Ethical Failures Are a Growing Concern

Rising costs
Volkswagen’s diesel scandal costs hit $50 billion.

It’s becoming personal
Samsung’s bribery charges.

Domino effects
The domino effect of the Uber CEO’s resignation.

Regulators expect more
"Ethical failures are a growing concern," says the SAI Global report.

"The enforcement actions we are seeing today make clear that the SEC will take swift action, not only when the violations we suspect engage in wrongdoing, but when management fails to exercise the oversight necessary to ensure that employees follow laws and regulations intended to protect customers and maintain the integrity of markets."

—Thomas E. Curry, Comptroller of the Currency, September 2013
Framing Ethical Risk – A Few Examples

- Wells Fargo
  - Cross-selling credo
  - Pressure to perform from leaders
  - Incentives tied to results
  - Retaliation
  - Strong local autonomy

- BP
  - Focus on profit and pressure to grow
  - Bottom-line mentality
  - Heavy risk-taking
  - Looming deadlines

- Kobe Aluminum
  - Focus on profit + efficiency + quality
  - Pressure to perform from leaders
  - Incentives tied to results
  - Highly conforming culture
  - Strong local autonomy

- Volkswagen
  - Focus on growth and perfection
  - A demanding CEO and a special type of pressure
  - Speaking out was heavily sanctioned

Understanding the Link Between Culture, Ethics, and Risk (1)

- The more the pressure points, the harder it is to make good decisions. In a VUCA world
  - Policies fall short
  - Values are easily overridden

- A gap between stated values and what the organization actually values
  - Creates ambiguity and uncertainty
  - Adds complexity to what people have to address on a daily basis
Understanding the Link Between Culture, Ethics, and Risk

- People overestimate the sturdiness of their ethics
- Unethical behavior is much more likely when people experience conflict of interest and find ways to rationalize their conduct
- Cognitive and emotional depletion affects our ability to do the right thing
- It’s easier to fend off explicit requests than pressure to perform

The Two Culture Dimensions That Create the Most Risk

Culture is the organizing principle of what a company values

- Delegation of Ethical Dilemmas
- Ethical Capacity

It underscores what an organization values and prioritizes
It entails the contextual factors that affect how people respond to ethical dilemmas
SAI’s Global Strategic Culture Framework: Part 1

Delegation of Ethical Dilemmas

Principles of Conduct

- What are the organization’s implicit value? What are its stated values? Is there a conflict between the two?
- What priorities and principles of conduct are leaders reinforcing? Is power used as a responsibility or an entitlement?

Leadership & Power

- Manager conduct is a key driver of an ethical culture
- Power asymmetries make managers’ requests impactful
- Leaders’ moral maturity affects employees’
- Leaders who ignore ethics accelerate amoral practices and facilitate a process of moral degradation

Incentives & Sanctions

- Incentives make unethical conduct more likely if
  - They strengthen self-interest disproportionately
  - Imply harsh penalties
  - Are associated with specific goals
  - We feel very close to the target
- Bonus point:
  - Values can afford a false sense of morality
  - Priorities that downplay the role of ethics reinforce the belief that others are less ethical than us

Reinforcers operate? Are there any double-standards?
Symptoms of Delegation of Ethical Dilemmas

- Lack of principles or unclear principles – Assuming that people can figure it out
- We must do it all (x & y & etc.)
- Business is business (it’s ok to talk about values, but let’s get back on track and focus on business)
- People cannot stop talking about revenue

Demanding results and not taking responsibility (e.g., “I don’t care how you get it done, just get it done”)
- Using power to patronize expertise and competence (e.g., “I know this business better than you”)
- Managers do not show any vulnerability in relation to competing priorities

- There are clear rewards for achieving results but not clear penalties for cutting corners
- There is an annual ethics award, but everybody evaluates career prospects based on performance only
- Penalties for not meeting performance goals exceed penalties for acting unethically
- Abuses of power are treated with a slap on the wrist

Delegation of Ethical Dilemmas in the Banking Sector

- The larger the gap, the more likely employees are to report that their firm is prioritizing profit over customer outcomes
- The smaller the gap, the more likely employees are to indicate that leaders walk the talk

Misconduct has cost the banking sector more than $200 billion over the past 10 years
Evidence That Ethical Capacity Works Like a Muscle

**Ethical Ownership**
- Diffusing responsibility and/or minimizing the consequences of our actions reduce agency and increase moral disengagement
- If we feel responsible, we pay attention to our behavior; if others set standards for us, we wait on them to make decisions for us

**Ethical Reasoning**
- Selective recollection and moral leniency applied to self
- Loyalty to group creates justification for unethical behavior
- Unfairness increases cheating
- Competition, especially in the presence of specific goals, leads to unethical behavior
- Creativity generates cognitive ease and a false sense of control

**Ethical Voice**
- Confidence in self and available means increase employee engagement
- Fear of futility suppresses voice
- Fear of retaliation underscores unethical conduct
Ethical Capacity in the Banking Sector

![Graph showing percentages of people agreeing or failing to agree with statements related to ethical capacity.]

- **Firms with less accountability are characterized by silos.**
- **These firms do not solicit employee feedback before implementing change.**
- **A fear and blame culture is quite widespread in these organizations.**

The cost of misconduct in the banking sector is likely to approach $400 billion by 2020.

