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# Managing Ethics and Legal Compliance:

## WHAT WORKS AND WHAT HURTS

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**T**en years ago, a Business Roundtable report titled *Corporate Ethics: A Prime Business Asset* suggested that “there are no precise ways to measure the end results of the widespread and intensive efforts to develop effective corporate ethics programs.”<sup>1</sup> Despite this difficulty in measuring their accomplishments, corporate ethics and legal compliance programs have become even more widespread over the last decade. Companies are investing millions of dollars on ethics and compliance management. A recent survey of *Fortune 1000* firms found that 98% of responding firms address ethics or conduct issues in formal documents. Of those firms, 78% have a separate code of ethics, and most distribute these policies widely within the organization. Many employees also receive ethics training and have access to a telephone line for reporting problems or seeking advice.<sup>2</sup> Much of this activity has been attributed to the 1991 U.S. Sentencing Commission’s Guidelines for organizational defendants. The Guidelines prescribe more lenient sentences and fines to companies that have taken measures to prevent employee misconduct.<sup>3</sup>

What do these ethics and legal compliance programs actually accomplish? A firm’s approach to ethics and legal compliance management has an enormous impact on employees’ attitudes and behaviors. In this study, we found that specific characteristics of the formal ethics or compliance program matter less than broader perceptions of the program’s orientation toward values and ethical aspirations. What helps the most are consistency between policies and actions as well as dimensions of the organization’s ethical culture such as ethical leadership, fair treatment of employees, and open discussion of ethics in the

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organization. On the other hand, what hurts the most is an ethical culture that emphasizes self-interest and unquestioning obedience to authority, and the perception that the ethics or compliance program exists only to protect top management from blame.

In order to investigate what works and what hurts in ethics and compliance management, we administered a survey to over 10,000 randomly selected employees at all levels in six large American companies from a variety of industries. The companies varied in their ethics/compliance program approaches. Because we were relying on employees' perceptions, we had to be concerned about socially desirable responses—having employees tell us what they thought we wanted to hear rather than the truth. We took a number of steps to guard against such biased responding. Surveys were completely anonymous, they were sent to employees' homes, and they were returned directly to the researchers for analysis.

In designing the survey, we first had to identify meaningful outcomes of ethics/compliance programs. Second, we wanted to understand how different approaches to ethics/compliance management would affect these outcomes. For example, a program can punish rule violators after the fact or it can focus on prevention. Programs can emphasize deterrence of illegal conduct or encouragement of ethical conduct.

Previous research presented us with conflicting ideas and little empirical evidence to support the effectiveness of particular approaches. Some studies have suggested that formal codes of conduct are associated with decreased unethical behavior,<sup>4</sup> while others have suggested that formal codes and ethics programs make little real difference.<sup>5</sup> Still others<sup>6</sup> have argued that an integrity or values-based approach should produce better outcomes than an approach that is oriented toward legal compliance, despite the fact that most companies emphasize a legal compliance approach.<sup>7</sup> Finally, some have proposed that ethics management must be integrated into daily organizational life in order to be effective.<sup>8</sup> Our goal was to conduct a comprehensive study that would provide managers, consultants, and policy makers with solid evidence regarding what works and what doesn't in ethics/compliance management.

## **What Can Effective Ethics/Compliance Programs Accomplish?**

We began by asking: "What should we look for to determine whether an ethics/compliance program is effective?" Sample items are listed in Table 1. We identified seven outcomes relevant to effective ethics/compliance management.

### *Unethical/Illegal Behavior*

The bottom line for ethics/compliance management is the extent of unethical/illegal behavior in the organization. Effective ethics/compliance

management should be associated with less unethical and illegal behavior. Employees know the most about the misconduct that exists, so we asked them to report on the extent to which they had observed (from never to very frequently) 32 specific unethical or illegal behaviors over the preceding year (e.g., lying to customers, padding an expense account, falsifying financial reports, giving kickbacks, stealing from the company, misusing insider information, violating environmental laws/regulations). Asking employees about "observed" misconduct in the firm is also less prone to produce socially desirable responses. Employees are more likely to report that they saw others engaged in misconduct than they are to report their own misdeeds. The scale we developed was adapted from past research on business ethics.<sup>9</sup>

**TABLE I.** Outcomes of Ethics/Compliance Programs

**Sample Survey Items (from Multi-Item Scales)**

- *Unethical/illegal behavior observed during the past year.*  
(32 items - sample items included in the text of the article; five-point scale from 1 = never to 5 = very frequently)

Employees responded to each of the following items using a five point scale from 1 (Strongly Disagree) to 5 (Strongly Agree).

