



## **INTEGRITY AS GOOD REPUTATION**

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## ABSTRACT

In the wake of the numerous recent corporate and organizational scandals, politicians and law makers have suggested more stringent reporting requirements to restore the reputation of our corporate world. Strict reporting, detailed codes of conduct, enforceable regulations and rules are certainly necessary but still do not grant the label of "integrity" to an organization. Enron had a pristine code of ethics, a code of conduct, and corporate governance procedures, but the executives were not following the spirit of their own procedures, nor did the external auditors or watchdogs warn investors or regulators about irregularities. Hence, without an ethical top management and impeccable ethical personal characters who prove to be trustworthy, unethical behavior will continue to exist and damage the reputation of the organization. A conscious attitude of integrity – which can be seen as a moral virtue - implies the awareness of one's economic-political and ethical responsibilities as an Agent to the Principal and the significance of strict implementation of one's ethical values and principles. The higher the integrity of a top executive or administrator of an organization, the better one can expect the reputation of the Principal (organization) and Agent (executive/administrator) to be. A good reputation will in itself result in higher loyalty and trust from a variety of stakeholders. The desire to establish a 'good reputation' may be instigated by either acting as if one is 'proper, fair and generous' or because one is a morally good person reflecting a high degree of integrity.

Being perceived as trustworthy may help to cement a more ethical and thus more socially responsible corporate environment, not necessarily out of altruistic motivations but because of self-interest. A conceptual analysis based on Game Theory will reveal the correlation between integrity and the limits of selfishness on the one hand, and the positive influence it may have on the reputation of an organization-principal or individual-agent on the other hand. Adding the notion of "generosity" and "fairness" to the principle of reciprocity makes our conceptual cooperation even more powerful and robust. In practical terms, "integrity as reputation" can have a significant influence in the corporate world as well as in the government – a fact that will be argued in this paper. The perceived image of integrity through accountable and transparent management and through implementing corporate social responsibility in an organization not only improves its (ethical) reputation but it also can bring about an enormous competitive potential and immediate economic effect.

## INTRODUCTION

Traditionally, there have been two distinct views on the role of ethics and more broadly the (in)significance of “social corporate responsibility” in business or any Agent-Principal relationship. The first perspective is articulated most famously by the Chicago economist Milton Friedman who declared that the corporate executives’ sole responsibility is to maximize the shareholder’s value<sup>1</sup>. The second view is that “ethics pays”, which implies that acting in a socially responsible way towards your stakeholders will automatically enhance shareholder wealth<sup>2</sup>. A third view is that executives (or government officials) must pursue strategies that respect their economic (or political) and ethical responsibilities<sup>3</sup>. Whether ethical behavior costs or pays in business or administration, it always counts according to this third perspective. I will argue along the same line that the corporate integrity of an organization or of a CEO / top administrator which functions as its *reputation* is the symbol that constitutes the cornerstone of its or their competitiveness. The top executive or administrator – an Agent - incorporates and reflects the values of the organization or Principal and, thus, personifies the moral values of the Principal. As long as the Agent acts *as if* he is ‘fair’ and ‘generous’, one builds “integrity as good reputation”.

Nevertheless, cynicism is all too prevalent and corruption is destroying the generation of ideals for future wellbeing and welfare. Indeed, in recent years, the spotlight on our corporate world has revealed that corporations’ misuse of trust is rapidly undermining their reputation as caretakers and implementers of the corporate mission and vision. The rise and fall of Enron is one of the more prominent examples of the creation, use of, and then destruction of a corporate reputation. Corporations such as Enron and WorldCom have revealed their darkest side, but CEOs do not necessarily need to be cynical practitioners; Johnson & Johnson’s commitment to its Credo’s responsibilities, its mission statement, which emphasized its corporate responsibility vis-à-vis its employees and the broad health community during the Tylenol crises in the 1980s, strengthened its reputation.

In the wake of the numerous recent corporate and organizational scandals, politicians and law makers have suggested more stringent reporting and controls to restore the reputation of our corporate world. This solution aims at strengthening and strictly enforcing the “(external) law”. However, strict reporting, detailed codes of conduct and enforceable regulations and rules are certainly necessary but insufficient conditions to grant the label of “integrity” to an organization. Enron had a pristine code of ethics, a code of conduct, and corporate governance procedures, but the executives were not following the spirit of their own procedures, nor did the external auditors or watchdogs warn investors or regulators about any irregularities<sup>4</sup>. Hence, one can have the best control and monitoring systems, the best legal system implemented, but without an ethical top management with impeccable personal integrity), unethical behavior will continue to exist and damage the reputation of the organization and ultimately undermine its *raison d’être*. Certain proper behavior is usually influenced and affected by certain moral virtues and social norms. These internalized principles and norms constitute what I will define as our conscience or “internal law”.

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<sup>1</sup> FRIEDMAN, Milton “The Sole Responsibility of a Corporation is to make a Profit”, New York Times Magazine, September 1970

<sup>2</sup> FREEMAN, R., “A Stakeholder Theory of the Modern Corporation”, in IPMI Business Ethics course, VERHEZEN, Peter, Jakarta, 2005

<sup>3</sup> PAINE, Lynn S., Values Shift, New York, McGrawHill, 2003, 302p

<sup>4</sup> WATKINS, Sherron S., “Ethical Conflicts at Enron: Moral Responsibility in Corporate Capitalism”, California Management Review, Vol 45, no4, Summer 2003, p16-18

Being reputable as a result of integrity or being perceived as trustworthy may help to cement a more ethical and thus a more socially responsible corporate environment, not necessarily out of altruistic motivations but because of self-interest. A *conceptual* analysis based on some insights of Game Theory will reveal the correlation between integrity and the limits of selfishness on the one hand, and the positive influence integrity may have on the reputation of an organization-principal or individual-agent on the other hand. Furthermore, a more *practical and pragmatic* approach will attempt to show that “integrity as reputation” can have a significant influence on the corporate world as well as on the government, indicating the enormous competitive potential the perceived image of integrity may have on the (ethical) reputation and economic performance of an organization.

