WORKING PAPER

MARCH 2017

The Five Levels of an Ethical Culture

How to Build and Sustain Organizations with Integrity

BSR®

The Business of a Better World

About This Report

This working paper was written by Alison Taylor, with additional guidance and insights provided by Dunstan Allison-Hope. Any errors that remain are those of the authors. Please direct comments or questions to ataylor@bsr.org.

The paper is based on a series of 23 confidential interviews with experts in risk, compliance, and ethics during 2015 in an effort to identify the common traits of organizational culture in unethical organizations. These interviews have been supplemented with research into a wide range of academic theories from the fields of organizational psychology, behavioral ethics, and group relations. We have also drawn on long experience in consulting with large corporates on strategy, risk, ethics, and sustainability. This has enabled us to bring a holistic perspective to the ethical culture challenge.

Working papers contain preliminary research, analysis, findings, and recommendations. They are circulated to stimulate timely discussion and critical feedback, as well as to influence ongoing debate on emerging issues. Most working papers are eventually published in another form, and content may be revised.

This working paper presents a draft model for understanding and driving more ethical and sustainability-oriented behavior in companies. We are seeking input on this model from BSR member companies, practitioners, and observers before we publish our findings and final conclusions in late 2017.

ACKNOWLEDGMENTS

The author wishes to thank Richard Bistrong, Andrea Bonime-Blanc, Sarah Brazaitis, Alice BrightSky, Warner Burke, Fiona Coffey, Patricia Dowden, Peter Christian Hall, Scott Killingsworth, Gabriel Kuris, Rosemary Mathewson, Roger Miles and Debra Noumair for their help, support and ideas.

DISCLAIMER

BSR publishes occasional papers as contributions to the understanding of the role of business in society and the trends related to corporate social responsibility and responsible business practices. BSR maintains a policy of not acting as a representative of its membership, nor does it endorse specific policies or standards. The views expressed in this publication are those of its authors and do not reflect those of BSR members.

SUGGESTED CITATION

Alison Taylor, “The Five Levels of Ethical Culture” (working paper, BSR, San Francisco, 2017).

Contents

Executive Summary

How to build and sustain an organization whose employees are happy, motivated, and ethical remains one of the most complex, elusive questions confronting business leaders. Organizational culture is determined by the interaction of systems, norms, and values, all of which influence behavior.

How to build and sustain an organization whose employees are happy, motivated, and ethical remains one of the most complex, elusive questions confronting business leaders. Organizational culture is determined by the interaction of systems, norms, and values, all of which influence behavior.

Much discussion of organizational culture still focuses on structural changes to corporate governance and compliance systems, along with drives to identify “bad apples.” Alternatively, we find glossy brochures, chief happiness officers, bonding exercises, and free beer. Still, public trust in business keeps falling and corporate scandals persist.

In a new BSR working paper, we argue that companies seeking to understand and build an ethical culture should consider systems thinking and group dynamics theory. In the paper, we define what a successful approach looks like, drawing on our experience helping companies create cultures of sustainability, reviewing a broad range of academic theories, and interviewing 23 ethics experts.

Our findings suggest that companies often overlook relationships among and within groups in the organization. Organizations are open systems: Their properties are greater than the sum of their parts, and these properties nest within other systems, forming a network of relationships. Efforts to change culture must therefore focus on every level in the system. These efforts should target individual engagement and motivation, interpersonal interactions, group dynamics, relationships among groups, and interactions with external organizations, including suppliers, customers, competitors, and civil society. Without a comprehensive, multilevel approach, employees will notice any mismatches in the signals an organization gives, and this will undermine efforts to build an ethical culture.

The paper explores five levels at which companies should build an ethical culture.

Individual: How individual employees are measured and rewarded is a key factor that sustains or undermines ethical culture. In the face of pressure to meet growth targets by any means necessary—a belief that the ends justify the means—unethical behavior is to be expected. Therefore, the rewards system is an excellent place to start. And diversity and inclusion initiatives enable individual employees to bring their whole selves to work: Employees who feel it unnecessary to hide aspects of their social identity to fit into the dominant culture will experience less conflict between personal and organizational values and will express themselves more confidently—making them more inclined to raise concerns about ethics.

Interpersonal: Organizations can also focus on how employees interact across the hierarchy. Abuse of power and authority is a key factor that degrades organizational culture. When decisions around promotions and rewards seem unfair and political, employees disregard organizational statements about values and begin pursuing their own agendas. Building an ethical culture from an interpersonal perspective requires meaningful protections that empower all employees and stakeholders, even the least powerful, to raise concerns and express grievances. Meanwhile, leaders must recognize the outsized role they play in setting culture and driving adherence to ethics, and they must learn to exercise influence carefully.

Group: Socialization into group memberships and relationships is a core aspect of human culture. At work, the key determinant tends to be an employee's group or team. As organizations become more geographically diffuse and loosely aligned, it becomes harder to set and define consistent organizational culture. Focusing on team conditions can empower middle managers to feel responsible for changing culture and group dynamics to foster more effective ways of working. While clarity in roles and tasks is key to a successful team, so is psychological safety. If employees feel secure in taking risks and expressing themselves, teams will be more creative, successful, and ethical.

Intergroup: The quality of relationships among groups is critical to consider in any attempt to build an ethical culture. Celebrating a team whose high performance may stem from questionable conduct gives it power and a mystique that is difficult to challenge, and this can undermine values across the organization. Teams working in sustainability or compliance often need to scrape for power and resources; when members are attached to matrixed working groups, accountability can get watered down.

Inter-organizational: Most discussions of organizational culture focus on internal relationships. Still, employees are keenly conscious of how a company treats suppliers, customers, competitors, and civil society stakeholders, so building and maintaining stakeholder trust will improve organizational culture. Moreover, companies need to ensure that their values and mission statements amount to more than words on a website. Business success and core values are not contradictory concepts. That said, building an ethical culture sometimes means walking away from lucrative opportunities. Companies can be sure their employees will notice.

However enormous the long-term rewards, there is no single, simple formula for building an ethical culture. We at BSR hope to gather ideas and continue this discussion. We'll be grateful if you download this working paper and send us comments, criticisms, and real-world examples of approaches that you have found successful—or not.

Five Levels of an Ethical Culture

Organizational Level	Structure and Process	Impact of Initiative	Work Climate and Norms	Impact of Initiative
Individual	**Incentives** that consider unintended consequence and proactively reward ethical behavior	**Reduces pressure** to meet goals by any means necessary	Support **diversity and inclusion** programs	Employees can align **personal and organizational values**
Interpersonal	Support **effective whistleblowing** and grievance mechanisms	Improved response to ethical challenges that threaten entrenched **power structures**	**Leadership development** focused on ethical conduct	Leaders understand how they **influence norms**, and use this influence to drive ethical conduct
Group	Ensure **role and task clarity** within teams	Reduced conflict and **role stress**, improved accountability	Build **psychological safety** within teams	Improved **performance, motivation, creativity**—and ability to raise concerns
Intergroup	Empower **oversight functions**	Improved decision making and **responsiveness** to risk and responsibility challenges facing the organization	Address group boundaries and **differing status, authority and access to resources**	Improved collaboration with **clear accountability**
Inter-organizational	Ensure sustainability commitments are incorporated into **strategic decisions**	Meaningful commitment to doing the right thing, even when there is an immediate commercial cost	Understand and improve **stakeholder trust** and relationships	Improved **reputation** and rights-aware decision making

Introduction

What is organizational culture, and how do you build culture that is ethical and sustainable? Questions of culture and ethics rose to prominence after the Enron and WorldCom scandals in the early 2000s and were revisited after the financial crisis. Scandals have recently affected a number of highly reputable companies.