- *Employee awareness of ethical/legal issues at work*  
"Employees in this company are quick to notice when a situation raises ethics or compliance issues."
- *Looking for ethics/compliance advice within the company*  
"When ethical issues arise, employees look for advice within the company."
- *Delivering bad news to management*  
"Employees here are comfortable delivering bad news to their managers."
- *Ethics/compliance violations are reported in the organization*  
"If someone here knew that a coworker was doing something unethical, he or she would report it to management."
- *Better decision making in the company because of the ethics/compliance program*  
"People in this firm make more effective ethical decisions because of the ethics and/or compliance activities that are in place."
- *Employee commitment to the organization*  
"I feel attached to the company because of its values."

*Employee Awareness of Ethical/Legal Issues that Arise at Work*

Norm Augustine, Chairman of the Board of Lockheed Martin, has stated, "We don't teach ethics, we teach ethics awareness." Many experienced managers of ethics and legal compliance consider raising employees' awareness of ethical and legal issues to be their primary challenge. No matter how strong their values, employees can not be expected to be naturally familiar with all of the laws and regulations that pertain to their work. Nor can they be expected to be automatically aware of the ethical ambiguities that they might face in a particular industry or position. However, if employees are aware of relevant ethical and legal issues, they will more likely ask the right questions and ultimately do the right thing when faced with a dilemma. Many people do the wrong thing simply because they are unaware—they don't know that they should be concerned or ask for help. Effective ethics/compliance management should increase employees' ethics awareness.

### *Looking for Ethics/Compliance Advice within the Company*

Once an employee is aware that she or he is facing an ethics or legal compliance issue, effective ethics/compliance management should make it more likely that the employee would ask for help and guidance within the firm. Many ethics offices spend much of their time responding to questions about company policy and the law (e.g., questions regarding gift giving or receiving, conflicts of interest, or human resources problems). Getting good advice early can nip problems in the bud and provide employees with accurate guidance on company policies and the law. It can also provide the ethics officer with input that can be used to plan future training needs or ethics code revisions. Essentially, employees' willingness to ask for advice within the company may be key to keeping the ethics/compliance program dynamic and responsive to employees' needs. In an effective ethics/compliance management program, employees are more willing to look for ethical/legal advice within the company.

### *Delivering Bad News to Management*

Many ethics/compliance managers believe that part of their job is to assure an environment of candor and safety in the organization. Unless employees believe they can deliver "bad news" to management without fear of repercussions, they may be unwilling to inform management of developing ethical risks or problems until it is too late.<sup>10</sup> For example, one of Badaracco and Webb's interviewees noted that "no one wants to report bad news up. What [management] should be hearing gets filtered."<sup>11</sup>

As a result of this reticence to report bad news to their supervisors, ethical and legal risks can escalate quickly if managers make decisions based upon half-truths or untruths that are passed up the management line. Effective ethics/compliance management should increase employees' willingness to report bad news to management.

### *Ethics/Compliance Violations Are Reported in the Organization*

Employees are the organization's first line of defense against ethical or legal problems because they are most likely to know about violations of the law or of ethical guidelines. One of the key components of most ethics/compliance programs is a reporting system (often a telephone "hotline") that employees can use to report ethical or legal violations that they observe. An ethics or compliance program can not be effective unless employees are willing to report violations to management. These violations can then be followed up and acted upon. Yet, employees may fail to report violations for many reasons. They may not care enough about the organization to go to the trouble or take the personal risk. They may fear retaliation especially if they don't trust that their identity will be protected. Or, they may believe that nothing will come of their efforts. Finally, if employees are uncomfortable reporting violations inside the company, they may be more likely to report violations outside, to the government or

media organizations. Accordingly, effective ethics/compliance management should influence employees to be willing to report violations to management.

*Better Decision Making in the Company  
Because of the Ethics/Compliance Program*

Many organizations have the formal components of an ethics/compliance program: a code, training, and a reporting hotline. However, are these program elements infused into everyday decision making, contributing to better decisions? Sometimes, employees view ethics/compliance programs as mere window dressing, implemented to respond to external pressure while leaving decision processes unchanged. Unless these programs have an impact on every day decision-making effectiveness, they are not a good use of resources. An effective ethics/compliance program will be perceived by employees as contributing to better decision making in the organization.

*Employee Commitment to the Organization*

Employee commitment is a general concept that is influenced by many management actions. Previous research has shown that a key dimension of organizational commitment has to do with value congruence—the extent to which employees feel a sense of belonging and connection to the organization. Commitment also has to do with how employees represent the organization to outsiders. Do they represent it as a good place to work and do they defend it when it's criticized? Further, previous research has suggested that employee commitment is higher in organizations with certain ethical culture characteristics.<sup>12</sup> Finally, management is clearly interested in employee commitment, especially in an economy in which companies are competing for the best employees.

## **What Influences Ethics/Compliance Program Effectiveness?**

There are several key organizational and program design factors that are associated with ethics/compliance management effectiveness. Table 2 provides the correlations for the relationships between these factors and the outcomes identified earlier.

