock and Graves, 1997; Ruf et al, 2001).<sup>3</sup>

### **Instruments for organizing ethics: A code of conduct**

One of the instruments of corporate social responsibility is a code of conduct.<sup>4</sup> The central research question in our investigation for Heijmans at the time the scandal came out concerned the usefulness of a code of conduct for Heijmans. In this section, we first consider the opinion expressed by the CEO of Heijmans about a code of conduct for Heijmans before the TV program in November 2001. Next, we discuss the outcomes of a questionnaire survey conducted among 140 top and middle managers in the week following the TV program. Finally, we briefly describe the CEO's view after the negative publicity about price fixing.

#### *The CEO's previous opinion*

From 1 January 1995 until August 2002, Mr. J.P.M. Janssen was the CEO of Heijmans. Although not a member of the Heijmans family, Mr. Janssen was able to preserve and embody the informal family culture of Heijmans very well. In May 2001, Janssen gave a lecture for 400 businessmen at Tilburg University (Janssen, 2001). In this lecture, he argued that the ethical quality of a company is not the result of obeying rules, but is rather determined by what employees 'have between their ears'. He especially stressed the role of the leader of the company, who should embody the values of the company by his deeds. In his lecture, Janssen rejected the usefulness of a formal written code of conduct. Paraphrasing Seneca, he stated, 'Golden bridles do not improve a horse.' If an entrepreneur does not have a virtuous character, then rules will not help. The rules of written codes of conduct only stimulate minimal compliance. Instead, Janssen expected more from entrepreneurs showing integrity, who express the values of the companies by their deeds. Such managers are also able to communicate these values to their subordinates who, in turn, communicate these standards to lower levels in the organization. At that time, Janssen expected that this informal way of communicating values would be sufficiently effective in implementing high ethical standards in a large organization.

*The opinion of top managers and middle managers just after the TV program*

In the week after the TV program by Zembla on 9 November 2001, in which Heijmans was also named as one of the large companies participating in the illegal price agreements, Heijmans organized a meeting for all its managers at top and middle management level. Almost all managers were present. This meeting took place during the research to the usefulness of a code of conduct for Heijmans and after the interviews with Heijmans top managers. The management day provided an excellent opportunity to distribute a questionnaire about the usefulness of a code of conduct and the type of code that the Heijmans managers would prefer. As the meeting took place one week after the TV program, all managers were highly interested in the subject. This explains the high rate of respondents : the number of completed questionnaires was 140, which covered more than 90 percent of all top and middle managers of Heijmans. Thus, the outcomes are representative for the whole group of top and middle management of Heijmans. Table 1 gives an overview of the results.

**Table 1 Results of questionnaire among 140 managers of Heijmans**

1 What is your opinion on the introduction of a code of conduct for Heijmans?						
a.	positive				81	
b	neutral				17	
c	negative				2	
2 What function should a code of conduct have?						
		very important	important	moderately important	unimportant	mean <sup>a</sup>
- to make company values explicit	37	59	4	0		2.33
- to improve internal management of ethics	31	56	10	3		2.15
- empowerment of employees	36	53	10	1		2.24
- to improve image	46	37	13	4		2.25
3 What characteristics would you prefer for a code of conduct for Heijmans?						
- basic values (versus concrete behavioural norms)						65
- ambitious (versus non-ambitious)						76
- only internally available (versus also externally available)						23
- with legal status (versus no legal status)						60
4 If you had to develop a code of conduct for Heijmans, what kind of process would you prefer?						
a	top-down					18
b	down-top					5
c	combination of both					77
5 If Heijmans were to introduce a code of conduct, should compliance with the code be monitored and infringements be punished?						
a	yes					62
b	neutral					31
c	no					7
6 Are you prepared to attend a short course to learn how to apply the code in practise?						
a	yes					51
b	neutral					33
c	no					17

<sup>a</sup> By weighting the options (very important: 3; important 2; moderately important 1; unimportant 0)

The results show that a large majority was positive about developing a code of conduct for Heijmans. Notwithstanding the traditional reluctance to follow formal procedures, the negative publicity and the resulting decline of the stock value of Heijmans after the TV program (by about

15%) made Heijmans managers aware of the importance of corporate social responsibility for Heijmans. A written code of conduct could probably help to restore the confidence of the customers and the public at large in Heijmans.