Many prominent culture change efforts focus on company off-sites, bonding exercises, and even the appointment of chief happiness officers tasked with increasing the "fun" quotient of the working environment.[1] Such measures are not effective in a vacuum. They can easily misfire and increase employee cynicism, as illustrated vividly in the hit comedy, *The Office*. It seems that culture can't be reshaped simply by introducing office pool tables, brainstorming pods, and free beer. Indeed, how corporate culture is created and changed remains an elusive, complex question for senior leaders, consultants, and academics. When culture change is specifically focused on building a working environment in which ethical conduct flourishes and fraud and corruption wither, the challenge can become even more daunting.

The growth and expansion of the ethics and compliance function in companies over the past two decades has been accompanied by an increased understanding of the importance of organizational culture in supporting or undermining ethical behavior. The traditional "bad apple" approach to wrongdoing, whereby effort is focused on identifying and sanctioning individuals with unethical intent, are no longer credible in the face of sustained evidence that systemic corruption and fraud exist in a range of large multinational organizations.

State-of-the-art compliance programs are increasingly mandated by regulators. They appear to be necessary but not sufficient, as repeated regulatory investigations into companies with best practice compliance functions have demonstrated.

In fact, research suggests that norms wield far more powerful effects than processes and oversight structures, even when these are backed up by legal sanctions.[2] While more and more regulators and practitioners acknowledge that culture is just as important as process, each organizational culture is unique. There is no consistent framework for what a "good culture" looks like.

The past two decades have also brought growing traction for the concepts of sustainability and corporate social responsibility. Commitments to environmental sustainability, responsible labor practices, economic inclusion, and human rights are frequently cited as essential elements of employee engagement and organizational values, though the connection to reducing unethical behavior such as fraud and corruption

---

[1] André Spicer, "The cult of compulsory happiness is ruining our workplaces," *Guardian*, December 12, 2016, https://www.theguardian.com/commentisfree/2016/dec/12/cult-compulsory-happiness-ruining-workplaces-office-fun.

[2] Steven Appelbaum, Kyle J. Deguire, and Mathieu Lay, "The relationship of ethical climate to deviant workplace behavior," *Corporate Governance: The International Journal of Business in Society*, 5(4) (2005): 43-55, doi:10.1108/14720700510616587.

tends to be less explicitly drawn. Whether these efforts are seen as cynical corporate rebranding or genuine evidence of shifting priorities will largely depend on how they are implemented.

Overall, despite all the attention and debate, consistent and workable approaches to building (or rebuilding), ethical organizational culture remain elusive. One reason for this is the nature of unethical behavior. It varies greatly in form and is, by definition, covert and hidden. No compliance program can check all of its possible manifestations. While corruption can flourish as a top-down, organization-wide phenomenon, it can also be confined to particular divisions, teams, or regions. It can even be driven unilaterally by a "rogue employee," though this is far less common than has customarily been suggested.

A second reason this area is so challenging is that attempts to create "cultures of compliance" often contain their own internal contradictions. As Donald C. Langevoort has argued, there is a "conundrum [that] the origins of noncompliance may be found in seemingly benign (even prized) behaviors, traits and cultural artifacts that are thought to generate success in a hyper-competitive marketplace."[3] This conundrum is illustrated by a recent academic study based on leaked data from the Ashley Madison "Discreet Encounters Made Easy" dating website, which found that while companies with a high proportion of top executives who were Ashley Madison subscribers were less ethical, they were also more creative and innovative.[4] Most companies struggle to manage this dilemma as to what traits and behaviors to reward, and industry disruption and geopolitical uncertainty are giving momentum to perceptions of an external environment in which ruthless and competitive business practices are seen as the only way to survive.

CULTURE AND GROUP DYNAMICS

According to Edgar H. Schein, who pioneered concepts of organizational culture, culture is the most difficult aspect of organizational life to alter. It can outlast leadership transitions, changes in products and services, geographic footprint, and other physical, measurable attributes of a company. Culture is made up of formal systems and processes but also "work climate"—the set of informal behavioral norms and values in an organization. Schein argues that leaders initially set the culture, and it deepens and becomes self-reinforcing over time, as structures and incentive systems develop to reward certain practices and forms of behavior.

Schein describes culture as a concept that is intriguing precisely because "it points us to phenomena that are below the surface, that are powerful in their impact but invisible, and to a considerable degree unconscious."[5] To illustrate this, he describes the layers that make up a corporate culture. The first layer, an organization's artifacts and rituals, are easily observable and rank high in the employee's consciousness. They include facilities, offices, furnishings, the way employees dress and behave, and the myths and stories the organization tells about itself and its history. A company that fills its conference rooms with antique paintings and mahogany furniture is saying something about its culture and aspirations, as is a company whose line managers wear sneakers and sit in cubicles with their teams.

The second layer, that of espoused beliefs and values, reflects an organization's statements about what it stands for—its primary goals and *modus operandi*. This includes statements such as "We put our

---

[3] Donald C. Langevoort, "Cultures of Compliance," SSRN (2016), forthcoming in *American Criminal Law Review*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2840762.

[4] William David Greiser et al, "Fifty Shades of Corporate Culture," SSRN (2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2843776.

[5] Edgar H. Schein, *Organizational Culture and Leadership*. (San Francisco: Jossey-Bass/Wiley, 2004), p8.

customers first" and "We value the diverse perspectives of our employees." The values of a company will include perceptions an employee has about its reliability and trustworthiness. An organization focused on aggressive expansion into new markets will necessarily have a different culture than a domestic operation in a highly regulated industry. But even within a given sub-sector, attitudes toward collaboration, competition, processes, and hierarchy can vary enormously, and all of them affect culture.

This second layer of culture can conflict with the third layer—an organization's underlying assumptions. This third level describes traits that are rarely, if ever, discussed; they are taken for granted. Employees become acclimatized to these "unspoken rules" over time and may not even be conscious that they exist. Nonetheless, they are critical to understanding the organizational culture.

For example, employees may avow belief in open communication around integrity and values while communicating a strong, unstated belief that concerns should not be shared with the boss. A heavy focus on internal checks and balances can be undermined by implicit signals that smart employees should learn how to game the system. A chief executive officer may speak regularly about transparency and meritocracy but make opaque, highly political promotion decisions. These contradictions will be noted and absorbed by employees, consciously or not. The existence of this third layer of assumptions explains why so many organizations engage in apparently contradictory behavior, as well as why so many culture change efforts fail. Becoming aware of the powerful impact of these implicit signals and contradictions is a first step toward creating an effective ethical culture.

Culture change is difficult, and enacting meaningful change takes time and effort. It is much easier to degrade a culture than to build it. As one ethics expert we spoke with commented: "All companies are corrupt or corruptible. It takes a great deal of time and energy to create corporate cultures that really work. They are much harder to build than they are to tear down; you are swimming against the current."

A second expert echoed this, remarking that "It's hard to talk in terms of an unethical organization—we can talk about behaviors that are likely to lead to ethical violations. These are an absence of perspective taking, an unthinking, reactive way of dealing with time and pressure, an absence of an alternative narrative, or an absence of authority. Our legal system means that we want to find a wrongful mind, but people in a corrupt organization don't feel wrongful. Corruption in organizations is more about an absence."

To make matters more complicated, as prominent organizational psychologist W. Warner Burke has pointed out, "You don't change culture by trying to change culture. … Taking a direct, frontal approach to changing values is fraught with difficulties, resistance and strong human emotion."[6]

This working paper argues for consideration of systems thinking and group dynamics theory in understanding and building ethical culture. Much of the discussion of organizational culture is still focused on structural changes to corporate governance and compliance systems or on glossy brochures describing corporate values. Alternatively, it focuses on specific behavioral "nudges." However, interventions targeted only at governance and oversight structures, or at manipulating individuals to make more ethical decisions, are sure to be insufficient.