*Program Orientation*

Ethics/compliance programs can be designed with very different goals and orientations. Previous research has referred to two types of approaches, a compliance-based approach and an integrity or values-based approach. According to Paine, a compliance approach focuses primarily on preventing, detecting, and punishing violations of the law, while a values-based approach aims to define organizational values and encourage employee commitment to ethical aspirations.<sup>13</sup> She asserts that the values-based approach should be more effective than a compliance-based approach because a values-based approach is rooted in personal self-governance and is more likely to motivate employees

**TABLE 2.** Relationships between Ethics/Compliance Management and Outcomes

<b>Ethics/ Compliance Management</b>	<b>Unethical Conduct</b>	<b>Ethics Awareness</b>	<b>Advice Seeking</b>	<b>OK to Deliver Bad News</b>
<b>Program Orientation</b>				
Values	-40	45	49	48
Compliance	-36	41	44	31
External Stakeholder	-18	32	32	26
Protect Top Management	34	-23	-31	-43
<b>Formal Program Characteristics</b>				
Code Familiarity	-08	23	21	11
Refer to Code	-06	20	19	09
Formal Report Mechanism	-32	43	47	39
Performance Appraisal	-30	44	39	39
<b>Program Follow-Through</b>				
Detection of Violators	-42	45	49	41
Follow-up on Reports	-48	47	59	54
Consistent Policies/Actions	-56	54	61	55
<b>Ethical Culture</b>				
Executive Leadership	-52	54	59	65
Supervisory Leadership	-55	56	59	67
Fair Treatment	-54	45	55	72
Ethics Talk	-43	54	58	60
Ethics in Decisions	-41	49	54	52
Ethical Behavior Rewarded	-54	47	51	61
Unethical Behavior Punished	-45	41	49	37
Obedience to Authority	44	-37	-45	-62
Employee Focus	-42	40	46	62
Community Focus	-36	39	45	44
Self-Interest Focus	45	-36	-40	-55

:Note: Pearson correlations computed with pairwise deletion; decimal points eliminated to save space; all correlations are statistically significant.

to behave in accordance with shared values. She argues that compliance approaches can be counterproductive because they emphasize avoiding punishment instead of self-governance. They define ethics in terms of legal compliance rather than ethical aspirations, and they implicitly endorse a "code of moral mediocrity."

**TABLE 2.** Relationships between Ethics/Compliance Management and Outcomes (continued)

<b>Ethics/ Compliance Management</b>	<b>Likely to Report Violations</b>	<b>Employee Commitment</b>	<b>Better Decision Making</b>
<b>Program Orientation</b>			
Values	48	59	56
Compliance	41	37	49
External Stakeholder	26	38	39
Protect Top Management	-36	-39	-27
<b>Formal Program Characteristics</b>			
Code Familiarity	22	16	27
Refer to Code	18	16	26
Formal Report Mechanism	44	43	54
Performance Appraisal	37	42	50
<b>Program Follow-Through</b>			
Detection of Violators	49	44	59
Follow-up on Reports	57	54	60
Consistent Policies/Actions	62	69	67
<b>Ethical Culture</b>			
Executive Leadership	60	70	65
Supervisory Leadership	61	66	63
Fair Treatment	59	76	56
Ethics Talk	58	61	62
Ethics in Decisions	50	52	58
Ethical Behavior Rewarded	59	63	55
Unethical Behavior Punished	49	42	52
Obedience to Authority	-52	-58	-44
Employee Focus	50	67	49
Community Focus	42	55	47
Self-Interest Focus	-45	-57	-43

A recent study of *Fortune 1000* firms was conducted in part to determine the orientations of their ethics/compliance management efforts.<sup>14</sup> The survey found that the compliance and values-based approaches are not mutually exclusive. Rather, most firms' approaches to ethics/compliance management combine these orientations in some way. Nevertheless, the compliance approach predominated over the values-based approach in over half of the firms. The U.S. Sentencing Guidelines (implemented in late 1991) contribute to the development of compliance approaches because fines and sanctions for companies convicted of

crimes vary dramatically depending upon management's cooperation and whether the firm has a legal compliance program in place.<sup>15</sup>

Given that a compliance-based approach predominates in most firms, our study needed to test the contention that a values-based approach is "better" (achieves more positive outcomes) than a compliance-based approach. Also, many companies hope to maintain or improve their public image and relationships with external stakeholders by adopting an ethics/compliance program. Therefore, we identified an orientation toward satisfying external stakeholders (customers, the community, suppliers) as a third approach in our study. Alternatively, employees sometimes suspect that an ethics/compliance program is introduced in part to protect top management from blame for ethical failures or legal problems. In fact, Paine associated this suspicion with a compliance-based program, suggesting that skeptical employees may see a compliance-oriented program as "nothing more than liability insurance for senior management."<sup>16</sup> Another of Badaracco and Webb's interviewees put it this way: "I'm cynical. To me, corporate codes of conduct exist to cover the potential problems companies may have. It provides deniability. It gives the employers an excuse. . . . The top officers can say, 'These employees messed up. They violated our way of doing business.'"<sup>17</sup> Therefore, we also assessed the impact of a "protect top management from blame" orientation.

