Ethics and Compliance Based Leadership Models: Essential to Compliance, and Performance

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Explore the need and benefit for companies to build upon a culture of compliance by adding an emphasis on an ethics and value based system.
Introduction/Abstract

This white paper is intended to introduce an argument for greater emphasis on companies creating and establishing a culture built from ethics, values and compliance as an organizational control. Material examples and indicators, that the benefit of a value/ethics based compliance program far exceeds a rules-based compliance program and can also lead to improved employee and organizational performance, will be shared in this paper.

This paper will also introduce an argument that companies have an opportunity to aspire for more than a culture of compliance. They should instead emphasize and incentivize leaders and decision makers to guide and support their company through an ethics-based decision model.
Leadership Paradigms and Culture

The ability of leaders to recognize and deal with complex business issues that affect an organization have become increasingly difficult. It is nearly impossible to design a protocol or procedures for dealing with dynamic situations that companies face today. Failure to comply with regulations presents one risk, but there is also the risk of making the wrong decision in an unregulated or charted area.

Over the past decade, the escalating nature of well-publicized organizational failures, have led to a demand for improved business practices, compliance, and more importantly ethics and responsibility. Companies are faced with a need to implement controls and develop business models that safeguard the company and the stakeholders. Awareness of the regulatory demands and procedures still leaves companies in a position of risk. Effective and engaged leadership is the foremost component in guiding a company through today’s complex business world.

Leaders must be able to take a vision and chart a path for the organization while communicating a clear mission. They must act with purpose in providing direction, unifying individuals and stakeholders toward a shared goal, and ensuring that the company is collectively nimble but resilient. There is a level of engagement from leaders that is needed, before it can be addressed how a company’s culture and decision model can guide it through both adhering to regulated and unregulated areas of business.

Each organization has its own culture. Although standard work environments and work arrangements continue to evolve, a company’s culture helps to unify employees and provide direction. Organizational culture often refers to the ideologies, values and principles of a company. The culture is a determining factor in how employees will interact with each other, how they will behave and how they will approach situations.

Compliance-Based

To successfully elevate compliance management to a reliable strategic advantage, compliance must be embedded in a firm’s culture part of the core business model.

Ideally, a culture of compliance is a holistic approach by everyone within an organization to recognize the regulatory obligations of a company and work together to ensure they are met. At its worst, a company that does not support or possess a culture of compliance can be overwrought with competing priorities or a desire to impede compliance efforts, and even render some controls meaningless. Although truly developing a culture of compliance remains a challenge for many institutions, the notion and premise appears to be well embraced, or at minimum, strongly encouraged through internal and external motivators.

Companies can no longer stop at building a culture of compliance. Compliance is the act of following the rules. The unfortunate aspect is that rules are often made to address deficiencies or gaps to legislate personal accountability and empowerment. While these rules are often external requirements, and they are many and varied, compliance also involves following the organization’s internal rules, policies and procedures, and acting in accordance with ethical practices.
In contrast, compliance management is the means by which organizations can assure compliance in accordance with the rules, regulations, laws, and other requirements to which the organization is subject to. Compliance management involves oversight, assessment, reporting, educating, and noting needs for remediation, while the element of “assurance” comes from reliable evidence of compliance.

**Ethics-Based**

A culture of compliance is highly effective with attempting to address the rules and regulations that govern a specific industry. However, regulations or required actions that a company must take are a minimum standard and often succeed a major corporate failure. A notable example is the Sarbanes-Oxley Act. The act was the direct result of the Enron scandal. Enron, an American energy company, filed for bankruptcy after a series of both legal and illegal accounting practices that misled the company’s stakeholders and employees.

The accounting practices, propagated by senior leaders of Enron, used accounting loopholes that purposefully confused shareholder statements and legal special purpose entities, to hide debt. Although the actions were clearly negligent and some were criminal, many of the actions that took place were possible due to the lack of controls. I believe that an ethics and compliance-based program can be an organizational control in most instances.

Generally defined as “the branch of philosophy that involves systematizing, defending, and recommending concepts of right and wrong conduct,” ethics has many nuances.\(^1\) Another definition of ethics is the “rules or standards governing the conduct of the members of a profession.”\(^2\) An ethics-based model and its applications are about judgments and decisions that are connected with values. In business, these values may come from a clear mission statement, may be evident in the culture of the company, how the company is viewed in the communities they serve, or through customer sentiment. Companies can either select to do what they are obligated to do by complying or what they are motivated to do through their values.