We contend that the influence wielded by the immediate office and the team environment is profound. Consideration of the relationships among and within groups in the organization has been neglected, and it

[6] W. Warner Burke, *Organization Change: Theory and Practice* (Thousand Oaks: Sage, 2013), p46.

can provide a valuable lens for understanding and change. Organizations are open systems that are dependent on their environments for input and then transform these inputs to produce output.[7] Living systems are integrated wholes with properties greater than the sum of their parts, which nest within other systems to form an inseparable pattern of relationships. Culture change efforts therefore need to focus at every level in the system—targeting individual engagement and motivation, interpersonal interactions, group dynamics, relationships between groups and teams, and interaction with other organizations, which include suppliers, customers, competitors, and civil society.[8] In the event of a mismatch among the signals an organization gives across systemic levels, contradictions will be noted by employees, and culture change efforts will fail.

WHAT DOES AN UNETHICAL CULTURE LOOK LIKE?

In 2015, we gathered the perspectives of 23 experts on ethical conduct in organizations in an attempt to understand whether unethical cultures have characteristics in common.[9] Respondents strongly agreed that they do. The characteristics of ethical and unethical organizational cultures are summarized in the table below.

Organizational Level	Unethical Culture	Ethical Culture
Individual: *how personal and organizational values intersect* 	Cognitive dissonance between personal and organizational values Discretionary bonuses and performance targets are unrealistic, set without regard to market conditions or employee behavior	The task of the organization is personally meaningful to employees There is a commitment to diversity and inclusion, enabling individuals to bring their "whole selves" to work Incentives are realistic and set with regard to market conditions, rewarding values and behavior, as well as achievements
Interpersonal: *the quality of relationships across the hierarchy* 	Highly hierarchical and authoritarian Leadership is complacent, hoards information, and focuses on plausible deniability. Leaders are likely to be regarded as high-performing, high-status figures	Inclusive, flat management style encourages contributions from all levels Speaking up about concerns is encouraged, and employees can take risks and make mistakes in order to drive creativity and innovation

[7] Daniel Katz and Robert L. Kahn, *The Social Psychology of Organizations* (New York: Wiley, 1978): 18-34.

[8] Leroy Wells, "The Group as a Whole: A Systemic Socioanalytic Perspective on Interpersonal and Group Relations," in *Groups in Context: a New Perspective on Group Dynamics*, ed. Jonathon Gillette and Marion McCollum (Lanham: University Press of America, 1995), 50-85.

[9] Alison Taylor, "What do Corrupt Firms Have in Common? Red Flags of Corruption in Organizational Culture," Columbia University Center for the Advancement of Public Integrity (2015), http://web.law.columbia.edu/sites/default/files/microsites/public-integrity/files/what_do_corrupt_firms_have_in_common_-_capi_issue_brief_-_april_2016.pdf.

	Employees cannot raise concerns without fear of retribution	
Group: *dynamics within teams* 	The senior leadership team has high authority, while delegating responsibility and evading accountability Roles within groups and teams are unclear and may internally contradict, generating team conflict and anxiety. Alternatively, roles are rigid and over-bounded, with few incentives to cooperate	Roles within groups are clear, and there is enough psychological safety to speak up and share ideas Goals are shared by teams and are impactful and inspiring. Team members can depend on each other to work together to drive success
Intergroup: *dynamics between teams* 	Intense rivalry among groups and teams, with highly differentiated access to power and resources Disempowered oversight functions provide little meaningful oversight of risk, compliance, and ethics Devolution and high local autonomy, with limited oversight	Collaboration and cross-functional teams are the norm, not the exception, but this is accompanied by role clarity and clear accountability Groups work to achieve shared goals, and group oversight “cost centers” have resources, respect, and authority
Inter-organizational: *the organization and its external environment* 	Obsession with growth at all costs and a belief that the ends justify the means Relationships with other organizations are hyper-competitive, driven by short time horizons and insecurity	How growth is achieved is as important as whether it is achieved Relationships with other organizations prioritize collaboration and the need to build sustainable stakeholder trust

> "You don't change culture by trying to change culture. Taking a direct, frontal approach to changing values is fraught with difficulties, resistance, and strong human emotion."
>
> — W. Warner Burke, Columbia University

This working paper aims to go a step further by making some suggestions about how to improve organizational culture via initiatives that are designed to support and reinforce each other. The paper is intended to provoke discussion and stimulate ideas, to encourage leaders to examine interactions within the organizational system in order to identify and tackle the culture challenge. Our suggestions are based on the expert study mentioned above, decades of experience of working with organizations on ethics and integrity issues, and a range of academic theories. Measures need to include changes to systems, structure, and processes, along with efforts to improve the working climate, which will have a positive impact on norms and behaviors. We are seeking input from our member companies and other interested observers before we publish our conclusions in a report in September 2017.

Our recommendations are designed to support more traditional ethics and compliance programs, the optimal approach to which has been exhaustively discussed elsewhere. They are not meant to substitute for the programs.

The Five Levels of an Ethical Culture

Individual: How Personal and Organizational Values Intersect

Individual accountability and responsibility is a dominant concept in Western culture. It is the basis for our legal system. However, separating personal from organizational ethics is almost impossible in practice because human behavior is highly context-specific, and people are far more influenced by their surroundings than they might wish to believe. The behavioral ethics field has done a great job of demonstrating that personal traits are less important than systemic and social factors in determining a propensity to behave unethically. Notwithstanding what Hollywood movies suggest, the world is not clearly delineated into "good guys" and "bad guys." While personality is far from irrelevant, most humans will cheat a little bit if the circumstances arise—though not so much that their personal sense of morality is threatened.[10]

So far, practitioner responses to findings about behavioral ethics have tended to focus on behavioral cues, or "nudges," designed to improve individual behavior in specific situations.[11] One of the best-known examples is the finding that employees are more inclined to observe the requirements of a code of conduct if they sign it before—not after—they read it.[12] And one expert I interviewed had found that reading a company's mission statement out loud at the beginning of senior leadership team meetings improved discussion and ethical decision making. Other studies have found that putting healthy food choices at the front of the cafeteria line improves eating habits.[13]

Techniques to slow down the decision-making process and promote rational, considered assessment over instinct and intuition (what Daniel Kahneman and others call "System 2 thinking"[14]) are certainly helpful but will not be sufficient if they are contradicted by other organizational cues. As Scott Killingsworth has argued persuasively, such situational interventions are difficult to pull off in practice and are likely to lose resonance and momentum over time, as the attempt at behavioral manipulation becomes evident.[15] Another recent trend, the use of internal surveillance and email monitoring to identify the level of behavioral risk posed by certain individuals, seems almost certain to backfire because it will inspire paranoia and insecurity—key traits of unethical organizational cultures.[16]

Although undeniably more challenging, leaders may find it more effective to consider prompting fundamental adjustments in how individual employees think about and align their personal and organizational values and goals. Leadership could commit to thoughtful consideration of how incentives

---

[10] Dan Ariely, *The Honest Truth about Dishonesty: How We Lie to Everyone—Especially Ourselves* (New York: HarperCollins, 2012)

[11] Richard H. Thaler, and Cass R. Sunstein, *Nudge: Improving Decisions about Health, Wealth, and Happiness* (London: Penguin, 2009**.**

[12] Lisa Shu et al, "Signing at the Beginning Makes Ethics Salient and Decreases Dishonest Self-reports in Comparison to Signing at the End," Proceedings of the National Academy of Sciences of the United States of America, vol. 109, No. 38 (2012), http://www.pnas.org/content/109/38/15197.full.