#### *A Values Orientation Is the Most Effective Single Orientation*

Across the six firms in this study, employees perceived the presence of each of the four orientations (compliance-based, values-based, external stakeholder, and protect top management) to varying degrees, and all of them were important in influencing outcomes. However, it is clearly most important to have a program that employees perceive to be values-based. In these six companies, if employees perceived a values-based program, each of the seven outcomes studied was significantly more positive and the relationships were quite strong. Unethical/illegal behavior was lower, awareness of ethical/legal issues was higher, and employees were more likely to look for advice within the firm, to be willing to deliver bad news to management, and to report ethical violations. They also were more committed to the organization and more likely to believe that decision making was better because of the ethics/compliance program.

#### *Compliance and External Orientations Are Also Helpful*

Outcomes were also more positive if employees perceived a compliance or an external stakeholder orientation. Contrary to Paine's argument, if employees perceived a compliance-based program, all of the outcomes were significantly more positive. However, the relationships were not as strong as with the values orientation. If employees perceived an external stakeholder orientation, once again the same outcomes were significantly more positive. However, the relationships were even weaker than those for compliance orientation.



### *Combining These Orientations May Be Effective*

The data also supported the idea that these orientations are not mutually exclusive. For example, values orientation is highly correlated with compliance orientation (correlation = .60) and with external stakeholder orientation (correlation = .53). So, it is clearly possible to design a program that combines these different orientations, while also emphasizing a values-based approach. A values orientation can be backed up with accountability systems and discipline for violators. Values can include a concern for customers, suppliers, and the community as well as shareholders and internal stakeholders such as employees. The ideal mix of orientations likely depends on specific organizational circumstances, such as the organization's culture, product, and industry.

### *"Protect Top Management" Is Clearly a Harmful Approach*

Not surprisingly, where employees perceived that the ethics/compliance program was oriented toward protecting top management from blame, all of the important outcomes were significantly more negative. These relationships were particularly strong and negative for commitment to the organization, for the perception that it's okay to deliver bad news to management, and that employees would report ethical/legal violations to management. In addition, unethical/illegal behavior was higher, employees were less aware of ethical issues, and they were less likely to seek advice about ethical concerns. Furthermore, they did not believe that decision making was better because of the ethics/compliance program.

### *Summary of Program Orientation Findings*

A key finding of this study is the importance of designing an ethics program that is perceived by employees to be first and foremost about shared organizational values and about guiding employees to act on their ethical aspirations. Such programs motivate employees to be aware of ethical or legal issues, report bad news to management, report ethical or legal violations, and refrain from engaging in unethical or illegal conduct. In addition, unethical/illegal behavior is reduced, employee commitment is higher, and employees believe that decision making in the organization is better because of the ethics program.

This values-based approach can be supplemented with an orientation toward legal compliance and satisfying external stakeholders. Valuing external stakeholders such as customers and the community has a positive impact on all outcomes, as does holding employees accountable for their behavior through monitoring and disciplinary systems. Discipline for rule violators serves an important symbolic role in organizations—it reinforces standards, upholds the value of conformity to shared norms, and maintains the perception that the organization is a just place where wrongdoers are held accountable for their actions.<sup>18</sup>

Finally, a program must avoid conveying the message to employees that it exists to protect top management from blame. Having a program that is perceived in this way by employees may be worse than having no program at all. Recall Paine's proposal that employees were likely to associate a compliance approach with this "protect top management from blame" orientation. Our data did not support this contention. There was little association between employees' perceptions of the program as compliance-oriented and their perceptions of the program as being oriented toward protecting top management from blame. However, this protect top management orientation was even less likely to be associated with a program that employees perceived to be values-based. Perhaps the most important message to executives is that this protect top management perception is real. Employees judge top management's *motives* in implementing an ethics/compliance program. Also, it is important that they perceive it to be a sincere attempt to have all employees do what's right rather than just an attempt to create legal "cover" for executives in case of a legal mishap.

### ***Formal and Informal Ethics/Compliance Program Characteristics***

With regard to specific ethics/compliance program and organizational characteristics, we asked employees about formal characteristics including the official policies, procedures, offices, and supporting structures (e.g., telephone hotline). We also asked for employees' perceptions of the more informal ways ethics and compliance concerns are handled every day (e.g., how well the company "follows through" on its policies).

