Creating an Ethical Business Culture

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Session Agenda

- The Board and the Governance Process
- Creating an Ethical Business Culture
- Control of Organizational Corruption
- The Delicate Art of Compliance System Design
- Implications for Practice
What is organizational governance?

The process through which
(1) values and goals are established and communicated,
(2) the accomplishment of goals is monitored,
(3) accountability is ensured, and
(4) values are preserved.
What is organizational governance?
Parties in the Governance Process

- Oversight group – board and committees of the board
- Stewardship group – executive management
  - Dual role of stewardship of resources allocated by board and accountability of results of operations
- Performance group – operating and support management and staff
- Assurance group – internal and external auditing functions.
2) (A) The organization’s governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program.

Fed. Sent. Guidelines Chapter 8
The Two Basic Responsibilities of the Board

Governance “Umbrella”
Board of Directors

Strategic Direction
- Values
- Boundaries

Governance Oversight
- Accountability
- Values preservation
Key Components of Governance Oversight

- Stakeholders
- Governance “Umbrella”
  - Board of Directors
- Risk Management
  - Senior Management
  - Risk Owners
- Assurance
  - Internal
  - External
Creating an Ethical Business Culture – Dual Role

- **Strategic Direction**
  - Set boundaries
  - Establish values
  - Determine risk appetite

- **Oversight**
  - Risk management
  - Assurance
(a) To have an effective compliance and ethics program, for purposes of subsection (f) of §8C2.5 (Culpability Score) and subsection (c)(1) of §8D1.4 (Recommended Conditions of Probation - Organizations), an organization shall—

(1) exercise due diligence to prevent and detect criminal conduct; and

(2) otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.

Fed. Sent. Guidelines Chapter 8
Dukerich, Lange and Huber, “Ironic Processes in Organizational Corruption Control” The University of Texas, 2006

Organizational corruption
Action taken by organizational members, through their organizational positions or with organizational resources, that is illegal or unethical by societal standards

An organizational culture in which the occurrence of organizational corruption is held to an acceptable level
An Ethical Business Culture - An Organizational Corruption Perspective

- Two Types of Organizational Corruption
  - Purposive
  - Emergent
Organizational Corruption

- **Purposive**
  - Agent recognizes the moral issue and still proceeds to engage in the illegal or unethical behavior.
  - Agent has asked him or herself the question “Is this a moral issue?” and then proceeds to engage in illegal or unethical actions.

- **Emergent**
  - Agent does not recognize the moral issue and engages in illegal or unethical behavior.
  - Agent never asks the question “Is this a moral issue?”
Organizational Corruption

- **Purposive**
  - Engages in illegal or unethical actions in order to achieve gain or avoid loss (can be indirect)
  - Individual differences in propensity, cognitive moral development, low self-control
  - Situational characteristics (high hierarchical accountability, social relationships)

- **Emergent**
  - Organizational routine
  - Authorization
  - Dehumanization
  - Goals-means displacement
  - Situational factors that increase focus on means rather than moral consequences associated with ends
    - Job pressure
    - Role conflict
    - Perceptions of organizational justice
Organizational Corruption

The Arthur Andersen partner was on his cell phone when he said,
"Ship the Enron documents to the feds,"
but his Secretary heard,
"Rip the Enron documents to shreds."

It turns out that it was all just a case of bad cellular.

Sprint PCS The clear alternative to cellular℠
Managing the Risk of Organizational Corruption

1. Review Environment
2. Establish Objectives
3. Identify Risk
4. Assess Risk
5. Apply Response
6. Monitor & Communicate
Managing the Risk of Organizational Corruption

1. Evaluate and Rank Risk
2. Risk within Risk Appetite?
   - Yes: Accept
   - No: Select Response Strategy
     - Accept
     - Control
     - Transfer
     - Avoid
3. Assess Response Strategy
4. Prepare and Implement Strategy
5. Risk within Risk Appetite?
   - Yes: Retain
   - No: Continue with risk management
Control Processes

- Two Approaches
  - Administrative
  - Social
A Delicate Balance

- Cost versus Benefit
- Administrative versus Social
- Unintended Consequences of the control activity
  - What Dukerich, Lance and Huber call “ironic processes”
Administrative versus Social


  - Compliance Strategy vs. Integrity Strategy
## Strategies

<table>
<thead>
<tr>
<th>Objective</th>
<th>Compliance Strategy</th>
<th>Integrity Strategy</th>
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</thead>
<tbody>
<tr>
<td>Behavioral Assumptions</td>
<td>Prevent criminal misconduct</td>
<td>Enable responsible conduct</td>
</tr>
<tr>
<td>- autonomous beings</td>
<td>social beings</td>
<td></td>
</tr>
<tr>
<td>- self-interest</td>
<td>self-interest, values, ideals, peers</td>
<td></td>
</tr>
<tr>
<td>Leadership</td>
<td>lawyer driven</td>
<td>management driven with aid of lawyers, HR, IA, others</td>
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## Strategies