[13] Jane Black, "Small changes steer kids toward smarter school lunches," *Washington Post*, June 9, 2010, http://www.washingtonpost.com/wp-dyn/content/article/2010/06/08/AR2010060800999.html.

[14] Daniel Kahneman, *Thinking, Fast and Slow* (New York: Farrar, Strauss & Giroux, 2013)

[15] Scott Killingsworth, "Behavioral ethics: From nudges to norms," *Ethikos,* January 2017, https://www.bryancave.com/images/content/8/9/v2/89927/2017-01-jan-feb-ethikos-killingsworth.pdf.

[16] Ben DiPietro, "Employers Turn to Surveillance to Curb Employee Risk," *Wall Street Journal*, September 29, 2015, http://blogs.wsj.com/riskandcompliance/2015/09/29/employers-turn-to-surveillance-to-curb-employee-risk/.

and reward structures drive or undermine ethics, and it could embrace initiatives that support norms of diversity and inclusion.

There is "a conundrum that the origins of noncompliance may be found in seemingly benign—even prized—behaviors, traits and cultural artifacts that are thought to generate success in a hypercompetitive marketplace."

—Donald Langevoort, Georgetown University Law Center

INCENTIVES AND REWARDS

Organizations are social groups. Members have individual interests, but they work to pursue the primary task: the proliferation or duration of business. When managers are motivated to achieve performance targets by any means necessary (including ethical breaches), it is important to consider their motivating factors, not just their personalities.

One expert we interviewed stated: "Variable compensation based on sales is a disaster for corruption. There is a culture of asking for double-digit growth, and telling people that if they don't make targets they don't stay with the company. This creates incredible pressure, where people expect to give and receive bribes. In China operations I have seen, employees would literally weigh the costs and benefits. It's a type of balancing act. Often this is a top-down phenomenon, but there is also an individual calculation. You can't push compliance and 20 or 30 percent growth at the same time."

The recent problems at Wells Fargo & Co. offer an excellent illustration of the pernicious effect that incentive programs can have on organizational culture. The bank set aspirational goals of eight accounts per customer in its branches, and made manager bonuses dependent on achieving those goals. While this would put any employee under a level of pressure that could affect commitment to personal honesty, the pressure became unsustainable when employees began to be fired for not meeting those targets, as witnessed throughout the organization. Wells Fargo has now rightly determined that tackling incentives is the first priority in rebuilding an ethical culture.[17]

Interviewees in our ethical culture study universally agreed that pressuring individuals to meet high sales targets, and rewarding this to the exclusion of behavior or ethics, is a significant causal factor in corruption. But incentive and reward systems tend to be based on budgets set at the corporate level, which are then translated into performance management systems by human resources departments. This

[17] Ken Sweet, "Wells Fargo overhauls pay plan for bank branch employees," Associated Press, January 10, 2017, http://www.businessinsider.com/ap-wells-fargo-overhauls-pay-plan-for-bank-branch-employees-2017-1.

is a problem: Sales-based compensation targets set without regard to conditions in the local environment are considered a particular red flag for corruption.

Interviewees also frequently commented that companies have been slow to alter problematic incentive structures, despite widespread knowledge of their effects. This appears to relate to a fear of losing high-performing sales teams to competitors. However, many interviewees described examples of innovative approaches to incentives. These include making ethical behavior a key factor in determining executive compensation and rewarding employees with innovative approaches that tackle ethical challenges. A prominent example of innovation in incentives is the recent decision by GSK to fundamentally alter the incentives of its sales teams. GSK now rewards employees on their product knowledge and how doctors view them.[18]

Organizations that take a considered approach to the unintended consequences of incentive systems will see an improvement in ethical culture. However, understanding and balancing targets and reward systems will be easier and more effective if the organization is able to gain insight into where pressure and anxiety impact teams, and this requires open discussion and a willingness to share concerns.

DIVERSITY AND INCLUSION

A wealth of research suggests that diverse teams make better, smarter decisions.[19] Other research has found that increasing gender diversity on boards reduces risk taking and improves dialogue, ethics, and decision making.[20] So diversity certainly appears to correlate with a more ethical culture. However, the improvements cited may not emerge automatically from the use of quotas and diversity targets.[21]

For diversity initiatives to be effective, they need to focus on inclusion—the ability of employees to "bring their whole selves to work" and not feel they have to downplay or hide aspects of their social identity in order to successfully fit in with the organizational culture. A culture of inclusion will immediately reduce the likelihood of dissonance between personal and organizational values, ensuring that employees are not in a position where they have to deny or disregard these values in order to be successful.

Approaches that encourage employees to reflect on, and prioritize, personal values and characteristics in the workplace can be effective at highlighting the perils of group dynamics and ensuring that individuals feel confident to speak up when they are concerned about behavior they see around them. However, it is important that the onus is not put entirely on employees to drive this.

Leaders can help a great deal to create conditions for inclusion, and this may mean giving employees the option to opt out of specific tasks or projects that they are uncomfortable with, even if this has commercial consequences.[22]

---

[18] GSK, "Responsible Business Supplement," 2016, https://gsk.com/media/3610/responsible-business-supplement-2016.pdf.

[19] For example, Katherine W. Phillipps, "How Diversity Makes Us Smarter," *Scientific American*, October 1 2014, https://www.scientificamerican.com/article/how-diversity-makes-us-smarter/, and David Rock and Heidi Grant, "Why Diverse Teams Are Smarter," *Harvard Business Review*, November 1, 2016, https://hbr.org/2016/11/why-diverse-teams-are-smarter.

[20] Laura Liswood, "Women Directors Change How Boards Work," *Harvard Business Review*, February 17, 2015, https://hbr.org/2015/02/women-directors-change-how-boards-work.

[21] Margarethe Wiersema and Marie Louis Mors, "What Board Directors Really Think of Gender Quotas," *Harvard Business Review*, November 14, 2016, https://hbr.org/2016/11/what-board-directors-really-think-of-gender-quotas.

[22] Sherrell Dorsey, "Bringing Your 'Whole Self' to Work Is Harder Than It Sounds," Triple Pundit, February 1, 2016, http://www.triplepundit.com/special/fostering-diversity-and-purpose-at-work/bring-your-whole-self-to-work.

Interpersonal: The Quality of Relationships Across the Hierarchy

The interpersonal dimension of ethical culture involves developing an understanding of how individuals in the organization communicate and interact. While critical areas to examine include the flow of information and the level of conflict and trust, relationships across the organizational hierarchy merit particular attention.[23] A personality conflict in a team or work group may be just that, but it gains a new dimension when it arises between a surgeon and a nurse, a manager and an intern, or a professor and a student.

The abuse of power and authority is one of the key factors that cause organizational culture to degrade. When decisions around promotions and rewards seem unfair and political, employees will disregard organizational statements about values and begin to pursue their own agendas.

Building an ethical culture from an interpersonal perspective therefore involves two key interventions. The first involves ensuring meaningful protections so that all employees and stakeholders, including the least powerful, can raise concerns and express grievances. The second involves an effort to make leaders aware of the outsized role they play in setting culture and driving adherence to ethics—and to develop their interpersonal skills accordingly.

WHISTLEBLOWING AND GRIEVANCE MECHANISMS

When employees witness or learn of unethical behavior, they are immediately faced with a set of questions as to how to respond. Employees often refrain from reporting concerns because they believe that speaking up will not be welcomed by the organization and will evoke no response—particularly if it challenges organizational hierarchy. Often these assumptions are correct. A history of internal whistleblowers being ignored or silenced can prompt an employee to head directly to regulatory authorities, resulting in a high-profile corporate scandal.