#### ***Formal Program Characteristics Are Relatively Unimportant***

All six companies in the study had the "basics" of a comprehensive ethics/compliance program: an ethics/compliance office and officer, a formal code of conduct, and a telephone hotline. Despite the existence of these formal program characteristics, employees may be more or less aware of them and more or less likely to use them.<sup>19</sup> Therefore, we asked employees how familiar they were with the code's contents and how frequently they referred to the code for guidance. Interestingly, these factors had little impact on the outcomes, especially unethical conduct. It simply did not matter much whether employees were familiar with or referred frequently to the company's code of conduct.

We also asked employees whether their company has a formal mechanism for raising ethical and legal compliance issues and concerns and whether ethics is a formal part of performance evaluation in the company. Both of these program characteristics are dynamic, requiring some kind of ongoing attention from the organization; whereas a code can be drafted, distributed, and forgotten. To the extent that employees perceived the company to have a formal mechanism for raising concerns and to make ethics a formal part of performance appraisal, all of the outcomes were significantly more positive.

### *Program Follow-Through Is Essential*

With regard to program follow-through, we asked employees whether the company works hard to detect violators, whether the company follows up on ethical concerns raised by employees, and whether there is consistency between ethics/compliance policies and actual organizational practices. Follow-through tells employees that a focus on ethics and legal compliance represents a sincere commitment on the part of management.<sup>20</sup>

The more that employees in our study perceived the organization to be following through, the more positive were all of the outcomes. Further, employees' perceptions of follow-through were much more important than their perceptions of the formal characteristics. Employees' perception that the company's actions are consistent with its policies were particularly important. Employees need to perceive that policies are not just "window dressing" and that the company follows words with actions. Therefore, an approach that goes beyond the mere establishment of formal programs is necessary if employees are to be convinced that the organization really means what it says.

### *Ethical Culture in the Organization*

Managing ethics in organizations is not just about managing formal ethics/compliance programs. Researchers have suggested that the broader ethical context in an organization—referred to as the ethical climate or culture—is particularly important,<sup>21</sup> perhaps more important than specific ethics/compliance program goals or characteristics. The elements of ethical culture that guide employee thought and action include leadership, reward systems, perceived fairness, ethics as a topic of conversation in the organization, employee authority structures, and an organizational focus that communicates care for employees and the community.

### *Executive and Supervisory Leadership*

A decade ago, the Business Roundtable report *Corporate Ethics: A Prime Business Asset* referred to the crucial role of top management. "To achieve results, the Chief Executive Officer and those around the CEO need to be openly and strongly committed to ethical conduct, and give constant leadership in tending and renewing the values of the organization."<sup>22</sup> Posner and Schmidt also documented managers' belief that "the behavior of those in charge is the principle determinant of the 'ethical tone'" in their companies.<sup>23</sup>

We were interested in the role of executive leadership because executives play a crucial role in creating, maintaining, and changing ethical culture.<sup>24</sup> We also wanted to investigate the role of supervisory leadership. Leaders at every level serve as role models, and employees have more daily contact with their supervisors than they do with executive leaders. Supervisors are responsible for rewards and punishments and they carry the message of how things are really

done in the organization. Therefore, in separate sets of questions we asked employees for their perceptions of executive and supervisory ethical leadership.

Perceptions of these two groups were highly related (correlation =.78), suggesting that employees don't think differently about supervisors and executive leaders with regard to their attention to ethics and legal compliance. Essentially, if executive leaders value and pay attention to ethics, so do supervisory leaders.

Leadership was a key ethical culture factor—one of the most important factors in the study. Where employees perceived that supervisors and executives regularly pay attention to ethics, take ethics seriously, and care about ethics and values as much as the bottom line, all of the outcomes were significantly more positive. Employees paint all leaders with the same broad ethical brush. When it comes to ethics, leaders are leaders, and the level (supervisory or executive) doesn't seem to matter much to employees.

### *Fair Treatment of Employees*

We also explored a less obvious aspect of ethical culture— employees' perceptions of general fair treatment in the organization. Why should general fair treatment of employees be related to ethics-related outcomes? First, the word ethics can mean different things to different people or groups. Kent Drury-vesteyn, former ethics officer at General Dynamics, said that when managers say "ethics," employees hear "fairness."<sup>25</sup> To most employees, ethics means how the organization treats them and their coworkers. This helps to explain why so many calls to ethics hotlines concern human resources issues of fair treatment in hiring, layoffs, performance appraisals, and promotions. Also, recent research has highlighted the importance of fair treatment for ethics-related outcomes such as employee theft.<sup>26</sup> When employees feel that they are treated unfairly, they may try to "balance the scales of justice" by engaging in unethical behaviors such as stealing from the organization. Some companies have acknowledged this connection between fair treatment and ethics management. For example, we know of a company that sees the elimination of executive dining rooms and other perks as important to making their ethics programs work. Employees see that rules apply to everyone because every employee, up to the CEO, has to have expense reports signed. "That sends a good message [to employees]. . . . Nobody is above the rules and code of conduct. . . . A high level person could get dismissed if they violated [a rule] as much as another person." Another company pegged executive pay to employee pay because of similar concerns about the implications of fair and consistent employee treatment for ethics management.