## THE LIMITS OF SELFISHNESS AND “INTEGRITY AS REPUTATION”

All forms of interactive cooperation are based on a minimum level of trust and on the principle of reciprocity embedded within a social contextual framework. Even pure selfishness would not survive without a minimum level of trust<sup>5</sup> being used to ensure empathy to cooperate. Indeed, it is in a moment of unilaterally giving trust that one entices the other to reciprocate. Once a minimum level of trust has been established, reciprocal cooperation can flourish. Trust is not only essential in social interactions but even more so in business environments.

### Integrity and the principle of reciprocity

A lack of integrity and adherence to religious commandments and rules may be refuted and remain elusive and thus non-conclusive in a postmodern context. Nevertheless, the notion of integrity, a human moral virtue<sup>6</sup>, has often been used as a defense against unethical behavior such as bribery, providing protection against an a-social form of partiality or the deceit of corruption. Integrity implies that one acts in accordance with morally justifiable value systems<sup>7</sup>.

As long as we consistently and intentionally adhere to this ‘internal law’, the executives or administrators can be considered to be persons of integrity. Integrity consists in adhering to the moral and social commitments that compose our conceptions of the good life; it constitutes the conception of our good life. Integrity has its origin in “our wanting to realize our conception of a good life.” Integrity<sup>9</sup> relates to the integration of moral values into moral proper (business) behavior, and of integrating processes of transparency into accountability. Integrity discerns what is right and what is wrong, and requires a degree of moral reflection. Secondly, in the case of integrity, one acts on what one has discerned, even at personal cost, which implies that a person of integrity is steadfast in keeping his commitments. Finally, one says openly that one acts on the understanding of right from wrong, unashamed of doing the right thing<sup>10</sup>. Integrity is the faculty that enables us to discern right from wrong. Integrity is not by itself a

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<sup>5</sup> I here define trust as an attitude of vulnerability while rightly or wrongly expecting the other to keep his/her promises (without being able to exercise any control over the other’s behavior).

<sup>6</sup> I don’t distinguish morality (or moral) from ethics (or ethical), though semantically morality refers to the customs and values of a certain culture whereas ethics refers more to a normative philosophy.

<sup>7</sup> BECKER, T.E., “Integrity in organizations: beyond honesty and conscientiousness”, *Academy of Management Review*, 23, 1998, p157

<sup>8</sup> KEKES, John, *The Morality of Pluralism*, New Jersey, Princeton Univ Press, 1993, p96

<sup>9</sup> Integrity is here defined as “wholeness” from the Latin *integer*. A person of integrity is someone whose conduct follows from his principles in spite of public opinion, official pressure, or personal temptation, whose conduct forms a certain kind of morally intelligible whole, even if these values may be falsified as not ‘true’.

<sup>10</sup> CARTER, Stephen, *Integrity*, New York, Harper Books, 1997, p7-9

guide; it does not tell us what is right or wrong, but it “helps us see the ‘truth’ of right and wrong<sup>11</sup>”. Integrity is the basis for trust: a reputation for integrity, which one must possess in order to be trusted by colleagues, must be earned. A conscious *attitude of integrity* – which can be seen as a moral virtue - implies the awareness of one’s economic-political and ethical responsibilities as an Agent to the Principal and the significance of strict implementation of one’s ethical values and principles, or more cynically, acting *as if* one is proper, fair and honest. The greater the *integrity* of a top executive or administrator of an organization, the better one can expect the *reputation* of that Agent and consequently its Principal (organization) to be. A good reputation will in itself result in greater *loyalty* and *trust* from a variety of stakeholders, likely resulting in better economic performance as well.

I admit that a purely instrumental interpretation of the notion of “integrity” as a tool to improve the administrator’s or manager’s reputation may undermine the inherent value of the ethical virtue of integrity and trustworthiness. Nevertheless, my aim is not to criticize virtues such as integrity and trustworthiness necessary for proper ethical management, but to ‘seduce’ management into a certain behavior that is as if it is virtuous and trustworthy, though its intentions may be nothing but focused on self-interest.

The ability of a CEO, Administrator or management team to retain their integrity will depend on the way in which virtues are exercised in sustaining the institutional form of good ‘best practices’ and good (corporate) government. The integrity of a [best] practice requires “the exercise of the virtues by at least some of the individuals who embody it in their activities<sup>12</sup>”, and represents the values of the institution or organization. Conversely, the corruption of institutions is always in part at least an effect of vices and undermining good governance rules. Without an overriding conception of a *telos* of a whole human life, without clear ethical objectives and clear vision on values, conceived as a unity, our conception of certain individual virtues incorporated in institutional practices has to remain partial and incomplete.

Integrity also contributes to the efficiency of law and order. However, not all rules are explicitly written down as regulations; quite often the integrity of community members is sufficient to respect the unwritten rules without the need of any detailed legislation or adjudication on each possible point of conflict<sup>13</sup>. Such communities may not be that effective in cases of conflict, but nevertheless are quite useful. I had the personal opportunity to experience this on quite a number of occasions in Java and Bali (Indonesia) where the *adat* or customary social obligations and moral principles serve as a way of self-legislation, and even prevail against some written civil codes. In such cases, integrity fuses citizens’ (or members’) moral and political lives: “it asks the good citizen, deciding how to treat his neighbor when their interests conflict, to interpret the common scheme of justice to which they are both committed just in virtue of citizenship<sup>14</sup> [or community membership]. Integrity then is the fidelity to an accepted scheme of principles which each member has a responsibility to identify, ultimately for himself, as his community’s perspective or socio-moral scheme.

A state which accepts integrity as a political ideal has a better case for legitimacy than one which does not. Integrity not only assimilates political and moral obligations into the general class of associative obligations but also supports them. The commitment to the notion

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<sup>11</sup> *Ibidem*, p19

<sup>12</sup> MACINTYRE, Alasdair, *After Virtue*, Notre Dame – Indiana, Notre Dame University Press, (1981) 1984, p195

<sup>13</sup> DWORKIN, Ronald, *Law’s Empire*, Cambridge, Harvard University Press, 1986, p217. Integrity in legislation “restricts what our lawmakers and other lawmakers may properly do in expanding or changing our public standards.”

<sup>14</sup> *Ibidem*, p189-190

of integrity expresses a virtue that allows its members to adhere to moral and social obligations. Integrity evaluates and judges what is good or bad, permitted or forbidden<sup>15</sup>.