The degree to which employees will raise concerns and grievances, via whistleblowing lines or other channels, varies across regions and divisions in a particular company, reflecting different cultural and team conditions.[24] Whistleblowers are often highly unusual individuals who, for a variety of reasons, are less influenced by the customary pressures to normalize and fit in with the group.[25] They can be treated as scapegoats, disliked and distrusted for their lack of adherence to group norms and behaviors.

Providing anonymity for whistleblowers—meaningful protection that they will not face retaliation—is a very effective way to build an ethical culture. So is awareness that sanctions and punishment are meaningful, even at senior levels. Interviewees argued that it is not sufficient to have grievance mechanisms in place. They need to be used. Moreover, members of the organization need to be made aware that employees who breached the rules have faced consequences, even if confidentiality concerns prevent full details from being shared.

---

[23] Leroy Wells, “The Group as a Whole: A Systemic Socioanalytic Perspective on Interpersonal and Group Relations,” in *Groups in Context: a New Perspective on Group Dynamics*, ed. Jonathon Gillette and Marion McCollum. (Lanham: University Press of America. 1995), 50-85.

[24] David Bogoslaw, “Cultural differences in attitudes to whistleblowing,” *Corporate Secretary*, December 8, 2014, https://www.corporatesecretary.com/articles/corporate-secretary-week/12848/cultural-differences-attitudes-toward-whistleblowing/.

[25] Eyal Press, *Beautiful Souls: The Courage and Conscience of Ordinary People in Extraordinary Times* (New York: Picador, 2013)

LEADERSHIP DEVELOPMENT

When organizational fraud or corruption comes to light, it is standard practice for senior leaders to explain that this happened without their knowledge or awareness, resulted from a one-off lapse of oversight, and has no wider implications for the quality of leadership or governance.[26]

Leaders need not be personally aware of unethical behavior to hold some responsibility for it. The leadership of an organization integrates employees into a system via rules, norms, processes, and tasks. Leaders are responsible for the strength and effectiveness of this integration mechanism, regardless of their level of knowledge of individual wrongdoing. This is the real meaning of “tone at the top,” and it suggests that a focus on corporate governance, oversight, and senior responsibility can yield huge benefits in terms of interpersonal ethics.

Interviewees agreed that leadership is the most critical factor driving or undermining an ethical culture. The most obvious risk is a prevailing emphasis on increasing growth and profit at all costs; for example, it has been argued that Volkswagen Group’s push to be No. 1 in diesel in North America opened it up to unethical conduct.[27] One expert we interviewed commented*:* “What people watch is whether management is doing anything to cook the books when they need to, which sets the tone that it’s OK to break a couple of rules to get things done.”

Interviewees also mentioned arrogance, complacency, and opacity as being leadership characteristics that tend to encourage unethical behavior. “Massive complacency is a trait, and that can continue after getting into trouble. Plausible deniability. The idea is ‘just get the deal, and don’t tell me how you got it.’ Also, using competition and the threat of dismissal to take people outside their comfort zone.”

A lack of engagement with the challenges employees face in remote markets or in high-pressure divisions allows leaders to plausibly deny knowledge of corrupt activities. Leadership needs to do more than pay lip service to ethical culture, which means it must actively seek out understanding of what is going on at the operational level. This, in turn, means taking personal responsibility for activities across the business—which can be risky. Senior leadership teams often compete with each other for resources, visibility, and power; admitting to failures and problems can have negative consequences for leaders and the broader functions they control.

One expert interviewee commented: “Leaders tend to hoard information. Information is power, and power is exercised for the good of the leadership and not of the company. Good news travels up the chain, but the bad news rolls downhill. When a difficult decision is made, the basic dynamic is to avoid accountability so that no one is personally responsible. Risk and ownership of risk is not embraced and clearly assigned. During the financial meltdown, that’s what happened: What firms did was embrace their own rewards and pass risks on to others, so no one was individually responsible for a decision to bet the farm.”

Any lapses at the top will be amplified and mirrored throughout the organization. Training and development activities to help leaders build interpersonal skills and understand the consequences of their

[26] Jack Ewing, for example, “Volkswagen C.E.O. Martin Winterkorn resigns amid emissions scandal,” *New York Times*, September 23, 2015, https://www.nytimes.com/2015/09/24/business/international/volkswagen-chief-martin-winterkorn-resigns-amid-emissions-scandal.html.

[27] Danny Hakim, Aaron M. Kessler, and Jack Ewing, “As Volkswagen Pushed to Be No. 1, Ambitions Fueled a Scandal,” *New York Times*, September 26, 2015, http://www.nytimes.com/2015/09/27/business/as-vw-pushed-to-be-no-1-ambitions-fueled-a-scandal.html.

activities can help. This should include an explicit focus on complex ethical dilemmas and the need for leadership to model appropriate behavior throughout the organization. Structures to drive accountability are also important, as discussed in more detail below.

Group: Dynamics Within Teams

Organizations are made up of groups that interact with each other. Groups in an organizational context can be defined as entities that can be clearly identified. It is easy to distinguish members from non-members, and there are differentiated roles and interdependency with other groups. Group memberships often generate significant ambivalence and anxiety, as most people wish to be accepted while also maintaining their own identities and independence.[28]

Socialization into group memberships and relationships is a core aspect of human culture. Since typical white-collar workers spend one-third of their lives at work, the work climate profoundly influences their personal vision of the world. The key determinant of the work climate tends to be the group or team in which an employee sits. This is increasingly the case as organizations grow more geographically diffuse and loosely coupled, and consistent organizational culture becomes more difficult to set and define. A focus on group and team conditions can empower middle managers to take responsibility for changing culture and group dynamics in a way that supports more effective ways of working.

In an unethical culture, new employees are socialized into their group or team with the understanding that corruption or fraud is at least insignificant. This process takes place via three mechanisms: institutionalization, whereby an unethical decision or act becomes embedded in structures and processes; rationalization, wherein self-serving ideologies develop to justify the behavior; and socialization, by which new employees are induced to view unethical decisions as permissible. Interviews suggested that ethical challenges tend to arise in remote teams subjected to little oversight, low transparency, and highly directive leaders. All this supports the contention that "deviant subcultures insulate actors from the wider culture." [29]

An examination of team conditions and organizational subcultures, along with the identification of subcultures that might pose concern, is an essential element in building an ethical culture. This was summarized by one interviewee as follows: "Unethical behavior is likely when people are put in high-risk roles with inadequate support. People are naïve about what happens when you put people out in the field. The issue is the level of local autonomy. With high decentralization, people become immersed in a certain cultural milieu, and it becomes entirely normalized. If there isn't much movement between teams, that can silt up the group identity and make the fortress impregnable. It's the relationship of structure and social process that's the sweet spot, rather than it being a causal model."

PSYCHOLOGICAL SAFETY

A recent study by Google Inc. found that psychological safety was the key distinguishing factor among its high-performing teams. The ability of employees to take risks without fear of humiliation and punishment

---

[28] Jon Stokes, "The Unconscious at Work in Groups and Teams: contributions from the work of Wilfred Bion," in *The Unconscious at Work: Individual and Organizational Stress in the Human Services*, ed. Anton Obholzer and Dr. Vega Zagier Roberts. (New York: Routledge, 1994), 19-27.

[29] Blake E. Ashforth and Vikas Anand, "The Normalization of Corruption in Organizations," *Research and Organizational Behavior*, 25, 1-52 (2003), 1-52, doi:10.1016/S0191-3085(03)25001-2.

drives creativity, inclusion, and productivity.[30] The study, based on over 200 interviews and extensive data analysis, found that "Individuals on teams with higher psychological safety are less likely to leave Google, they're more likely to harness the power of diverse ideas from their teammates, they bring in more revenue, and they're rated as effective twice as often by executives."