It is important to note that the survey questions concerning fair treatment had nothing to do with the ethics/compliance program. Rather, they were general questions that asked whether employees think of the company as fair in terms of rewards and punishments (do employees get the rewards and punishments they deserve), whether employees are treated fairly in general, and

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whether supervisors treat employees with courtesy, dignity, and respect. Employees' perception of fair treatment was strongly related to all outcomes and was one of the most important factors in the study. It had the strongest correlation with employee commitment and with the perception that it's acceptable to deliver bad news to management.

Companies demonstrate their good ethics to employees primarily through fair treatment. If a company passes the "fair treatment test," employees are more likely to be open to ethics and legal compliance initiatives and to cooperate in making them successful.

### *Ethics in Discussions and Decisions*

We also asked employees whether people in the company talk openly about ethics and values and whether ethics and values are integrated into decisions. One of the ways ethics and values get "baked into" the corporate culture is to make these sorts of discussions the norm.<sup>27</sup> Our previous experience with one company provides an example of how this should not be done. An oil company employee asked if he could bring an ethical problem to a meeting of divisional presidents. Their immediate response was, "If he wants to talk ethics, let him talk to a priest or a psychiatrist. The office is no place for it." Imagine what employees would think of a formal ethics/compliance program in such an environment.

In our study, perceptions that ethics is talked about and integrated into decision making were important for all outcomes. Open discussion of ethics and values in the company was particularly important for employee commitment, the perception that it's acceptable to deliver bad news, the belief that employees would report an ethics violation, and that decision making is better because of the ethics/compliance program.

### *Reward Systems that Support Ethical Conduct*

Good managers know that people do what's rewarded and avoid doing what's punished. Therefore, an ethical culture should include a reward system that supports ethical conduct.<sup>28</sup> We asked employees whether ethical behavior is rewarded and unethical behavior is punished in their organizations. Perceptions of both of these dimensions were important for all outcomes. However, employee perceptions that ethical behavior is rewarded were more important than were perceptions that unethical behavior is punished. The belief that ethical behavior is rewarded was particularly important for employees' commitment and their perceptions that it's okay to deliver bad news to management and that employees would be likely to report ethical violations.

### *Unquestioning Obedience to Authority*

An ethical organizational culture must emphasize each individual's accountability and responsibility for his or her own actions and an obligation

to question authority when something seems wrong. An unethical culture is more likely to require unquestioning obedience to authority—"just do as I say and don't ask any questions."<sup>29</sup> In this study, we found that where employees perceived a structure that expects unquestioning obedience to authority, all outcomes were significantly more negative. Most affected were employee commitment to the organization, willingness to report an ethical or legal violation, and willingness to deliver bad news to management.

### *Organizational Focus*

Research on ethical climate has found that employees' perceptions of the organization's focus are associated with both unethical behavior and employee commitment.<sup>30</sup> In this study, we considered three types of focus: employee focus (where employees perceive an organizational focus on what's best for them and their coworkers); community focus (where employees perceive an organizational focus on what's best for customers and the public); and self-interest focus (where employees perceive that everyone in the organization is simply out for himself or herself).

Where employees perceived the organization to be focused on what's best for employees (employee focus) or for customers and the public (community focus), all of the outcomes were significantly more positive. However, where employees perceived that people in the organization were mostly out for themselves (self-interest focus), all outcomes were significantly more negative.

### *Summary of Ethical Culture Findings*

As a set, the ethical culture factors emerged as the most important influential factors. Of these factors, leadership, fairness perceptions, the perception that ethics is discussed in the organization, and the perception that ethical behavior is rewarded were the most significant factors in the study.

As to "what hurts" in ethics/compliance management, two culture factors were quite harmful. Outcomes were more negative where employees perceived an expectation of unquestioning obedience to authority, and where they perceived a focus on self-interest rather than concern for employees and/or the community.

## **What Works and What Hurts in Ethics/Compliance Management: Prescriptions for Action**

What should firms be doing if they want to achieve the most positive outcomes from their ethics/compliance management efforts? What should they avoid doing?

### ***Tap the Trenches—Employee Perceptions Matter***

Badaracco and Webb recently presented “a view from the trenches” in a report that summarized the results of in-depth interviews with recent graduates of the Harvard MBA program.<sup>31</sup> These young managers reported pressures to be unethical, insufficient help from formal ethics programs, and executives who were “out-of-touch” on ethical issues. The authors recommended in-depth interviews with lower-level employees to learn more about employee perceptions. While few companies have the resources to conduct in-depth interviews with a large number of employees, they can conduct surveys and focus groups to learn what their employees are thinking. Employees can tell a company a great deal about what’s going on in its trenches. Our survey suggests that they are willing to report both the positive and the negative, such as the extent to which they perceive strong ethical leadership, employee fair treatment, and consistency between words and actions, or the extent to which they perceive a focus on self-interest and unquestioning obedience to authority. Obviously, asking these questions may make ethical issues more salient to employees. Therefore, asking the questions assumes that you want to know the answers and that you are willing to take corrective action.