A trustworthy person of high integrity would respect the principle of reciprocity. In a business context, cheating on the disclosure of data or offering a bribe may be an attempt to gain an unfair advantage over one's competitors by resorting to falsification of financial records to conceal unethical (and often illegal) behavior, thus undermining our virtue of integrity. The other person to whom I have promised something counts on me, on my capacity to keep my word, and by calling me to my responsibility, renders me responsible. Hence, a social bond, instituted in contracts imposing a judicial structure on the giving of my word as an exchange, is intercalated within the structure of trust. The principle that contracts – as between the Agent and Principal – constitutes a rule of recognition that surpasses the face-to-face relation of a promise made between two individuals. The other person to whom I gave given my word becomes a third party designated by the pronoun "everyone", an impersonal but not anonymous pronoun since everyone functions in a public space.

Rational egoism is the view that it is irrational to act contrary to one's self-interest and thus, rationality does not require one to refrain from harming others, especially when one would benefit from it<sup>16</sup>. However, if such an act would harm one's own reputation, such an act to harm others becomes irrational. It may be self-fulfilling and even 'useful' to extend our rational concept of self-interest and recognize people's ability to think about socio-moral goals that emerge as a superior alternative to the standard economic instrumental view<sup>17</sup>. The immediate impact of reputation on behavior will limit the radius of selfishness. It is the concern for others that is often the primary motivating force for acting in accordance with moral rules and for moral ideals as manifested by virtuous excellence. In addition, it is in one's self-interest to avoid shame<sup>18</sup>, guilt and remorse<sup>19</sup> and one must act morally if one wishes to avoid them. Further, the risk of punishment and penalties may prevent certain immoral behavior.

Despite the possible punishment and penalties when crossing social, moral or legal thresholds, or being hurt by emotions of shame and guilt, it is the fear of losing one's good reputation that may deter us most behaving unethically and to push us to adhere to the rules of the game. Indeed, I will argue that pursuing pure greedy and non-compassionate self-interest is self-destructive and that one will need to 'give some trust' to achieve beneficial cooperation. These limits carry a socio-economic and moral dimension, but even in the biological world our genes seem to inherently limit greed<sup>20</sup>.

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<sup>15</sup> RICOEUR, Paul, Oneself as Another, Chicago, the Chicago University Press, 1992, p271-3. Ricoeur suggests an interesting, almost dialectic, bond of mutual interaction between self-esteem and the ethical evaluation of actions aiming at a "good life" (in Aristotle's sense), as there is a bond between self-respect and the moral evaluation of those same actions, falsifiable of the universalization of maxims of actions. Keeping one's word and thus being honest requires ethical self-esteem and moral self-respect, representing the most advanced stages of the growth of selfhood and propriety in one's interpersonal relations. Ricoeur clearly distinguishes self-esteem from self-respect: 1) (ethical or teleological) self-esteem is more fundamental than (moral or deontological) self-respect, 2) self-respect is the aspect under which self-esteem appears in the domain of norms, and 3) the (Kantian) *a priori* of duty create situations in which self-esteem appears not only as the source but also as the recourse for respect, when no sure norm offers a guide to exercise *hic et nunc* of respect.

<sup>16</sup> GERT, B., Morality. Its Nature and Justification, New York; Oxford, Oxford University Press, 1998, p352

<sup>17</sup> SEN, A., "Rational Fools: a critique of the Behavioral Foundations of Economic Theory", Scientific Models and Man: the Herbert Spencer Lectures, London, Oxford University Press, 1976, p1-25

<sup>18</sup> WILLIAMS, Bernard, Shame and Necessity, Berkeley; LA: Univ of Berkely Press, 1993, 252p

<sup>19</sup> TUDOR, Steven, Compassion and Remorse, Leuven; Paris, Peeters, 2001, 229p

<sup>20</sup> DAWKINS, R., The Selfish Gene, Oxford; New York, Oxford University Press, 1989, p233. Giving trust enhances cooperation and creates Social Capital. The Darwinian theory gives us a subtle understanding of the principle of reciprocity. Vampires are great mythmakers. The real facts about vampires tell us a different tale than the vampire's incarnation of our deepest fear for blood sucking evil. "The bats [...] rise above the bonds of kinship, forming their own lasting ties of loyal blood-brotherhood."

## Integrity and the limits of greed

The focus of this paper is to analyze the virtue of integrity as a force of goodwill which constitutes the intangible asset of reputation. The significance of reputation will become obvious from the conclusions drawn from Game Theory research.

The simple game-theoretic model seems to capture in miniature something of the tensions between individual acquisitiveness and the goals of collective cooperation. In the simple game of the Prisoners' Dilemma (PD), there is no way to ensure trust. Based on the roll-back-effect-game, one ends up with non-cooperative behavior since both 'maximizing' participants will defect in the last but one game, resulting in a typical suboptimal PD equilibrium<sup>21</sup>. When we assume frequent encounters – as in iterations of successive rounds of the game – they give us the opportunity to build up trust or mistrust, to reciprocate or defect, to forgive or to avenge. In other words, the PD becomes more realistic as a model when it is made open-ended, i.e. when two players engage in repeated games, never knowing whether they might meet again: the Iterated Prisoners' Dilemma (IPD)<sup>22</sup>.

The IPD is now the orthodox paradigm for the evolution of cooperation among selfish individuals, which is also strongly supported by Axelrod's computer tournament where Tit-for-Tat (TfT) finished first. The strategy called Tit-for-Tat (TfT) cooperates on the first round and thereafter simply repeats its opponent's play of the previous round. Since both defection and cooperation are reciprocated, an optimal response to TfT is to cooperate all the times. Because a participant using TfT will never be the first to defect, two participants who have chosen the TfT strategy will always cooperate<sup>23</sup>. This winning strategy is simple and straightforward: actors should neither be envious of the other player's success nor be the first to defect; nor should they be too clever or cunning; they should reciprocate with both cooperation and defection<sup>24</sup>. As everyone knows, actions speak louder than words. The habit of cooperation– built on an initial trust – over a certain period of time generates greater trust as people work together, even when people do not necessarily possess the virtue of caring for others. I would interpret this *trust* as '*particularistic*'<sup>25</sup>, i.e., specific to a certain known group with whom one cooperates, and usually within a specified time period.