The level of psychological safety is also a critical indicator of whether a team is likely to be subject to unethical behavior. For example, at Siemens AG, former executives said they believed that paying bribes was necessary to maintain contracts and jobs: "We thought we had to do it. Otherwise we'd ruin the company."[31] Although interviewees highlighted other values that might justify corrupt behavior, this sense of urgency and necessity was the most frequently cited means to justify the undermining of commitments to ethics and compliance.

Our ethical culture study found that an archetypal corrupt team is based in a location far from headquarters, where it succeeds in meeting unreasonably challenging sales targets under a keenly directive, controlling leader. The team is widely regarded as successful and high-performing, though mystique or confusion attends the basis for its performance. Information is synonymous with power and is tightly held. Individuals in the team are fiercely loyal to each other and are driven by a sense of insecurity, competition, and short time horizons. There is heavy use of in-group language, commonly including euphemisms for misconduct and metaphors of war and sport.[32] Unsurprisingly, this is a team where anxiety is extremely high, and where uncertainty or failure is not tolerated.

The creation of psychological safety will mean that team members feel able to share challenges and concerns, know their voices will be heard, and take action to solve them cooperatively. By acknowledging uncertainty and fallibility and by modeling curiosity, all team members can help promote an ethical culture. Leaders can help by rewarding and acknowledging these behaviors—and their own vulnerability.

ROLE AND TASK CLARITY

Another key factor affecting ethical culture in groups is role and task clarity. Teams work best when there is clarity about the task at hand and indicators of success. An academic study by J. Richard Hackman found that direction is optimized when the task is challenging, energizing, clear, and consequential.[33] Structure, clarity, and dependability were also cited by Google as a secondary driver of high team performance.

Where there is ambiguity around tasks and roles in a group, members may suffer from intra-role conflict (incompatibility regarding what is expected within a role) and inter-role conflict (two individuals are given roles that overlap or are inconsistent). This can show up if incentives are unrealistic or misaligned. For example, team leaders who are responsible for both goal performance and effective compliance, but who cannot achieve both—perhaps because the targets set are unrealistic in view of ethically challenging

---

[30] Julia Rozovsky, "The Five Keys to a Successful Google Team," Re:work with Google, November 17, 2015, https://rework.withgoogle.com/blog/five-keys-to-a-successful-google-team/.

[31] Siri Schubert and T. Christian Miller, "At Siemens, Bribery Was Just a Line Item," *New York Times*, December 20, 2008, http://www.nytimes.com/2008/12/21/business/worldbusiness/21siemens.html.

[32] Scott Killingsworth, "War Games: How Framing Shapes Our Conduct," *Ethisphere Magazine*, June 17, 2015, http://insights.ethisphere.com/war-games/.

[33] Hackman, J. Richard, *Leading Teams: Setting the Stage for Great Performances* (Boston: Harvard Business Review Press, 2002), 61-91.

external conditions—will suffer from anxiety over the conflict presented by the assigned role. They will need to choose which goal is more important and more likely to lead to success.

It is important for team leaders to set clear roles and tasks for team members, and to pay special attention to signs of conflict and anxiety in their teams. Rather than assuming that conflict is due to interpersonal difficulties among the members in question, leaders should consider whether the roles members have been asked to take on are the primary driver of this tension, and they should aim to provide more direction and task differentiation.

Intergroup: Dynamics within Teams

The quality of relationships among groups and teams in an organization is critical to consider in any attempt to build an ethical culture. It is important to understand the quality and nature of the boundaries separating groups in an organization. Boundaries act as the "container" that holds the task the group is addressing, while also governing interaction with members outside the group.[34] Boundaries can be temporal, geographic, hierarchical, or functional. For example, if meetings never start or end on time and lack a clear agenda (they have weak time boundaries), this will signal something important to attendees about the meetings' purpose and effectiveness. If conversations within a team are open and constructive, but meaningful discussion ceases whenever senior executives are present, this may indicate that the group has a strong sense of hierarchical boundaries.

Transactions among groups in an organization are regulated by variations in the permeability of the boundaries. A group whose boundaries are too permeable will suffer from a loss of identity, purpose, and motivation, as well as a lack of role clarity. Excessively rigid boundaries can also be a problem. Unethical teams limit their interactions with the rest of the organization and resist oversight. But even if ethical challenges are not present, over-bounded teams will ignore external ideas and input, and this will limit creativity and performance.

Groups within organizations will have varied access to power, authority, and resources, and these differentials will have a powerful effect on organizational culture. Many decisions about how corporate resources are to be allocated present difficult moral questions about the degree to which competing ethical considerations will be honored. Which teams are elevated, valued, and rewarded is a key indicator of how important those ethical considerations might be.

Ethical culture will quickly be undermined by the celebration of a team whose performance is high and whose conduct is questionable. Such teams tend to develop power and mystique that is difficult to challenge. This can subsequently undermine values across the organization, as it can drive higher targets that more ethical teams must struggle to meet. "The metals division in the Middle East developed a reputation for forecast-beating results, but no one could explain how they did it. The head of the division was very powerful, connected to the CEO, and his team were very loyal and discreet. It only seemed like a problem in retrospect," commented one investigator.

The challenge of managing intergroup relationships to support an ethical culture should not be underestimated. Excessive centralization can cause problems, but so can a high degree of local empowerment. One expert summarized as follows: "I have a foot in each camp on whether autocratic,

[34] Sarah J. Brazaitis, "Group Relations and Conflict Resolution," in *Handbook of Conflict Resolution, Theory, and Practice*, ed. Peter T. Coleman, Morton Deutsch, and Eric C. Marcus. (San Francisco: Jossey-Bass/Wiley, 2014), 947-968.

top-down structures or local autonomy cause worse problems, but it is worth noting that the worst problems I have seen have been in companies with significant local autonomy. Where you see issues are command-and-control autocracy within structures of significant local devolution. In any organization structured with a large sample of relatively autonomous groups, some will inevitably devolve into corruption. You tend to see disconnect between organizational and individual interests, and highly bonused leaders percolating the pressure down. It is interesting to theorize that the worst problems would occur when a strong, highly incentivized leader with no oversight takes control of a team."

OVERSIGHT OF RISK AND RESPONSIBILITY

The status and effectiveness of groups that conduct oversight, manage risk, and set ethical direction is critical in driving the positive impact of any efforts at culture change—but this process is becoming more challenging. It is no longer sufficient to manage governance, risk, and compliance solely via a focus on detecting what is illegal and responding to regulatory risk. Ethical issues are becoming broader and more difficult to evaluate, and are increasingly converging with sustainability risks. Obvious examples include labor standards in the supply chain, carbon emissions and climate change, human rights, and civic activism.

Compliance teams are increasingly well resourced, but they are being asked to oversee issues of ethical conduct and behavior that range beyond legal compliance and to address the challenges arising from new and unregulated products and services, as well as wider questions of corporate values. This raises immediate issues of oversight and integration. One team tends to conduct risk assessments and oversee compliance, but the management of ethical issues needs to be implemented throughout the business.

There are examples of companies trying more innovative approaches to address the oversight of existing and emerging ethical challenges, in the process becoming more responsive and able to anticipate reputational and ethical challenges and stakeholder pressures. Some large organizations, including Microsoft, Telenor Group, and Telia Co. AB are driving closer integration among audit, legal, and sustainability functions, aligning these teams beneath a single senior executive leader. Operational risk committees are more inclined to consider ethics and sustainability issues beyond legal compliance as material factors for such companies. It has also become standard practice to integrate sustainability into a formal board committee. Finally, recent moves have significantly reduced the obsession with quarterly reporting and short-term performance35, as evidence continues to emerge that companies that focus on long-term value creation perform better.36

If these moves are meaningful and well-resourced and are able to influence corporate strategy and mission, they will provide significant support for ethical culture. Still, integration presents its own challenges, as we shall discuss next.