This is weakly confirmed by the reactions to the second question about the function that a code of conduct would have to perform. Hummels and Karssing (2000) distinguish several functions of social and ethical accountability, for example,

- Explication of values and norms. Codes of conduct clarify the policy of the company. It shows what the company expects from its management and employees. The reflection on values and norms will also help to reduce inconsistencies in the policy of the company;
- Instrument for the management to improve the ethical standards, to solve ethical dilemmas and to prevent moral conflicts;
- Empowerment of employees by strengthening their moral consciousness;
- Improves the image of the company and the dialogue with external stakeholders. The stakeholders know from the code of conduct what they may expect from the company.

As shown by Table 1, the percentage of managers that considered improving the public image of the company to be very important is 46%, which is higher than for other functions. On the other hand, there is least consensus about this function of a code of conduct: there is also a relative high number of managers that consider the image function to be of moderate importance or unimportant compared to other functions. This may be interpreted as a signal that some managers think that a code of conduct may not convince the public of Heijmans' good intentions and that priority should first be given to the internal functions of a conduct. Only after Heijmans has improved the ethical standards internally, it will be ready to signal its standards to the society by a public code of conduct. On average, the image function was judged as the second important function.

The most important function is the explication of values. This is understandable, as Heijmans had taken over many other companies in the previous 10 years. As a result, it had grown from about 2,000 to 10,000 employees. However, by taking over other firms, Heijmans also imported strange company cultures. A clear awareness of Heijmans values therefore tends to weaken. Moreover, if a company becomes very large, it can no longer be assumed that informal channels are sufficient to communicate the company values. Therefore, the communication needs to be strengthened by formal means like a code of conduct. Furthermore, the table shows that empowerment of managers and the improvement of the management function were also considered important.

The third question refers to the characteristics of the code of conduct that Heijmans managers would prefer. When developing a code, an organization is confronted with a set of choices regarding the content of the code (Kaptein and Wempe, 1998). First, global formulations of the basic values of the company or concrete rules of behavior can be chosen. A disadvantage of the second option is that not all actions can be incorporated in rules. Therefore, a code must also make explicit the considerations behind the actions that enable organization members to act

with integrity in line with the basic values of the company. This probably explains the preference of Heijmans managers for the broad formulations of core values.

Second, a code can describe the actual situation or it can aim at improving moral behavior and define ambitious targets. For example, if one uses concrete rules, one could follow a safe strategy by formulating rules that reflect the already existing practices of the company. Alternatively, one could formulate rules that differ from the already existing practices and reflect a commitment to improve them. For example, when C&A introduced a code of conduct for the supply of merchandise in 1996, it included a rule that the use of child labour is absolutely unacceptable. At that time, the audit organization of C&A, SOCAM, now and then still detected child labour during inspections of the C&A's suppliers. It was only after some years, that SOCAM did not detect any child labour anymore. Naturally, the code should correspond as much as possible to the concrete problems encountered in actual situations. However, when the code is too closely linked to current standards, it does not motivate the staff to improve their behavior. Moreover, when the organization is in a process of transition, it might be necessary to rewrite it too often. On the other hand, if the gap between the ideals in the code and reality is too great, the code loses its motivating and stimulating effect, too. Heijmans managers preferred the first option. Confronted with negative publicity, they apparently wanted to improve the situation and, therefore, wanted a code of conduct that would stimulate this process.

Another choice concerns the publication of the code. If the main function of the code of conduct is to improve the internal management of ethical standards, an internal code for employees suffices. On the other hand, if the company wants to improve its reputation and restore its credibility by communicating its commitment to its values to the general public, an external code is required. As expected, the Heijmans managers clearly preferred the latter option.

The last aspect of the character of the code concerns the legal status of the code of conduct. Although a company can voluntarily choose to introduce a code of conduct, it can generate legal duties for internal and external stakeholders. According to Galle (2000), the legal status of a code of conduct depends on the character of the code. In particular, the legal status of a code of conduct is stronger if:

- the code communicates concrete rules and clear minimum requirements that should be met
- the code is consequently applied by the management and functions in the daily practice of the company. If the code of conduct remains a simple paper commitment without real force, its legal status is weak
- the code is complemented by procedures that foster compliance with the code, like the presence of an ethics officer, an ethical committee, auditing, social reporting, and a systematic distribution of the code
- the code explicitly refers to national or international laws or specific legal agreements
- the rules in the code of conduct are accepted in the branch as being in accordance with good entrepreneurship

Unexpectedly, a majority of the Heijmans managers preferred a code of conduct with a legal status. This outcome is inconsistent with the response given by most managers that they would prefer ambitious formulations and basic values to minimum requirements and concrete rules. This outcome can, therefore, better be interpreted as a sign of serious commitment to the code. This is also confirmed by the answers to the fifth question, which show that a majority supported procedures that foster compliance with the code of conduct.