Tit-for-Tat has established a reputation on both experimental and theoretical grounds as being a particularly robust strategy. Results from these tournaments demonstrate that under suitable conditions and without central authority or strict moral rules, cooperation can indeed emerge in a world of egoists, as long as a cluster of individuals are willing to rely on the principle of reciprocity<sup>26</sup>. The basic idea is that an individual must not be able to get away with defecting without the other individuals being able to retaliate effectively. Defection in the business world could refer to unlawful price competition, corrupt behavior undermining the

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Vampires could form the vanguard of a comfortable new myth, a myth of sharing, mutualistic cooperation. They could herald the benign idea that, even with selfish genes at the helm, nice guys can finish first."

<sup>21</sup> HOLLIS. Martin, *Trust within Reason*, Cambridge, Cambridge Univ Press, 1998, 170p

<sup>22</sup> AXELROD, R., *The Evolution of Cooperation*, New York, Basic Books Publishers, 1984, p34-37.

<sup>23</sup> BINMORE, Ken, *Game Theory and the Social Contract II. Just Playing*, Cambridge: London, The MIT Press, 1998, p265.

<sup>24</sup> KRANTON, R.E., "Reciprocal exchange: a self-sustaining system", *American Economic Review*, 86, 1996, pp 832

<sup>25</sup> Extending the radius of particularistic trust may result to a more generalized form of trust where people are assumed to be proper and fair unless proven otherwise.

<sup>26</sup> AXELROD, R., *The Evolution of Cooperation*, o.c., p54: The TIT FOR TAT strategy is completely based on the principle of reciprocity. "What accounts for Tit For Tat's robust success is its combination of being nice, retaliatory, forgiving, and clear. Its niceness prevents it from getting into unnecessary trouble. Its retaliation discourages the other side from persisting whenever defection is tried. Its forgiveness helps restore mutual cooperation. And its clarity makes it intelligible to the other player, thereby eliciting long-term cooperation."

principles of a fair price mechanism or improper advertising, to give just three examples. Cooperation could mean to comply with the rules of the industry or to be a person with high integrity who is trustworthy with whom it is beneficial to engage in mutually beneficial business activities.

The almost utopian sounding conclusion of this “nice and forgiving” winning strategy in Axelrod’s computer game which has been confirmed by Richard Dawkins’ Darwinian evolutionary research in biology,<sup>27</sup> surprised many experts in the field of biology and other sciences, when participants in the game had tried to be too cunning by submitting subtly ‘nasty’ (i.e. one sometimes defects and deceives first) or free-riding strategies which proved to be less robust than the winning TFT strategy. In fact, it is hard to deny that a complex society is not likely to survive if all its members are governed solely by exclusively selfish motives.

When more information on the interaction and of participants is added – i.e. discussion between participants is allowed – then one observes that the establishment of a group identity and cooperation within this group seems to be more plausible<sup>28</sup>. Such iterations as a result of an ‘increased shadow’ contribute to a group identity enhancing trust between them. As such, the participants learn to cooperate within groups, predicated on trust, i.e. to share the belief that reciprocation will materialize, now or later. Trust is created through the Iterated Prisoners’ Dilemma, namely when people repeatedly interact with one another. Someone is more likely to take advantage of you if you are never going to see him again – as in a single PD – than if you are going to meet again. So it is not solely the iteration of the social interaction but the fact that prolonged cooperation yields improved promising rates which could reflect or create group identity<sup>29</sup>. Such iterated cooperation, based on trust and reciprocal behavior, will result in a “good reputation”.

The good reputation of the TFT strategy, incorporating the principle of reciprocity, could be slightly amended in situations where mistakes and uncertainties in complex biological or social interaction may occur. Such amended TFT strategy is labeled a *Tit-for-2-Tat* (Tf2T) or a *Generous Tit for Tat* strategy (GTfT).

Free-riding driven by greed would immediately cause a retaliation from the actor following a TFT strategy. Only when the free-rider is willing to return to cooperation could the game avoid a continuous defection before slipping into a Hobbesian *brutish State of Nature*. Although TFT is forgiving in the following move, it reacts to any immediate previous defection with retaliation, applying a strict form of reciprocity. Despite the theoretical robustness and the superior performance of the TFT strategy in the computer tournaments, mistakes give rise to sequences of alternating mutual defections because of its equal reciprocity strategy or strict mutuality strategy<sup>30</sup> which could prove quite costly in society<sup>31</sup>. Indeed, such an ‘equal reciprocity’ strategy may cause an unstable mathematical equilibrium, unless one adds an

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<sup>27</sup> DAWKINS, R., *The Selfish Gene*, Oxford: New York, Oxford University Press, 1989, p217 & p71.

<sup>28</sup> DAWES, Robyn M. & Richard THALER, “Cooperation”, *Journal of Economic Perspectives*, Vol 2, No3, Summer 1988, pp195.

<sup>29</sup> *Ibidem*, p195-196. It is the acknowledgement of certain identification with the group within which one interacts that reinforces this improved Pareto strategy. Experiments show that openness of information, allowing discussion between the participants, raises the cooperation rate from 30% (i.e. a situation without discussion reflecting the Nash Strategy outcome) to 70%. But this is only applicable when the subjects believe their contribution to cooperation benefits members of their own group.

<sup>30</sup> NOWAK, Martin & Karl SIGMUND, “Tit for Tat in heterogeneous populations”, *Nature*, Vol 355, Jan 1992, pp251.

<sup>31</sup> NOWAK, Martin & Karl SIGMUND, “The Alternating Prisoner’s Dilemma”, *Journal of Theoretical Biology*, 1994, 168, pp219-220

extra forgiving feature that does not immediately react to a defection, assuming for example that the defection was a 'miscalculation' or even default by the 'occasional' assumed defector<sup>32</sup>.

The Tf2T or GTfT conceptually differs from the TfT strategy in that the former does not immediately revert to a defection, it remains generous until the provoking actor cheats in a subsequent move, and only then will he retaliate. In simulations where 'niceness' and reciprocity are prevailing, the difference between TfT and Tf2T is hardly noticeable, because in both cases the participants cooperate. Only under circumstances of high uncertainty and in situations in which mistakes surround most biological interactions, may a TfT strategy penalize populations whereby accidental defection entails a series of alternating retaliations. Unlike 'group identity'<sup>33</sup>, identified as principally responsible for cooperation based on particularistic trust, a heterogeneous population employs simple TfT strategies with behavior being dependent upon the outcome of the previous round. This behaviour leads to persistent periodic or highly irregular (if not chaotic) oscillations between the frequencies of the strategies and the overall level of cooperation as consequences<sup>34</sup>. Adding 'generosity' into the Game Theoretical model increases cooperation in a heterogeneous population. This amended TfT strategy (i.e. a GTfT or Tf2T strategy) corrects occasional mistakes and as such can thus lead to long periods of steady cooperation<sup>35</sup>, even in heterogeneous populations (i.e. not known members).