COLLABORATION ACROSS BOUNDARIES

For groups and teams to work together across organizations, they need to overcome a range of boundaries, including physical distance, time zones and schedules, status and authority, and differentiated knowledge bases. Accelerating technological developments have made remote work and

[35] Matt Turner, "Here is the letter the world's largest investor, BlackRock CEO Larry Fink, just sent to CEOs everywhere," *UK Business Insider*, February 2, 2016, http://uk.businessinsider.com/blackrock-ceo-larry-fink-letter-to-sp-500-ceos-2016-2?r=US&IR=T.

[36] Dominic Barton, James Manyika, and Sarah Keohane Williamson, "Finally, Evidence That Managing for the Long Term Pays Off," *Harvard Business Review*, February 9, 2017, https://hbr.org/2017/02/finally-proof-that-managing-for-the-long-term-pays-off.

collaboration more achievable than ever, but tools to enable communication and collaboration are not an end in themselves. Teams still need to overcome miscommunications, misunderstandings, competing assumptions, and social norms that drive deference to authority.[37]

Cross-functional committees and shared issue ownership are often presented as the best way to manage ethics and values in an organization. It is not difficult to see why. Many ethical issues facing organizations require interaction among diverse functions, including internal audit, risk, sustainability, compliance, and human resources, and policy then needs to be implemented by the "core" business functions. Committees comprise representatives who need to advocate for the interests and agendas of the groups they belong to while also responding to subtle pressure to take a big picture perspective, lest they be perceived as parochial.[38] The relative power and status of these various groups can also show up in cross-functional meetings, affecting the objectivity of the resulting analysis.

Without careful planning and attention to potential unintended consequences, such cross-functional groups can easily suffer from diffuse accountability, leading to conflict or neglect of the core task and resulting in ethical lapses. The General Motors Co. ignition-switch scandal illustrates this phenomenon: Managers failed to make connections, and there was no clear responsibility for organizational risk.[39] One interviewee noted: "Much literature concerns a mythical ethical man making decisions with the facts in front of him; this isn't real. The realities of hierarchy mean that thriving in an organization involves suppressing bad news, which means that taking responsibility is hazardous. The decision maker checks only that the paperwork is complete, and those who complete the paperwork are relieved of responsibility for the decision. Then everyone is protected individually, but it can add up to widespread harm."

For an organization to consistently implement an ethical culture, attention needs to be paid to the boundaries among groups in general, and to their consequences. Strategies to address the challenges presented will increase intergroup understanding and cooperation, and will also support organizational ethics. Visits to other teams and sites, and the creation of consistent structures and shared resources, can be helpful.

Leaders can model inclusion and minimize the negative impact of status and authority gaps. Knowledge management and knowledge sharing are also critical. Groups can and should acknowledge their different perspectives and organizational values and discuss their potential consequences. Raising and considering differing values, assumptions, and beliefs—rather than pretending they don't exist—is an important step in addressing any gap between explicit messaging and implicit understanding.

Inter-Organizational: The Organization and its External Environment

Most discussions of organizational culture focus on the relationships among employees within the organization, for obvious reasons. However, there is no doubt that employees will also absorb and pay attention to how a company treats its suppliers, customers, competitors, and civil society stakeholders.

---

[37] Edmonson, Amy C. *Teaming: How Organizations Learn, Innovate, and Compete in the Knowledge Economy*. (San Francisco: Jossey-Bass Pfeiffer/Wiley, 2014), 185-217.

[38] David N. Berg, "Senior Executive Teams: Not What You Think," *Consulting Psychology Journal Practice and Research*, vol 57 (2: 107-117, March 2005, doi:10.1037/1065-9293.57.2.107.

[39] Jeff Bennett and Joann S. Lublin, "GM Recall Probe to Blame Cultural Failings," *Wall Street Journal*, June 4, 2014, http://www.wsj.com/articles/gm-ceo-to-discuss-ignition-switch-probe-findings-thursday-1401897900.

These attitudes and activities will have a huge effect on a company's culture and its boundaries with the rest of the world.

This issue is becoming more pressing as organizations themselves evolve to become more networked and diffuse, with the use of remote and contracted employees transforming the very definition of what it means to work for a company. A growing focus on labor conditions and the quality of relationships throughout a company's supply chain highlights the web of relationships and systems that any modern organization must leverage in order to survive, and it has brought a new dimension to concepts of success and resilience. Large multinationals, increasingly held responsible (at least in reputational terms) for what goes on in their supply chains, still struggle to balance engagement and oversight. The anti-corruption field faces similar challenges: A high proportion of investigations involve payments channeled via third parties. Overall, how to manage and optimize the system in which the organization operates is one of the most pressing, rapidly evolving questions that a company faces.

Organizations can approach external relationships with a fundamentally combative or collaborative stance. The elimination of competitors is a core element of standard business practice, but companies increasingly need to collaborate with peers in order to address shared challenges and public concerns. There is also a need to build trust across the wider network of relationships to help build resilience against mounting reputational threats. A recent research study has argued that a high level of stakeholder trust can help corporations weather disruption, protests, and a host of other damaging reputational threats.[40]

Overall, companies tend to focus on employee engagement and internal conditions when they are seeking to understand culture. But a focus on the way a company operates across the wider systems and networks it is part of is a critical indicator of culture.

MISSION, VALUES, AND STRATEGY

Organizations interested in building an ethical culture focus on systems, processes, and norms for good reason. These are the building blocks that form culture and are the obvious areas for intervention. However, the organization's mission, vision, and core values—often described as its "purpose"—will also have a very direct impact on culture. It may be stating the obvious to say that the organization's core task may support an ethical culture or may undermine it, but this fact is often absent from discussions on culture, which can wrongly suggest that the challenge is the same across organizations and industries. A nonprofit organization that aims to tackle child labor in the supply chain has a very different core purpose from that of an investment bank. To be sure, mission-driven organizations can suffer from weak oversight systems and unethical behavioral norms, but their core task is at least aligned with an ethical imperative, and this will help motivate employees to drive and support an ethical culture.

For publicly listed corporates, this presents a number of strategic challenges. The most immediate is how an organization should drive a strategy that allows it to grow, make money, and satisfy its fiduciary duty to shareholders while also maintaining a meaningful commitment to values beyond the proliferation and duration of business. In contrast, an exclusive focus on shareholder value enables clear decision making and priorities, even if these may generate problems over the longer term. One expert commented: "Short-term business cycles and long-term client care are out of balance. We reward people for shifting product,

---

[40] Henisz, Witold J, Dorobantu, Sinziana and Nartey, Lite J, "Spinning Gold: The Financial Returns to Stakeholder Engagement, Strategic Management Journal September 2013 http://knowledge.wharton.upenn.edu/article/when-engaging-with-your-stakeholders-is-worth-its-weight-in-gold/

not making customers happy. This results in hit-and-run selling, the myth that customers don't understand anything. This removal of real world externalities plays to a certain type of pathology. A focus on money and bonus to the exclusion of everything else legitimizes and normalizes deviance. Anyone who has walked on a trading floor for even a few minutes wouldn't believe for a second that there is a commitment to client welfare."

There are two challenges here. They are closely related but not synonymous. The first concerns planning and time horizons, and the other relates to strategic priorities over these time horizons.