The fourth question refers to the type of process the Heijmans managers would prefer when introducing a code of conduct. One option is that the top management appoints a small team that looks at other codes of conduct and constructs a code that fits the values and norms of the company, which the board approves. However, such a rapid top-down process has several disadvantages. First, it is doubtful whether the team that constructs such a code is aware of all relevant moral problems at all levels in the firm, and whether solutions already exist. Second, the code will only reflect the opinions of a small group of people within the firm. Many workers are not involved and hence not committed to the code. As Marnburg (2000) argues, the effectiveness of a code of conduct depends crucially on the ability of workers to identify with the code. This means that people from all levels have to be involved in the process of preparing the code. If this process succeeds in creating commitment among all relevant stakeholders, then the code may have a substantial impact on actual behavior in the company. Several studies have shown that the presence of an ethical infrastructure including a code of conduct improves the integrity of managers and workers (Vardi, 2001; Adams et al 2001). On the other hand, the commitment of the top managers of the company is also important. This is confirmed by research in the United States (Van Luijk, 2000). The leaders of the company must embody the intentions of the code of conduct and be prepared to be accountable for their own behavior. The Heijmans managers seemed to be aware of the importance of the commitment of both top managers and employees in lower ranks and preferred an interactive process in which the top of the company would take the lead and expressed its commitment, but in which managers and workers in lower ranks would also be able to express their opinion and give feedback before the code is finalized and introduced.

As already mentioned, the fifth question refers to the type of strategy for organizing ethics that Heijmans managers wanted. There are several ways of defining and organizing ethical behavior. Building on the work of Sharp Paine (1994), Hummels and Karssing (2000) distinguish three types of strategies. In the first strategy - the compliance strategy - the company develops concrete standards of behavior, which are communicated to all members of the organization. The focus is on required behavior (Trevino and Nelson, 1999). Supervision of the behavior of the managers and employees or other business partners guarantees the ethical quality of the organization partners. Those who are found shirking are punished. The second strategy - the integrity strategy - does not rely on compliance with strict rules, but rather on the responsibility and integrity of the individual employees on the basis of internalized values. The third strategy - the dialogue strategy - pays attention to the expectations of the stakeholders of the company. This

strategy focuses on responsiveness to the ideas, interests and values of others. The responses to question 3 indicate that the Heijmans managers favoured a code of conduct that would reflect basic values rather than concrete norms. This implies an integrity strategy with a focus on values. In contrast, the responses to question 5 suggest that the Heijmans managers also wished to see that compliance with the code of conduct be guaranteed by procedures to monitor the employees' behavior. This is in line with the responses to the last aspect of question 3, which show that the Heijmans managers preferred a code of conduct with a legal status. Taking these different responses together, it seems that the Heijmans managers were reluctant to implement a code of conduct with too many concrete norms, but that they were also aware that the code of conduct should be confirmed by corresponding behavior in order to convince the public of the sincerity of Heijmans. This is also reflected by the responses to the last question. Notwithstanding the high work pressure, a majority of Heijmans managers was prepared to follow a short course in order to learn how to apply the values and norms of the code of conduct in daily practice. Finally, it should be noted that the answers to questions 2 and 5 do not provide insight into the managers' opinions with respect to the value of the dialogue strategy. Although the responses to question 3 show that the Heijmans managers supported the introduction of a public code of conduct that would be available to external stakeholders, it is unclear whether this choice was motivated by the desire to improve dialogue with these external stakeholders.

In addition to the questions reported in Table 1, the questionnaire included two questions related to some personal characteristics of the respondents (age and tenure) and one open question about the type of subjects to be dealt with in the code of conduct. We found no systematic differences between old and young managers nor with respect to tenure. The only notable difference was that older workers seemed to be relatively more in favor of a compliance strategy than younger workers.