<table>
<thead>
<tr>
<th>Methods</th>
<th>Compliance Strategy</th>
<th>Integrity Strategy</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Education</td>
<td>Education, leadership, accountability, org systems &amp; decision process, audit and control, penalties</td>
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<tr>
<td></td>
<td>Auditing and control Penalties</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Lawyers</strong></td>
<td>Executive and management with lawyers, IA,</td>
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**Staffing**
### Strategies

#### Activities

<table>
<thead>
<tr>
<th>Compliance Strategy</th>
<th>Integrity Strategy</th>
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<tr>
<td>-develop standards</td>
<td>-lead development of org values and standards</td>
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<tr>
<td>-train and communicate</td>
<td>-train</td>
</tr>
<tr>
<td>-handle reports of misconduct</td>
<td>-integrate into org systems</td>
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<tr>
<td>-conduct investigations</td>
<td>-provide guidance and consultation</td>
</tr>
<tr>
<td>-oversee compliance audits</td>
<td>--assess values and performance</td>
</tr>
<tr>
<td>Enforce standards</td>
<td>--oversee compliance audits</td>
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“Ironic Processes” in Administrative Controls

Situation 1

● “Interference” Controls

  ● Prevent corruption by interfering with employees’ ability to complete act
    ● Password for access to date, keys, segregation of duties
    ● Reduction in employees’ autonomy
    ● May foster organizational corruption
      ● Some may view with resentment,
      ● Some with the challenge to beat the system
Situation 2

“Punishment” Controls

- Prevent corruption by punishing those who commit undesired actions
- Requires monitoring of behaviors and outcomes
  - Reduces people's sense of autonomy and self-control
  - Creates sense of distrust and could provoke retaliation against organization
- Less rigid monitoring system also has problems
  - Minor infractions that are not detected reinforce behavior and downward beliefs in getting caught
“Ironic Processes” in Administrative Controls

Situation 3

- “Autonomy-reducing” Controls and Emergent Organizational Corruption
  - Employees focus on rules
  - If rules distorted or don’t fit all situations may lead to emergent corruption because employees are condition to just follow rules and not consider actions as “moral issue”
Situation 4

“Autonomy-reducing” Controls and Emergent Organizational Corruption

- May reduce employee monitoring of other employee’s actions
- Lead to purposive or emergent corruption that would have been otherwise detected and eliminated
Situation 5

- Internalization of organizational values
  - Process for doing this are difficult to fit to each individual
  - Some individuals will not be receptive and perceive this as manipulation – can foster purposive organizational corruption in them
Situation 6

- Control mechanisms that attempt to align employee and organizational values
  - Side effect of reducing employee monitoring of other employees’ actions
  - Employees that come to believe that socialization has been successful and that the organization’s internal environment is highly ethical may be prone to dismiss and rationalize actions that are ethically questionable
Situation 7

- Control mechanisms that attempt to increase organizational identification can facilitate emergent organizational corruption
  - High identity may lead to a failure to question morality of actions prescribed by organizational routines
  - Lead to reduced monitoring of the actions of other organizational members
Implications

- What actions can organizations take to achieve control objectives and minimize counterproductive effects
Implications

Situations 1 and 2
Monitoring controls
- Increase effectiveness (probability)
  - Cost and potential retaliation
- Disproportionate punishment (loss)
  - Zero tolerance
- Make clear to employees why control is necessary for the organization and less attention to control or rule itself
Implications

Situation 3
Counter facilitation of emergent corruption from autonomy reducing controls
- Don’t have strict focus on following rules for rules sake – focus on original purpose of rule
- Principle versus rule based
Implications

Situation 4
Increased corruption because employees don’t feel need to monitor behavior of others

- Emphasize harm to the organization of the actions by any employees who engage in corrupt practices
- Keep an urgency to emergent corruption by calling attention to it (sharing of examples etc)
Implications

Situation 5
Side effects of attempts to align employee and organizational values

- Don’t overdo value shaping efforts
- Most effective – learned experiences or independent choice rather than indoctrination
Implications

Situation 6
Reduced monitoring of others because in this organization “we are all aligned and good people”

- Make salient harm to the organization by corrupt actions of members
Implications

Situation 7
Actions meant to align employees’ values with organization’s can lead to over-identification with the organization

- Rather than “high levels” seek “moderate adherence”
  - Variable level of identification rather than one-size-fits all
    - Difference among jobs (IA and compliance for example)
    - Differences in individuals
Overall

- Communicate explicitly adverse consequences to the organizations or valued stakeholders
  - Communications – especially stories form those affected
- Design control systems that are understandable, that communicate that they are consistent with societal values, that are enforced