Being generous would add value despite its seemingly apparent logical contradiction. People who adopt a norm of cooperation will do well by eliciting it from others, and attracting interaction from other cooperators. However, one cannot successfully fake being cooperative for an extended period of time, just as one cannot be successful in getting people to believe in too many lies. Therefore, it is better and more effective to be honest and so enhance the possible consistency of credible reputation than to try to act *as if* one were honest<sup>36</sup>. What pays off is a reputation for the virtue of generosity or honesty, not necessarily (the virtue of) generosity or honesty in itself. The best way, however, to establish a reputation for honesty is actually to be honest since people with the calculated intention to appear honest will eventually slip up and undermine their credibility as an allegedly honest person. Nevertheless, the self-interest of a businessman to make people believe that he acts *as if* he is honest is sufficient to ensure that honest behavior (or at least the appearance of honesty) will continue to exist. The reputation of honesty does not necessarily result in a genuine form of generosity. Indeed, honesty can ruthlessly exploit the principle of (calculative) reciprocity as long as participants perceive this behavior as 'fair', open and transparent.

What is perceived as 'fair' in sustainable cooperation for most people? Equity or equal opportunity? One very often reaches *fair play* by sharing equally the sum to be divided. Despite some specific cultural variations, this outcome is far from what rational analysis would dictate for cold-hearted selfish players. In striking contrast to what 'rational' selfish income maximizers ought to do, most people throughout the world place a high value on 'fair' outcomes.

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<sup>32</sup> NOWAK, Martin & Karl SIGMUND, "Chaos and the evolution of cooperation", *Pros. Nat. Acad Science*, USA, Vol 90, June 1993, pp5091: This vulnerability to errors is not evident under the clinical conditions of computer runs. In real applications, however, it should not be overlooked.

<sup>33</sup> AXELROD, R. & R.A. HAMMOND, "The evolution of Ethnocentric Behavior", a paper prepared for Midwest Political Science Convention, Chicago, April 3-6, 2003, 30 pages. When individuals see themselves as members of an in-group they are more likely to contribute to collective welfare, even at a cost of individual advantage. Indeed, group affiliation is central to identity formation and identity politics.

<sup>34</sup> NOWAK, Martin & Karl SIGMUND, "Chaos and the evolution of cooperation", *o.c.*, p5091

<sup>35</sup> NOWAK, Martin & Karl SIGMUND, "Chaos and the evolution of cooperation", *o.c.*, p5091.

<sup>36</sup> FRANK, Robert, "A Theory of Moral Sentiments", in MANSBRIDGE, Jane (Ed), *Beyond Self-interest*, Chicago, Chicago Univ Press, 1990, p71-96.

As in a laboratory environment, the ultimatum game shows us that trust in fair play is of the utmost importance for cooperation. In other words, these experiments have shown players to be more generous – likely out of self-interest. Conversely, unfairness incites costly acts of revenge. In an Ultimatum Game<sup>37</sup>, played only once and not repeated, it would be not beneficial to fully apply the rational logic of selfish behavior aiming to maximize our 'benefits' by taking a free ride. Reality, however, shows us that humans do not play this way, and instead tend to offer 50% of the prize on average and to reject offers below 20%. In many decision-making settings people do not behave as 'rational' agents who aim to maximize their own income<sup>38</sup>. People seem to behave this way because they maximize a utility function which not only includes a monetary payoff but also some inequity aversion<sup>39</sup>.

None of our current theories can explain altruism or generous behavior when there is anonymity and therefore no chance for applying the principle of reciprocity or reputation enhancement. However, Ultimatum Game Theory teaches us that people do not act simply to maximize their economic self-interest. They are ruled not only by cold economic logic but also by emotions and a sense of fair play that shows us that altruistic punishment or righteous vengeance deters potential free-riders. The message that if they fail to contribute to the common good and that someone out there may nail them for it, would be sufficient to enforce those would-be free-loaders into social cooperation as long as the group of fair-minded people outnumbers them.

It will prove to be hard to fine-tune emotions in social interactions occurring under strict anonymity<sup>40</sup>. Moral emotions<sup>41</sup> leading to integrity, i.e. being honest and generous, may be prompted to behave in ways that would benefit ourselves and our group in the long term<sup>42</sup>. Rejecting low offers is costly in the Ultimatum Game, although the cost is offset by a gain in the reputation of a person who insists on fair play. Such a reputation may encourage us to reject dismal offers in order to keep our self-esteem, which is defined as an internal device for acquiring a reputation which is beneficial in future encounters. The result is fairer play than might otherwise be 'rationally' predicted.

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<sup>37</sup> NOWAK, Martin; PAGE, Karen & Karl SIGMUND, "Fairness versus Reason in the Ultimate Game", *Science*, Vol 289, September 2002, p1173-1175. Imagine that somebody offers you \$100; all you have to do is agree with some other anonymous person on how to share the sum. The rules are strict. The two of you are in separate rooms and cannot exchange information. A coin toss decides which of you who will propose how to share the money. Suppose that you are the proposer: you can make a single offer of how to split the sum, and the other person – the responder – can say yes or no. If the responder says yes, the deal goes ahead; if the answer is no, neither of you gets anything. Instinctively, many people feel they should offer 50%, because such a division is "fair" and therefore likely to be accepted. More daring self-interested people, however, think they might get away with offering somewhat less than half the sum. The empirical analysis shows that 2/3 of offers are between 40-50%. Only four in 100 people offer less than 20%. Proposing such a small amount is risky, because it might be rejected. More than half of all respondents reject offers that are less than 20%. That results in a paradox: why should anyone reject an offer as 'too small' since the rational option for a selfish individual is to accept any offer? A selfish proposer who is sure that the responder is also selfish will therefore make the smallest possible offer and keep the rest.