Symptoms of Low Ethical Capacity

- Ethics and compliance are treated as a requirement.
  - When an ethical issue arises, you hear “**this is not our problem. let’s call the compliance team**.”
- There is a tendency to assign blame (e.g., **a few bad apples**).
- Employees believe it’s more important to fit in than to do the right thing.
  - **There is no time to address pressure points**, grey areas, and implications for behavior.
- Conversations about voice, diversity and inclusion, and ethics are shallow.
- **People believe that is better to keep low and quiet.**
- **HR or Compliance tell employees “are you sure you are happy here?”** after a report / complaint is filed.
- People are reminded about the futility of their voice (e.g., **what do you gain from speaking up? etc.**)
- Employees have no idea how the information they share is used.
Predicting Risk – Wells Fargo

<table>
<thead>
<tr>
<th>Culture Determinants</th>
<th>Wells Fargo’s Profile</th>
<th>Level of Risk</th>
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<tbody>
<tr>
<td>Principles of Conduct</td>
<td>Strongly at odds values. On the one hand, Wells Fargo proclaimed its commitment to the customer and fostering trust. On the other, it pushed customers as many products as possible.</td>
<td>∅</td>
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<tr>
<td>Leadership &amp; Power</td>
<td>Siloed and autonomous leadership principles. Local leaders used their influence to force overly ambitious goals over employees.</td>
<td>∅</td>
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<tr>
<td>Incentives &amp; Sanctions</td>
<td>Incentives were tied to cross-selling. Salespeople received 15—20% of bonus compensation if they met their sales goals. 1% of the workforce was let go between 2011 and 2016.</td>
<td>∅</td>
</tr>
<tr>
<td>Ethical Ownership</td>
<td>According to Wells Fargo, the businesses owned ethics. Yet, leadership framed the scandal as a “compliance and operations” problem.</td>
<td>∅</td>
</tr>
<tr>
<td>Ethical Reasoning</td>
<td>The compliance and ethics program trained employees to spot conflicts of interest and provided them with a Code of Conduct. Though valuable, these resources were insufficient to cope with the sales pressure employees faced on a daily basis.</td>
<td>∅</td>
</tr>
<tr>
<td>Ethical Voice</td>
<td>Wells Fargo fostered a culture in which threat, intimidation and retaliation played a significant role. Eventually, 5% of the workforce denounced the sales practices that occurred across the organization.</td>
<td>∅</td>
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Where Is Your Organization Today?

Two Guiding Questions

- Is your organization delegating dilemmas?
- What’s your organization’s ethical capacity?

<table>
<thead>
<tr>
<th>Level of Risk</th>
<th>Description</th>
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<tbody>
<tr>
<td>Mature</td>
<td>Risk is low; growth is ethical</td>
</tr>
<tr>
<td>Righteous</td>
<td>Risk is moderate. Focus on principles does not compensate low ethical capacity</td>
</tr>
<tr>
<td>Ambivalent</td>
<td>Risk is moderately high due to intense pressure despite ethical capacity</td>
</tr>
<tr>
<td>Immature</td>
<td>Risk is very high; growth is not sustainable</td>
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Assessment Process: Key Considerations

**PRINCIPLES OF CONDUCT**
- What are the organization's stated values? What do they mean?
- What does the organization value in the face of difficult decisions?
- What criteria are given priority within specific contexts (e.g., hiring, promoting, etc.)?
- How frequent are certain dilemmas?
- What conditions are likely to override ethical considerations?

**LEADERSHIP AND POWER**
- Are leaders walking the walk?
- How do leaders exercise power?
- What criteria are used to hire and promote leaders?
- How do leaders behave under pressure?

**REWARDS AND SANCTIONS**
- What are the organization's formal rewards/sanctions?
- What is implicitly recognized, rewarded and sanctioned?
- What behavior gets reinforced in case of a trade-off between ethics and business?

**ETHICAL OWNERSHIP**
- What's the responsibility of business?
- How does compliance work with business leaders?
- How is ethics framed in the organization?
- What goals do stakeholders hold in relation to ethics?
- How is stakeholder accountability monitored?

**ETHICAL REASONING**
- What resources do currently support ethical reasoning?
- What factors constrain reasoning at work?
- What types of dilemmas are people able to detect?
- Is there an open/honest dialogue about pressure points?

**ETHICAL VOICE**
- What channels are available? How effective are they?
- Where/how can people practice their voice?
- What's the value/cost of voice and silence?
- How does the organization follow up on voice/silence?
- Do people feel in control of voice practices?
A Pathway to Proactive Risk Mitigation

Assess

Assess key systems using the framework to determine whether and how they can help reduce dilemmas and create ethical capacity

Hold Accountable

Hold key stakeholders accountable by focusing executive conversations, business planning and board activities on the delegation of ethical dilemmas occurring in the organization at any given time

Measure

Use the framework to measure:
1. The impact of your E&C program
2. Your organization's culture
3. Ethical risk

Match

What's your organization's ethical capacity?

Re-design

Re-design systems and key resources to fully incorporate the framework's principles

Ensure the organization's ethical capacity match the level of risk that delegation of dilemmas pose at any given time

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Linking Culture to Ethics and Risk Using the Strategic Culture Framework

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