There are distinctions between the following two programs: compliance-based programs and values or ethics-based programs. Both of these result in the dominant culture and basis for decisions that exist within an organization. The compliance ideology uses “legal terms, training, rules of conduct, and penalties for noncompliance. The values-based system relies upon self-policing and intrinsic motivation, rather than coercion” or consequences.\(^3\) On one hand, the company’s values and corporate responsibility may resonate with their employees and stakeholders there is a lack of rigor and protocol. On the other hand, a compliance program is pragmatic in addressing regulatory requirements and driving compliance via a “carrot or a stick,” if necessary. But the compliance directives alone are not effective in a rapidly changing a dynamic business world where avoiding regulations can sometimes spark untapped creativity.

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Compliance and Ethics: A Dynamic Duo

An organization that strives to have a compliance-based culture does not necessarily lack ethics. However, a framework for making decisions and operating in unregulated areas are also paramount. I propose that organizations should seek to develop a model and culture that is derived from a value or ethical system and one with a focus on compliance.

Creating an organization that encourages exemplary conduct and ethics may be the best way to prevent damaging misconduct. Lynn Paine wrote in a *Harvard Business Review* article detailing how culture and organizational leadership led to corporate failures amongst notable companies.\(^4\) Paine summarized the impact that an unchecked incentive plan had on Sears, Roebuck & Company. According to Paine, when faced with declining revenues and shrinking market share, Sears’ management attempted to boost the performance of the segment through new goals and incentive plans. The company increased the minimum work quotas and introduced productivity incentives for technicians. Service advisers were provided specific per-product sales quotas. For example, the goals were set to sell a specific amount of shocks or tires—these are referred to as wear and tear items that could be subjective as to whether or not a replacement should be recommended. The pressure of the organization was transferred to the employees without checks or balances that could ensure that proper protocol and judgment remained intact.

Under the new incentive plan, the employees’ judgment suffered. In a very subjective gray area coupled with reliant and often ignorant customers, the employees were guided by an incentive instead of an ethical standard or culture of doing the right thing.

It did not take long before allegations became public. Although the company did not acknowledge a purposeful effort to deceive customers in order to drive up revenue, the results were undeniable. Leaders of the company recognized management’s responsibility for putting in place a compensation plan that created a toxic and brand damaging environment. The senior executives eliminated commissions for service advisors and discontinued most of the sales quotas, but the damage was already done.

To further correct the impact of the shortsighted plan, the company instituted a system of unannounced shopping audits, an internal monitoring system and an employee counsel to help advice on how goals would be translated and applied to certain levels of the company. The impact, including cases brought by numerous attorney generals and rebates to customers, cost Sears an estimated $120 million, over one year.

Creating an ethics-based program or culture alone also has its challenges. Without a hybrid program—one that offers a balance of rewards and penalties for approaching situations and tasks with program and culture built from integrity, values and ethics can meet the regulatory

requirement an ethical stance and compliance—both can leave a company susceptible to risk. A combination of both ethics and compliance can strike the right balance and fortitude. Together, an organization, and those within, can be enabled and encouraged to make thoughtful decisions in the best interest of all stakeholders.

Building a culture of both compliance and ethics requires a sustained and deliberate effort from organizational leaders. According to Thomas Fox, an attorney assisting companies in FCPA compliance, “To build an ethical organization, the compliance practitioner needs to instill ethics and compliance into the organization.” This can be accomplished through establishing formal and informal constraints, or incentives. Another way to build and reinforce a culture of compliance and ethics is by ensuring that protocol and decision processes are in place.

**Decision Model**

Regardless of how an ethics policy is conceived, programs can act as an organizational control or predictor. An ethics and compliance based culture can create predictability in behavior of employees, as well. Either overt or as a subconscious process by decision-makers, a decision model can help ensure considerations when making decisions. This can provide greater assurance that both regulatory compliance and ethics are considered as decisions are made (see visual reference below).

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What do we do?

This model steps through the process of taking into account, regulations, shareholders, and stakeholders. Making ethical decisions will depend on the companies value system. The decision should consider the effect on customers, employees, business partners, the environment, and social impact.

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Is the proposed action legal or is there a legal obligation?

Yes

Is it ethical? (Consider all stakeholders.)