<sup>38</sup> FEHR, E. & S. GÄCHTER, "Reciprocity and Economics: The economic implications of Homo Reciprocans", Elsevier, *European Economic Review*, 42, 1998, pp 848. Both authors strongly believe that the notion of reciprocity drives cooperation, but possible sanctions – a form of negative reciprocity, may become a possibility – added to keep self-interested people within the boundaries of mutual reciprocal cooperation.

<sup>39</sup> KAHNEMAN, D.; KNETSCH, J.L. & R. THALER, "Fairness and the assumption of economics", *Journal of Business*, 59, 1986, p258-300 quoted in NOWAK, Martin & Karen PAGE, "Empathy leads to Fairness", *Bulletin of Mathematical Biology*, 2002, 64, p1102

<sup>40</sup> NOWAK, Martin; PAGE, Karen & Karl SIGMUND, "Fairness versus Reason in the Ultimate Game", *o.c.*, p1774.

<sup>41</sup> Moral emotions such as pity, empathy, sympathy and compassion, I argue, are closely related to the answer of a fundamental moral question that our behavior should be directed not to harm others.

<sup>42</sup> HARDIN, Russell, "Altruism and Mutual Advantage", *Social Service Review*, Univ Chicago, September 1993, pp361.

Reputation based on the moral behavior of 'generous empathy'<sup>43</sup> plays a significant role in achieving fair play or reciprocal cooperation. If players know that there is some probability of being found out about their previous encounters, then fairness can evolve<sup>44</sup>. Fairness is defined in this context as an even split of the total sum to be shared – as in fair price mechanisms where each participant shares a 'profit'. It is of interest though that fairness is described by the other players as 'some type of do-as-if-you-would-be-done-by principle' – i.e. balanced or even generalized reciprocity – which in this discussion is somehow based on the notion of empathy that offers what you yourself would accept<sup>45</sup>. People do not act merely to maximize their economic self-interest. They are ruled not only by cold economic logic but by (moral) emotions and a sense of fair play. It is the notion of empathy and of sympathy that results in the virtue of being honest or trustworthy, resulting in a certain level of 'generosity'. The notion of 'fairness' and the metonym 'generosity' can be part of 'good responsibility management'.

When researchers examined the phenomenon of 'taking advantage' of the goodwill of the other(s), the results suggested that greed overrules fear for the sanctions as result of free-riding<sup>46</sup>. This conclusion has influenced my analysis that solutions against a-social behavior (such as free-riding in the form of bribery and corruption) will need 'more' than strict and formal sanctioning. Indeed, if TFT strategies based on trust and reciprocity fail, institutional changes and reform will be recommended. However, I am convinced that only a change in individual attitude towards greed and taking advantage of the other's generosity or unaware naivety may result in a reduction of asocial, immoral or illegal behavior. Hobbes and quite a number of other political scientists suggest that strict legal institutional sanctioning may deter the greedy selfish. I on the contrary argue that without a minimum level of social internalized convention and/or moral virtues, free-riding may not be curbed. I argue that one needs to tame the factor of greed through fending it off by the possible deterring loss of reputation undermining the possibility of future cooperation, as one will be excluded from the game, or by relying on a moral reasoning that avoids harming other people.

### Cooperative Reciprocity and Retaliation

Game Theory argues that free-riding (i.e. being corrupt which could be considered the opposite of being a person of integrity) makes no sense if it causes the loss of time, money or personal safety, or if it damages your political or social reputation. Gleeful vengeance by 'fair playing citizens' going after the reputation of a bad 'fair player' (because of corruption) seems to be a civilization's glue. Unfortunately, such 'vengeance' will require also civic or institutional

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<sup>43</sup> 'Empathy' - an *Einfühlung* or an *Einführendes Verstehen*, the ability to enter into the feelings of others - and the closely related notion of 'sympathy' – the self who feels with others either passively or actively, hereby (morally) acknowledging the other - can lead to fair or reciprocal cooperation. Empathy has a cognitive and affective component, or an intentional stance and an emotional inclination. It is also important to note that the notion of empathy is morally neutral, and can be either positively or negatively used. A crook can be very smart misguiding somebody by using his empathic ability to 'understand' the victim.

<sup>44</sup> NOWAK, Martin & Karen PAGE, "Empathy leads to Fairness", *Bulletin of Mathematical Biology*, 2002, 64, p1101-1116 & NOWAK, Martin; PAGE, Karen & Karl SIGMUND, "Fairness versus Reason in the Ultimate Game", *Science*, Vol 289, September 2002, p1173-1175

<sup>45</sup> NOWAK, Martin & Karen PAGE, "Empathy leads to Fairness", *Bulletin of Mathematical Biology*, 2002, 64, p1111-1112: "We have found that in this context in the Ultimatum Game, empathy is evolutionary favored and results also in the evolution of equal sharing of the prize. This is independent of an assortative structuring of the population or of knowledge of other players' strategies, such as is necessary in reputation effects and strategies designed for repeated interactions, or of the possessions of a utility function more complicated than the monetary payoff. We have shown how evolutionary game theory can explain human behavior in the Ultimatum Game, which is not explicable by classical game theory. In this context players' strategies have an intermediate level of complexity. ...they do not require the level of reasoning of the classical 'rational' player who must reason about his opponent's rationality. Here he simply asks, 'how would I behave in his place?'"

<sup>46</sup> DAWES, R. & R. THALER, *o.c.*, p193. In the standard game contribution rates averaged 51%. In the no fear (money will be given back) game contributions rose to 58%, but in the no greed game contributions were 87%.

sanctioning. Therefore, to curtail corruption or unethical behavior it is necessary to implement a combined force of:

- (1) Proper **institutional reform** resulting in harsher penalties,
- (2) Reinforcement of accepted civic and social **norms**, and
- (3) The procurement of an innate understanding of the necessity of "good reputation" for survival within an interdependent and diverse world.

My focus has been on the third component.

Similarly, one could apply these requirements upon corporate **integrity** by (1) relying on *personal accountability* (i.e. the reputation to stick to or to comply with the rules of the game, or to incite 'Integrity Strategies' within the company), (2) by issuing *transparent rules and norms*, and (3) by using the *social pressure* which can be derived from stakeholders – in the form of a Social Corporate Responsibility Pact, and thereby reminding corporations to create a more moral corporate environment. Transparent rules and norms are related to institutional reform and institutional 'external' law regulations. Social pressure is obviously related to social norms and moral values and principles. The focus has been on the personal accountability within the games analyzed, where "integrity as reputation" will make or break the person's fortune in situations driven by "self-interest".