Table 2 presents a list of subjects mentioned by the respondents to be included in the code of conduct. Most managers mentioned general values like reliability, integrity, clarity, honesty, and openness. This is understandable because of the damaged image of Heijmans after the TV program by Zembla and the consequent decline in the stock value of Heijmans by 15 %. Although these general values relate to all stakeholders, in the context of the public attention for collusion in the construction sector, they are particularly relevant to the relationship with society at large (including the government) and customers. This is confirmed by the values that relate more specifically to these two stakeholder groups, like being a good example, having transparent offer procedures (and cost calculations), and offering no gifts to government officials. In addition, values related to employee relations were often mentioned. The high priority given to good employee relationships and the commitment of employees can be explained by the fact that good relational contacts are crucial for the success of a construction company (Kay, 1993). If workers trust each other, they are more prepared to share knowledge and this increases the synergy within the organization, because shared knowledge is more productive than the sum of the expertise of individual workers (Boxall, 1996). In addition, the commitment of workers has a

positive influence on the profitability of the total company by diminishing the use of costly explicit control mechanisms and increasing the flexibility of the organisation. Furthermore, good people management motivates workers to make greater efforts and to share their creativity with the company. This raises the productivity of workers and also contributes to the profitability of the company. A final advantage of good people management is that committed workers are less inclined to leave the company (Huselid, 1995). For example, Brouwer et al (2001) found that paying attention to the problems of older workers reduces the number of workers that leave the company. As many workers have unique and valuable competencies that are difficult to reproduce, it might be hard and costly to find new suitable candidates.

**Table 2** Subjects suggested for the code of conduct (number of times mentioned)

<i>General values</i>	142	<i>Employees</i>	33	<i>Society</i>	23
Reliability	29	Good social relationships	16	Being a good example	11
Integrity	24	Commitment	5	Contribute to social values	7
Clarity	24	Sanctioning of unethical behavior	4	Market-conform operating	3
Honesty	20	Good fellowship	3	Compliance with law	1
Openness	19	Communication	2	No bribes	1
Cooperativeness	7	Equal opportunities for minorities	1	Compliance with fiscal duties	1
Consistency	7	Privacy	1		
Respect	4	Challenging work	1		
Trust	3				
Image	2	<i>Customers</i>	21	<i>Shareholders</i>	11
Own value	2	Transparent offer procedures	10	Acquisition and synergy	5
Realism	2	No offering/acceptance of gifts	8	Profitability	3
Professionalism	1	Good relationship	4	Risk management	1
Safety	1	High product quality	4	Stable stock value	1
Certainty	1	High service	3	Corporate governance	1
		<i>Competitors</i>		<i>Suppliers</i>	
		Good relationship	1	Good relationship	4

### *The CEO's current opinion*

Soon after the TV program by Zembla, the CEO of Heijmans, Mr. Joop Janssen, announced two specific measures. First, he decided to engage an external accountant of KPMG who would attend meetings at which the price offers of were made by Heijmans managers and ensure that no secret price dealings were agreed.<sup>5</sup> Second, Janssen decided that all Heijmans managers involved



in making price offers should sign a document, in which they declare that they will not cooperate in illegal price dealings. Both measures are examples of the compliance strategy. First, the standard was communicated very clearly by having the managers sign a document that informed them well of the norm that cooperation in illegal price agreements was absolutely forbidden. Second, the KPMG officer must control the behavior of the Heijmans managers. If he finds evidence of ongoing secret price dealings, he will report that to the board of Heijmans and the manager will risk disciplinary measures.

In addition to these specific measures, Mr. Janssen also changed his opinion on the usefulness of a written code of conduct. The argument that a large company that has taken over many other companies needs formal instruments to enforce the informal communication of values and norms convinced him of the necessity of a written code of conduct. The illegal price agreements in the construction sector and the damaged reputation of Heijmans further increased the incentive to professionalize the ethical procedures in Heijmans. However, Mr. Janssen stated that he was aware that a code of conduct does not guarantee responsible behavior. Although it may be a useful instrument, he said he still believed that ethical standards are closely related to the company's culture and the attitudes of the top management, individual managers, and employees (ND, 2002).

### **Some lessons**

What can we learn from this case study?