Yes

Does it maximize shareholder value either through growing value increased or preventing a negative impact?

Yes

Is it ethical not to take the action?

No

Consult stakeholders and inform of the impact and proceed.

No

Take action to meet the legal obligation, if needed.

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No

Don’t do it. Seek alternative.

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Don’t do it. Seek alternative.

Do it.

Yes

What do we do?

Making ethics-based decisions are not binary, but a model can ensure that a thoughtful and considerate approach is taken. There is no universal understanding of what is ethical, but through design of mission and value statements and alignment within the organization, the answer can become a much more common line of thinking. This model can also help to avoid making decisions only upon the bases of it adding value to shareholders or having a legal obligation.

Business Performance

Although not definitive, the indicators suggest that a strong ethical basis and compliance model can be extremely positive for a company’s overall performance and bottom line. Research conducted by Simon Webley and Elisa More (2001), revealed that companies with a commitment to doing business ethically produced profit ratios at 18 percent higher than their competitors without a similar dedicated effort.6

Research suggests that building an ethical and regulatory compliant image in business creates a positive reputation amongst employees, customers, investors, and the public at large (Webley & More, 2001).

Even without a direct link to increased revenue the relationships between key business constituents are clear. A company committed to both compliance and ethics can create a culture and program

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that invoke trust from customers, shareholders, employees and partners. These are all drivers that can lead to increased business performance and profitability.

Employee loyalty and performance can be a result of values and ethics based business models, and leadership engagement. In August of 2014, FinCEN recommended a similar emphasis on organizational leaders having a clear understanding and further communicating the importance of the BSA/AML efforts within their company. Observations of “BSA/AML shortcomings” prompted FinCEN to issue an advisory in which they highlighted the importance of organizational leadership and culture. Ensuring that the value and impact of the BSA/AML work-effort resonates throughout the company, it is important to not only ensure compliance but also to understand the impact of the work and ethical responsibility. For example, companies are not just generating reports for the purpose of compliance; they are providing information to law enforcement that may prevent serious criminal acts such as human trafficking or terrorism. In my experience, this understanding moves a person from a one dimensional execution of requirements mentality to a more connected and engaged position, which will improve their desire to perform.

My experience at American Express leading global operations and compliance teams has reinforced by belief that ethics and value based leadership is paramount to business performance and business compliance. As a company, we value ourselves with understanding who our customers and stakeholders are. The understanding of who our customers are places our needs secondary and the purpose of our actions square at the forefront. Depending on a person’s role or responsibilities, customer’s change, but a need to service others and look out for others remains. We also encourage raising issues and learning from mistakes. By doing this you encourage honesty, transparency, and a positive environment to raise issues and critic for the purpose of improvement.
Conclusive Summary

The role of an organization’s leaders is to ensure the vision and direction of the company is met with organizational planning and guidance that provides a compass for all employees. The culture that is developed can ensure that employees do not just do the right thing based on protocol, but in the absence of clear procedures or directives, employees can make the right decisions. Leaders need to implement goals and objectives that are meaningful and linked to the appropriate behaviors not simply to the end result. The failure of Sears was not that the pressure of the company was transferred to more than just the leadership team. The breakdown was that incentives were given without the guidance of how someone was expected to reach the marks.

A company’s aspirations should be in building an ethical organization. I believe a combination of both an ethical guide and standard along with an engaged compliant culture is the optimal environment. Compliance organizations and their leaders understand that they often operate in a gray space and these require creative and values based decisions.

These unregulated areas are at times undefined, or have yet to be exploited with enough frequency to have been legislated. Either way, a culture of compliance may be less effective in the absence of rules and guidance. The legality of actions does not certify the absence of the penalties of those actions. Therefore, in order to safeguard a business in today’s environment, additional emphasis should be incorporated and encouraged amongst businesses and compliance organizations.

All in all, laws are minimum standards at which everyone is expected to adhere to. Laws are not put in place to inspire human excellence and ingenuity. It is not a guide for exemplary behavior. As Richard Breeden, former chairman of the Securities and Exchange Commission, once noted in an address, “It is not an adequate ethical standard to aspire to get through the day without being indicted.” If the expectation is only to comply, without further reason, understanding, or values, the objective can easily become only meeting the minimum standard.
References


Fox, Thomas (2013). How to Build a Culture of Ethics and Compliance.  
www.corporatecomplianceinsights.com