### ***Build A Solid Ethical Culture***

The ethics officer in a *Fortune 500* company once stated, “I have a hard time when people [ask] me, ‘Tell me about your company’s ethics plan.’ I want to tell them about everything we do. Because in my mind, everything we do is part of it.” This quote demonstrates that ethics/compliance management is first and foremost a cultural phenomenon.<sup>32</sup> As noted, ethical culture factors were among the most powerful factors in this study. It is not enough to have formal policies and programs. To achieve desired outcomes, concerns for ethics and legal compliance must be baked into the culture of the organization. Therefore, attention to the ethical culture should come first in any corporate ethics/compliance effort. Executive leaders and supervisors must regularly show they care about ethics and shared values (including demonstrating that values are as important as the bottom line), and they must show that they care through words *and* consistent actions. Consider employees’ reactions when the CEO of a major bank who preached responsible use of corporate resources sent a corporate plane to California to pick up a pair of shoes for his wife. This CEO didn’t understand that his actions spoke louder than his words.

### ***Create a Values-Based Program that Incorporates Accountability and Care for Stakeholders***

When it comes to creating a formal ethics/compliance program, managers need not choose between values-based and compliance-based approaches. Rather, these approaches are complementary. They are further complemented by an approach that is concerned about external stakeholders. However, to be most effective, formal efforts to manage ethics and legal compliance should be

oriented primarily toward values. A values approach can include valuing customers and the community, as well as employee accountability for ethical conduct.

### ***Focus on Formal Program Follow-Through***

Some companies approach ethics/compliance management with the idea that all they need to do is check off the U.S. Sentencing Commission's seven requirements for due diligence by appointing an ethics officer, writing and distributing a formal code of conduct, communicating standards via codes and training programs, and setting up hotlines and investigative procedures. The results of this study suggest that simply putting formal staff, structures, and procedures into place does little to influence important outcomes. More important were employees' perceptions that the company follows through on its formal codes, policies, and procedures by working hard to detect violators and by following up on ethical concerns raised by employees. Most important was the perception that actual practice is consistent with formal policies. Again, actions speak louder than words.<sup>33</sup>

### ***Answers to Practical Questions about Effective Ethics/Compliance Management***

#### ***Who Should Manage Ethics/Compliance Programs?***

Legal departments and legal personnel are among those most frequently given responsibility for ethics/compliance programs.<sup>34</sup> This may be because many companies have adopted ethics/compliance programs in response to the U.S. Sentencing Commission Guidelines. However, our findings suggest that legal personnel and departments may not be well suited to developing an ethical culture approach that is oriented primarily toward shared values and ethical aspirations. Lawyers are trained to protect the organization from legal problems. Therefore, their education and background best prepare them to develop a legal compliance approach, not a values approach. This background also contributes to a narrow legalistic interpretation of organizational problems when broader ethical culture deficits may be causing those problems. Finally, lawyers may be less likely to recommend an approach that is oriented toward caring for employees, customers, and the community.

A cultural approach suggests that responsibility for ethics/compliance management should be held broadly within the organization. If one individual is ultimately responsible (as the U.S. Sentencing Guidelines advise), that individual should be a high-level corporate officer with credibility, line management experience, a strong belief in the power of organizational values, solid support from the organization's executive leadership, and the ability to work with many other officers and departments (such as legal counsel, human resources, audit) toward the development of a strong ethical culture. In addition, human resources



should have an expanded role in ethics/compliance management because of the importance of issues such as employee fair treatment.

### *How about Off-the-Shelf Ethics/Compliance Programs?*

A narrowly defined compliance program is relatively inexpensive and easy to implement, as it requires little in-depth self-assessment and can be acquired as an "off-the-shelf" package from some consulting firms. Moreover, a formal compliance program, and the attendant policy documents and monitoring systems, can be more easily documented than a broader ethical culture. Many companies ask consultants to develop a compliance program for them: write a code, develop a training program, set up a hotline, and so on. However, the importance of ethical culture factors should make it clear that there are no ethics/compliance management "quick fixes." In fact, attempting such a "quick fix" (distributing an off-the-shelf code written by someone outside the company, along with a canned one-hour training program) may do more harm than good if it suggests to employees that top managers are just trying to protect themselves if the company ends up in court.