There is growing evidence that managing companies with a view to the longer term can act as a proxy for high-quality management and generate superior commercial success, compared with the fruits of an obsession with short-term value.[41] Given that effective consideration of environmental, social and governance risks requires thinking about the ultimate consequences of issues such as economic inequality and climate change, it is argued that any boost to long-term thinking automatically provides the "business case" that has been the holy grail of the sustainability field for many years. Practitioners are relieved that there is finally compelling evidence that ethical and financial imperatives need not contradict one another. Given that the dominant paradigm in the corporate world is still based on quarterly financial reporting, shifting to a new model is not without challenges. How to value and plan for more nebulous and long-term sustainability risks, particularly where the impact is indirect, remains an obvious hurdle. However, there is growing support from influential investors to reward longer-term management approaches, and this will certainly help the sustainability field.

The question is whether this shift to longer-term thinking can be sufficient in itself. One of the reasons that concepts of shareholder value have remained so dominant for so long is that the idea provides a considerable amount of strategic direction. As the sustainability, corporate responsibility, and human rights agendas have matured, companies have aimed to incorporate social and environmental considerations into their strategic planning, with varied success. Once additional social responsibility issues are incorporated, companies must then balance and prioritize a set of complex ethical considerations for which it is not easy to directly compare risks and benefits. Concepts of shared value[42] and the triple bottom line[43] have gained a lot of traction, and the dominant concept in the sustainability field today is that companies should focus on issues that are both material to their business and to their stakeholders, prioritizing decisions that are in the sweet spot of being important to both cohorts.

Still, it is unrealistic to assume that the shared value concept will present an objective solution for every ethical and strategic dilemma. As BSR's Laura Gitman recently argued, "While we can make a case for long-term business drivers for any sustainability action, the truth is, sometimes it just costs more to treat your workers with dignity and to pay them a living wage, and you may not be able to prove the financial benefits. It costs more to prevent pollution, yet the direct benefits are reaped by the public, not the

[41] Dominic Barton, James Manyika, and Sarah Keohane Williamson, "Finally, Evidence That Managing for the Long Term Pays Off," *Harvard Business Review*, February 9, 2017, https://hbr.org/2017/02/finally-proof-that-managing-for-the-long-term-pays-off.

[42] Michael E. Porter and Mark R. Cramer, "Creating Shared Value," *Harvard Business Review*, January-February 2011, https://hbr.org/2011/01/the-big-idea-creating-shared-value.

[43] Savitz, Andrew. ***The Triple Bottom Line: How Today's Best**-Run Companies Are Achieving Economic, Social and Environmental Success—and How You Can Too*. (San Francisco: Jossey-Bass/Wiley, 2013)

company. Regulation serves to address this market failure, but with weakened regulation all but guaranteed in the United States for the next few years, will the business case always exist?"[44]

How all this strategic decision making plays out matters a great deal for organizational culture. Contradictions and inconsistencies in the organization's stated values and actual priorities will all be picked up by employees, affecting their behavior and motivation—which will, in turn, affect the wider culture. Google's research found that the group's tasks and goals need to be personally meaningful and impactful to drive optimal team performance, but it did not fully address the question of whether financial performance imperatives are sufficient to create that sense of meaning and impact. More broadly, it has become common practice for corporate codes of conduct to make sweeping statements about corporate purpose and mission, such as declaring that "sustainability is in our DNA." But the uncomfortable fact is that many employees still roll their eyes and consider such statements insubstantial public relations exercises. For such commitments to take hold, it may not be enough for the company to pursue measures that support business growth without damaging responsibility commitments. To build an ethical culture, a business must demonstrate, repeatedly and consistently, that it will do the right thing, even when there is a commercial imperative for it not to do so.

As if this were not complicated enough, simultaneously pursuing growth and an ethical imperative also raises dilemmas about what behavior is valued and rewarded. As the Ashley Madison example cited at the beginning of this paper demonstrates, competitiveness, aggression, creativity, and speed of decision making are characteristics of people and teams that organizations tend to reward, because they help drive growth and performance. Trying to incorporate behaviors that support a societal mission (such as collaboration and inclusion) is becoming more common; the question is what happens when these imperatives contradict each other. It may not be enough to argue that all these elements are equally important, because it will be clear to employees whether this is indeed the case. If companies hope to build an ethical culture, they will need to ensure that this messaging is consistent by demonstrating a willingness to make financial trade-offs under at least some circumstances.

STAKEHOLDER TRUST

Leaders who hope to build an ethical culture may wish to make use of one final, powerful concept that can help clarify decision making, priorities, and normative imperatives. This is the idea of making decisions based on the principle of a duty to earn stakeholder trust. Patricia E. Dowden and Philip M. Nichols have argued persuasively that stakeholder trust can act as an effective proxy for normatively desirable behavior.[45] Since stakeholders include employees, suppliers, customers, shareholders, civil society and rights holders, the pursuit of stakeholder trust is challenging, but it can also help clarify the correct course of action when a company is presented with some of the strategic dilemmas described above.

How to measure stakeholder trust remains a complex question, but technology is increasingly able to provide answers here by analyzing swaths of online data to identify existing and emerging stakeholder concerns, as well as the effectiveness of corporate responses to them. Efforts to understand the wider

---

[44] Laura Gitman, "When the Business Case and Shared Value Aren't Enough," BSR blog, February 6, 2017, https://www.bsr.org/our-insights/blog-view/when-the-business-case-and-shared-value-arent-enough.

[45] Patricia E. Dowden and Philip M. Nichols, "Creating Stakeholder Trust as a Universal Principle for Business Behavior," SCCE, August 8, 2016, http://complianceandethics.org/creating-stakeholder-trust-universal-principle-business-behavior/.

network of relationships and interactions a company has are likely to yield a number of strategic benefits, too, and can help manage political, social, and reputational risk.

For those seeking a business case for these activities, the need to build resilience to risk and to identify emerging opportunities may provide it. As hyper-transparency becomes reality and news cycles are compressed, companies need to respond and be accountable in real time. Concepts of risk and impact converge around questions of reputation. 2016 brought a collapse of public trust in business, government, and the media, with only 37 percent of respondents to the 2017 Edelman Trust Barometer stating that they trust CEOs.[46]

Conclusion

At the time of writing, the corporate world is facing geopolitical, strategic, and technological disruption that is unprecedented in living memory. The public expects and demands that business take a leadership role to fill the gaps left by political actors, and to rethink societal obligations, risk management, and long-term sustainability. A far wider range of plausible scenarios is in play, and traditional risk management and strategy tools are not well placed to address current challenges. Open, interactive communication with those that are affected by, or have the power to influence, a company's strategy and agenda just shot to the top of the priority list.

Building an ethical culture is a challenging task that offers enormous long-term rewards. The benefits go beyond the management of fraud, corruption, conflicts of interest, and other forms of unethical conduct. It goes beyond the need to reduce the cost of regulatory action, investigations, and financial penalties. Companies with ethical cultures will have more sustainable growth, retain and attract the best employees, earn public trust and consumer loyalty, and be far better placed to survive disruptive political, social, and environmental forces. There is no one-size-fits-all solution to creating and sustaining an ethical culture, but this paper hopes to present some ideas and generate further discussion and ideas for how to do this.

[46] Richard Edelman, "An Implosion of Trust," 2017 Edelman Trust Barometer, January 15, 2017, http://www.edelman.com/p/6-a-m/an-implosion-of-trust/.

About BSR

BSR is a global nonprofit organization that works with its network of more than 250 member companies and other partners to build a just and sustainable world. From its offices in Asia, Europe, and North America, BSR develops sustainable business strategies and solutions through consulting, research, and cross-sector collaboration. Visit www.bsr.org for more information about BSR's 25 years of leadership in sustainability.

BSR®