First, the interviews with the top managers of Heijmans indicate that managers do not consider certain practices to be unethical if these practices have existed for a long time and are accepted within the sector. As my interviews with top managers of Heijmans before the TV program of Zembla suggest, these managers believed that the ethical quality of the relationship of Heijmans with its customers (including no price fixing) and the society at large was high. Although one manager explained that he was aware of the illegal price agreements going on in the construction sector, he did not feel that construction companies could be blamed. Given the historical background in which consultation between companies was formally allowed and given the sectoral culture in which most companies accepted ongoing secret dealings after the legal prohibition of these practices, individual managers did not consider them to be unethical. It was only after the publication and the strong indignation of society that managers in the construction sector started to realize that their everyday practices may indeed be unethical and had to change.

Second, the case illustrates the well-known phenomenon of negative publicity playing an important role in changing the CSR policy of a company. Similar to the cases of Shell and C&A discussed above, the negative publicity on price fixing induced an important change in Heijmans. First, it reacted specifically to the criticism by hiring external auditors to monitor the practice of making price offers. The negative publicity also changed the company's ideas about the usefulness of a code of conduct. Whereas the CEO of Heijmans did not believe in the usefulness

of such an instrument before the Zembla program, he changed his view after the negative publicity. Although it is still not clear whether this change in attitude will turn out to be more than a simple public relations tactic, the public code of conduct may be a good starting point because it enables stakeholders to appeal to the values of Heijmans and invites them to ask questions about the realization of the intentions communicated in the code of conduct. Providing convincing answers might require a further professionalization of ethical procedures by Heijmans.

Third, the empirical research to the managers' views on a code of conduct shows that Heijmans' managers and the CEO of Heijmans are aware that the code should not only contain rules, but also values that motivate to a change in attitude. The contrast between the top managers' view on illegal price agreements before the scandal and the response of the public after the TV program makes evident that the business culture has to change.<sup>6</sup> This requires a change in attitude that cannot be attained by a compliance strategy only. On the other hand, the managers are also aware that the communication of values is only credible if behavioral patterns will reflect these values. In order to insure that manager behave in accordance to the proclaimed values, the CEO also decided to enforce compliance to the most urgent rules with respect to the procedures of price offers. Since the Dutch society's trust in the construction sector has been severely damaged, restoring the reputation may take a long time and only take place if the company proves that it lives up to the values included in the code of conduct, like reliability, integrity, clarity and honesty.

Even if Heijmans will live up to these values in the coming years, one can doubt whether the code of conduct of Heijmans (which was published in February 2003) will restore Heijmans' reputation as long as Heijmans and other construction companies do not reveal all information about collusion in the past. All construction companies involved in the scandal have yet been very cautious with revealing information about price deals in the past, because of the possible negative legal consequences. As new evidence about secret price agreements during the period from 1998 to 2001 is still coming out, the distrust against construction companies has not disappeared yet. For example, when on February 14<sup>th</sup> 2004 new information was published about illegal price agreements in another segment of the construction sector (namely the construction of hospitals and schools), the stock value of Heijmans declined again by 4 % (NRC, 2004a). The head of the investigation committee of the Dutch parliament, Ms. M. Vos, demanded that the construction sector make public all cases of illegal price increments in the past. Until now, few construction companies have done so.<sup>7</sup>

Finally, the case study illustrates the importance of industry-wide regulation of offer procedures in the construction sector. It can be validly argued that individual managers and companies are not the only agents to be blamed for participating in illegal price dealings. Several attempts were made by companies to stop the illegal practice, but these companies found that it was extremely difficult to change the system individually because there was a high probability of losing orders (NRC, 2002b). They were all captives of the system. Although this mitigating

factor does not completely take away the responsibility of individual managers and companies to try to change the situation - for example, by communicating the problem to branch organizations and the government - the case shows that sector organizations in the construction sector as well as the government did not do enough to restructure the offer procedures after the prohibition of the existing procedure in 1992 by the European Commission. Another reason for blaming the government is that the illegal forcing up of prices was also facilitated by the lack of integrity of government officials who provided information about the prices that the government was prepared to pay.

## **Appendix      Results of interviews with 12 top managers of Heijmans**

The top managers were asked to classify Heijmans in respect of these concrete ethical aspects, choosing from four options: very high ethical quality (score 4), high ethical quality (score 3), moderate ethical quality (score 2), and low ethical quality (score 1). The results are reported by Table A1.