Effective ethics/compliance management requires a much deeper commitment. For example, before attempting to develop a code of conduct, a company must first clearly articulate its unique set of values. Employees and managers at all levels should be brought into this values development process and they should then be involved in the process of developing a code that is based upon those values. A code of conduct will have little meaning unless it is tightly linked to these values and other elements of the ethical culture. Similar to other new management initiatives such as total quality management and reengineering, ethics/compliance management can not succeed without management's commitment to a system-wide effort. The effort to develop an effective ethics and compliance program is, in short, a long-term process not amenable to "quick fixes."

### *Who Should Conduct Training?*

A common approach to ethics training begins with the top management team and cascades down through the organization. Each level of management is trained and then given responsibility for training their own direct reports. They wrestle together with common ethical dilemmas that arise in their work, discuss how the company's values and policies can provide guidance, and discuss what to do when new problems arise. If these managers believe in the training, this process can go a long way toward convincing employees that leadership at all levels really cares about ethics. The least effective approach is one that relies on external consultants who deliver an hour of ethics training that has little to do with employees' ongoing work.

### *Who Should Answer Telephone Reporting Lines?*

Many companies are outsourcing their telephone hotlines to outside consultancies or security companies in distant cities. The findings of this study suggest that it is better for the company to keep responsibility for reporting and investigation in house. A program that is primarily values-based should generate many calls for advice and questions about clarification of ambiguous ethical issues. A credible, trusted company insider is certainly more appropriate to handle those calls. A smaller number of calls will report ethical or legal violations. It is important that these callers believe the company is interested in receiving these calls, takes them seriously, and will commit resources to investigate and follow-through. Again, a company insider is more likely to leave that sort of symbolic message with callers. This does not mean that outside consultancies should never be used for this purpose. For example, one multi-national company known for its values-based ethics program has contracted with an outside firm to answer its ethics telephone line after business hours so that callers from different time zones will always find a human being at the other end of the line. They had found that many callers would hang up rather than leave a voice mail message. However, this ethics office has also made it absolutely clear that this is an after-hours service that isn't meant to replace company insiders who normally answer the line.

### *What Do the Study Results Imply for Public Policy?*

In 1991, the U.S. Sentencing Commission articulated seven requirements for corporations wishing to demonstrate due diligence and an effective legal compliance program. These requirements have had a profound impact on compliance management because many corporations have focused intently on them. However, this study has found that a narrow focus on the formal structures and processes addressed in the requirements (e.g., establishment of codes, training, hotlines) does not lead to an effective legal compliance program.

If the Sentencing Commission wishes to reduce illegal/ unethical behavior in the workplace, it must focus its attention beyond these superficial program characteristics. We found that the most important influential factors have to do with program follow-through and the broader ethical culture of the firm. The Commission could influence the effectiveness of corporate legal compliance efforts by incorporating these key factors in future guidelines and requirements. For example, the importance of policy/action consistency suggests that employees often see policies as just "window dressing." Therefore, the Commission should be looking for evidence of follow-through. Do employees perceive that the company will follow up on reports of violations? Do employees perceive that the firm's actions are consistent with its policies? Employees' perceptions of how rewards are distributed are even more important than their perceptions of the distribution of punishments (that violators are detected and punished). Currently, the guidelines focus more on detection and discipline. Leadership has also been ignored by the guidelines. Although they require specific high-level

individuals to be assigned responsibility to oversee compliance standards, they do not require that these high-level individuals actually interact with the top management team or that other leaders be involved in ethics/compliance management. In fact, previous research has suggested that most ethics/compliance officers have little contact with their CEOs.<sup>35</sup> The Commission could require that line managers at all levels be involved in ethics/compliance management. Employee fair treatment is another neglected issue. Its powerful impact on outcomes means that the Commission should consider it in their evaluation of program effectiveness.

We recognize that it is easier to look for evidence that a policy exists than it is to evaluate the deeper commitments that are key to compliance program effectiveness. However, if the Commission wishes to influence the development of "effective" programs, it must delve deeper into corporate ethical culture than it has in the past. This study demonstrates that it is possible to survey randomly selected employees and learn a great deal about the factors that are most important for program effectiveness.

## Conclusion

Contrary to the Business Roundtable's decade old statement, our study found that there *are* ways to measure the end results of corporate ethics and compliance programs. There are a number of important outcomes that can be measured reliably via employee surveys and that can be linked to key program and organizational influences.

A values-based cultural approach to ethics/compliance management works best. This approach requires the sincere commitment of leadership at all levels, including ongoing attention to key issues such as fair treatment of employees, rewards for ethical conduct, concern for external stakeholders, and consistency between words and actions. The ethics/compliance program itself should be values-based, motivating employees to aspire to ethical conduct, encouraging them to question authority when ethics are at stake, and holding them accountable for rule violations. The results of such an approach are impressive. They produce highly committed employees who are aware of ethics and compliance issues, who seek advice within the organization, and who are willing to deliver bad news to their managers or report ethical/legal violations. Results also include less unethical/illegal behavior in the organization and better decision making because of the organization's ethics/compliance efforts.

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