My analysis of the Tit-for-Tat and Tit-for-two-Tat (or Generous TFT) as well as the Ultimatum Game has indicated that by acting properly, 'fairly' and 'generously', one gains a good reputation among the participants. Such a generous TFT is a robust, i.e. stable, consistent, and morally good strategy. Instead of preaching (allegedly) universal moral principles in a business or bureaucratic environment, and assuming that institutional norms and regulations are either meekly enforced or irrelevant for a certain situation, one falls back on the desire of every human to sustain a good reputation within one's community or group. The GTFT strategy which is stable, consistent, and morally acceptable can be seen as an Integrity strategy where its good reputation may be a very powerful (competitive) weapon.

## THE PRACTICAL SIGNIFICANCE OF "INTEGRITY AS REPUTATION"

Despite numerous attempts to erect ethical or legal boundaries, it remains simplistic and naïve to believe that one may easily classify thresholds because they can be reversed or even inversed<sup>47</sup>. Strict institutional arrangements, thresholds and limits may often be too rigid and "un"-realistic<sup>48</sup>. Based on these few insights from Game Theory, this more practical perspective will attempt to show that an attitude of *integrity*, required to lead and inspire an organization, will almost automatically lead to a *good reputation* in any organization, "Integrity as reputation" can have a significant positive influence on the functioning of an organization, both economic (political) as well as ethical.

Formal integrity that promotes stability and consistency, and moral integrity which shows the appropriateness of change through individual reflection in order to reach a particular (and acceptable) view of the moral good, allows the actor to make compromises in concrete situations as long as the criteria of stability, consistency and a focus on moral good or good

<sup>47</sup> CORBEY, R., "Gift en transgressie: Kanttekeningen bij Bataille", *Tijdschrift voor Filosofie*, Leuven, 56, 1994, p300

<sup>48</sup> VERHEZEN, Peter, "From a Culture of Gift to a Culture of Exchange", *Jurnal Antropologi*, University of Indonesia, Jakarta, November 2003, p101-115

reputation are not jeopardized. Such compromises may lead to an *Ethic of Responsibility* which could be quite context-specific.

Indeed, more responsible processes may be synonymous with good management which actually leads to positive financial performance. *Responsibility management* approaches can potentially provide a solid basis of competitive advantage by allowing a 'fair' company to hire and retain the best employees, keep existing customers (less costly than gaining new ones), attract social/ethical investors, improve community relations by becoming neighbours of choice, and even improve productivity<sup>49</sup>. Better stakeholder relationships will likely have positive long-term performance outcomes. For example, improved employee relations as the result of integrity strategies have provided ample evidence of better productivity. At the other end, customers are becoming increasingly sophisticated about how, where, and under what conditions goods or services are made, reinforcing my initial statement that iterated cooperation (recurring sales for example) will decrease the chance of a successful greedy selfish strategy (where "cheating" would pay off). "*Integrity as reputation*" inspires people, especially if the leader of the organization, the CEO or *Chief Executive/Ethics Officer*, reflects the (ethical) values of the organization.

Every practitioner is accountable for his actions and intentions carrying out his function as an implementer of the corporate mission and vision, its strategic goals and objectives. The instrumental adage that the goals and ends justify the means by which one achieves those goals is unacceptable because it only emphasizes the ultimate consequences of a corporate action, not the process by which one governs the corporation.

Only when accountability, fairness and honesty become truly engrained into all companies, or for that matter, government practices, will responsibility management be considered a core element of business practice, rather than just a PR add-on. An obvious example of a company's vision which incorporates its understanding of responsibility is Johnson & Johnson's famous Credo, which articulates its stakeholder responsibilities explicitly. The real adherence to its Credo, not just cynical PR window dressing, makes J&J a company with high integrity.

### Transparency & Accountability

Because external demands for greater *transparency* and corporate *accountability* have been growing rapidly and are likely to continue to do so, responsible management and integrity strategies mean being transparent and honest in disclosing and reporting results to stakeholders. Transparency signifies accountability that provides reliable social, economic and ecological results consistently. Better stakeholder-related corporate practices may provide more competitive advantage, or reduce risks for liability to stakeholders who may sue irresponsible or unethical agents-principals.

There are still quite a number of companies – even more so in less developed countries – for whom responsibility management, integrity strategies and external accountability (other than financial accountability) remain a distant and even unidentified goal.

### Corporate Social Responsibility

Many brand name companies have suffered significant reputational damage from lack of attention to important issues related to *corporate responsibility* and have made changes. In light of decreasing product differentiation and heightened competition, integrity strategies and

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<sup>49</sup> WADDOCK, S. & Ch. BODWELL, "Managing Responsibility: what can be learned from the Quality Movement?", *California Management Review*, Vol 47, no1, Fall 2004, p31

Corporate Social Responsibility (CSR) initiatives<sup>50</sup> become more and more an innovative and less-imitable means of strengthening customer relationships.

It is interesting that a company's reputation magnifies the internal outcomes of CSR, and has a very positive influence on the loyalty and trust bestowed by its customers. The Body Shop corporation initially built a reputation that rested on three pillars of economic, social and environmental performance and was designed to appeal to everybody. The Body Shop has a reputable symbiotic relationship with its customers:

What brings me back to their stores is the feeling that every purchase from them is in a way a contribution to the improvement of life in places where their product comes from and, at the same time, a way to take care of myself. Even though their product is not unique, I am very loyal to them. If their prices went up relatively to similar product, I would still buy it, even if I had to cut down on the total amount.<sup>51</sup>

The loyalty of its customers guaranteed that the Body Shop succeeded in making "profits with principles". In essence, the Body Shop reflected an appeal to customers to "buy the company's product because of the people we are." The Body Shop's 'branded house' is the anchor-point in their differentiation in the cosmetics market.

Our corporate integrity is directly related to our personal accountability of our corporate actions, either following a compliance or integrity strategy. We achieve a corporate integrity by relying on our personal accountability supported and sustained by a broader social and moral accountability (Virtues and Rules), based on transparent rules and norms. Finally, the Corporate Social Responsibility of a corporate organization to which we belong encompasses the widest responsibility towards the social environment.