Table A1 shows no large discrepancies between the ethical qualities of various stakeholder relations. Especially the shareholder relations were relatively good. Heijmans paid much attention to several aspects of the relationship with the shareholders. In 1993, Heijmans received a stock-exchange notation in Amsterdam. Heijmans had a stringent internal provision for top managers that forbade insider trading. Another notable point is the high quality of the annual financial report of Heijmans. Both in 1997 and in 2002, Heijmans won the prestigious Henry Sijthoff price for the best annual report of companies with a notation at the stock exchange in Amsterdam in the category 'Other funds' (FD, 2002). Furthermore, the relationship with society at large (including the government) was also considered to be relatively good. Especially corporate citizenship received a high mark. The managers gave several examples of sponsoring of local community activities. Furthermore, Heijmans' efforts to reduce environmental damage were good. Using a detailed score card on environmental aspects developed by the Stichting Bouwresearch and consulting environmental experts of Heijmans, it was estimated that Heijmans belonged to the best category ('most aware of environment'). Only compliance with the tax law received an average mark below 3.

**Table A1 Scores for corporate social responsibility of Heijmans<sup>a</sup>**

<b>Employees (average: 2.7)</b>						
Aspect	just remuneration	fair opportunities	open communication	participatory management	role of unions	integrity
average score	3.0	2.8	2.4	2.5	2.4	2.9
Aspect	privacy	commitment	balanced leisure/ working time	employability	challenging work	procedures
average score	3.3	2.8	2.0	3.0	3.3	2.2
<b>Suppliers (average: 2.9)</b>						
Aspect	respect for local culture	honest trade relations	labor conditions of suppliers	product and environmental safety of suppliers	transparency of suppliers	no exclusive dealing agreements with suppliers
average score	3.0	3.0	3.0	3.0	2.5	3.0
<b>Shareholders (average: 3.1)</b>						
Aspect	profitability	risk management	corporate governance			
average score	3.0	3.0	3.3			
<b>Competitors (average: 2.9)</b>						
Aspect	no misleading advertisements	No price fixing	no trade barriers	no exclusive dealing agreements with customers	no bribes	respect of intellectual property of competitors
average score	3.0	3.6	2.8	3.0	3.5	1.6
<b>Customers (average: 2.8)</b>						
Aspect	product quality	honest product information	transparent cost calculation	confidential treatment of customer	living up to contractual duties	respect for customer
average score	3.2	3.0	2.4	3.0	2.8	2.3
<b>Society at large (average: 3.1)</b>						
Aspect	compliance with laws	transparency	honest dealings with politicians	Sustainability	corporate citizenship	no tax evasion
average score	3.0	3.1	3.3	3.0	3.3	2.7

<sup>a</sup> Scores range from 1 (low ethical quality) to 4 (very high ethical quality) and are based on 12 interviews with top managers of Heijmans using a score card with 100 concrete aspects of CSR

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<sup>1</sup> That means that no money was actually paid. A clearing system was used to clear these reservations (or so-called Mickey Mouse money).

<sup>2</sup> This seems implausibly high, because the profit rate of construction companies is relatively low. Assuming that the share of undeclared profits is relatively small for large construction companies, it seems that part of the price increase was used to finance the calculation costs of making price offers.

<sup>3</sup> There are, however, several other studies that find a neutral or negative relationship between profitability and CSR (Mc Williams and Siegel, 2001). For an economic theoretical model of CSR, reputation and performance, see Graafland (2002b).

<sup>4</sup> Other instruments are ISO or other certifications, social reports, social audits, social handbook, confidential person or ethical committee and ethical training. See Graafland et al (2003).

<sup>5</sup> It should be noted that the effectiveness of this measure can be questioned, because of the recent record of accounting firms like KPMG. Also in the case of the illegal price agreements in the Dutch construction sector, accountants were accused of cooperating with construction companies to hide these practices (NRC, 2002c).

<sup>6</sup> Currently the Dutch branch organization of the construction sector, AVBB, provides courses to stimulate the required change in attitudes in the construction sector.

<sup>7</sup> The NMa, the anti-trust organization of the Dutch government, has offered companies an opportunity to give information about illegal practices in exchange for a reduction in the penalty. Until now only a few construction companies have made use of this facility (NRC, 2004b).