### Corporate Reputation as competitive advantage

The PD has shown that it often is in our self-interest to cooperate and refrain from free-riding, which practically implies that the PD theorem is turned into an Assurance Game or Coordination Theorem by influencing the participants' moral perception, attitudes and 'preferences', through moral education that adheres to moral virtues and moral rules. In other words, cooperation<sup>52</sup> is assured by (1) the *custody*<sup>53</sup> of our own 'good' reputation<sup>54</sup>, (2) guided by social norms and moral values, by rules and virtues<sup>55</sup> and (3) *guarded* by an institutional

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<sup>50</sup> [WWW.BSR.ORG](http://WWW.BSR.ORG). The Business for Social Responsibility organization defines corporate social responsibility as "achieving commercial success in ways that honor ethical values and respect people, communities, and the natural environment." CSR reflects the company's status and activities with respect to its perceived societal obligations.

<sup>51</sup> An Interview quoted in BHATTACHARYA, C.B. & S. SEN, "Doing better at Doing good", *California Management Review*, Vol 47, no1, Fall 2004, p19

<sup>52</sup> WILLIAMS, Bernard, "Formal Structures and Social Reality", in GAMBETTA, Diego (Ed), *Trust, Making and Breaking Cooperative Relations*, Oxford, Basil Blackwell, 1988. p3-6: I would like to draw the reader's attention to Bernard Williams's 4 major reasons for cooperation, i.e. coercion and sanctions, self-interest, values and personal bonds, which are quite similar to my taxonomy of cooperation:.

<sup>53</sup> The notion of custody reflects in my opinion a burden which ones takes upon oneself, or which has been put on oneself. It also implies a feeling of being entrusted to our care, trusting that we will fulfill our obligations and made commitments.

<sup>54</sup> ARVIS, J-F. & R. E. BERENBEIM, *Fighting Corruption in East Asia. Solutions for the Private Sector*, Washington, The World Bank Division, 2003, p39. Reputational risks are much on managers' minds. Gerald Mestrallet, President of the Suez group, observed that "in today's world of global, instantaneously transmitted news, a reputation that took years to build can be shattered in minutes...I am convinced that the greatest threat to our group is not so much a financial or a political crisis as a crisis in our image." Similarly, the Shell Business Principles state that "Upholding the Shell reputation is paramount. We are judged by how we act. Our reputation will be upheld if we act with honesty and integrity in all our dealings and we do what we think is right at all times within the legitimate role of business."

<sup>55</sup> GERT, B., *Morality, o.c.*, Chapter 3. Moral rules, ideals and virtues constitute what is commonly described as 'morality' which is an informal system applying to all rational persons that governs behavior affecting others. The main aim of morality could be described as to lessen evil and to avoid harm.

form of justice. A trustworthy reputation functions as the *custodian* of restrained selfish behavior, inspired by social rules and moral values which can guide us towards acceptable social behavior, formalized by an 'artificial' and centralized Social Contract or *Leviathan* which *guards* us against the brutish nature of law. Each of these three generic solutions functions as thresholds aiming at beneficial cooperation and alliances.

A corporate reputation is an overall evaluation that reflects the extent to which people see the firm as substantially 'good' or 'bad'. Good reputations foster trust and confidence, bad ones do not. Corporate integrity of the top team of a corporation – the Board, CEO and executive managers – plays a crucial role in personifying and creating trust and confidence in the company. The representation of corporate reputation has been variously called "corporate image" and "corporate identity". The former is a person's beliefs about an organization whereas the latter encapsulates the attributes used to describe an organization.

For a corporate reputation to be useful as a competitive weapon, the organization's identity and behavior will need to be periodically validated. Fortune magazine polls industry analysts and managers in its annual surveys of America's most admired companies. It measures the beliefs about each company with regard to financial soundness, degree of innovativeness, product quality, ability to develop and keep key people, management quality, asset use, community and environmental friendliness and investment value.

An organization with a good reputation is one with an image that fits the ethical values of an individual agent, and which, when it is relevant, fosters good relationships, capturing the relational aspect of reputation. Good reputations are valuable because they enhance trust and confidence in the organization such that the individual feels that it is safe to do something with the organization. Good reputation has a number of positive payoffs. In banking, professional services, and education, trust and confidence in the organizations are important ingredients for doing business. In situations where trust and confidence in the company or organization are necessary for stakeholders to support its basic operations, the company can establish a good reputation and then post this as a "performance bond" to back every sale it makes and every stakeholder relationship it builds<sup>56</sup>.

I believe that we conclusively can say that ascertaining certain morally and legally acceptable behavior – such as the GTFT strategy – protects our reputation, not necessarily because of the high moral virtues or values pursued in such a strategy, but because it is in our own self-interest to establish a good reputation to win overall. I suggest future research should focus on analyzing in detail what kind of behavior – as expressed in the GTFT strategy – could sustain 'integrity as good reputation'. Consistent and coherent *honesty* based on the principle of reciprocity, and *accountable* behavior which is sincere or truthful (and thus transparent) definitely enhances our reputation in any community.

On a macro-economic level, numerous cases have proven that there is a correlation between integrity (as reputation) and economic efficiency. Two neighbouring countries, Singapore and Indonesia, or USA and Mexico for that matter, clearly indicate the relationship between high integrity and economic efficiency. Many studies have shown that the five richest

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<sup>56</sup> DOWLING, Grahame R., "Corporate Reputations: Should you compete on yours?", *California Management Review*, Vol 46, No3, Spring 2004, p27

countries in Asia are also the least corrupt<sup>57</sup>. Their highly rated integrity functions as good reputation, and handsomely pays off in economic investment and growth.

Corporate reputation reflects the organization's strategy, culture, and values. A good corporate reputation signifies trust in an organization, it creates an emotional and intellectual bond with a number of stakeholders, and acts as the source of authority and credibility for all the organization's dealings<sup>58</sup>. It follows the adage that one can do well by doing good.

*Jakarta - Leuven*

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<sup>57</sup> TAY, Simon & Maria SEDA (Eds), *The Enemy within. Combating Corruption in Asia*, Singapore; London, Easter University Press, 2003, 333p

<sup>58</sup> DOWLING, Grahame R., "Corporate Reputations: Should you compete on yours?", *o.c.*, p34