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# The Future of Business Ethics

OCTOBER 2017

After decades of investing in compliance and ethics, the corporate world nonetheless finds itself confronting challenges that can pose existential reputational risk. Companies face ever-louder calls to adopt and enforce ethical business practices. Despite a growing focus on organizational culture, many still compartmentalize their efforts. No single department can own responsibility for installing and maintaining an ethical culture in an organization. Human resources, ethics and compliance, and sustainability teams need to work toward common goals and values set by a corporation's senior leadership.

Companies professing a deep commitment to sustainable, ethical business practices to help foster genuinely positive organizational culture must understand that, where integrity is concerned, we must think beyond the "business case."[1] Sometimes a company simply needs to walk away from a lucrative opportunity that would contradict its core principles. The public increasingly distrusts private sector rhetoric on ethical business,[2] and there is a pressing need for leaders that will take, and adhere to, clear decisions about core values and priorities.

This paper summarizes conclusions from an extensive literature review and interviews with 70 experts and corporate leaders in sustainability, ethics, and compliance.

## THE STATE OF PLAY

At the OECD Integrity Forum in March 2017, the Organisation for Economic Co-operation and Development concluded[3] that a narrow focus on anti-corruption and fraud prevention has proved insufficient, and companies must broaden their approach to building "cultures of integrity." The way forward is unclear. As we have argued elsewhere, how to build and sustain an organization whose employees are happy, motivated, and ethical is one of the most complex, elusive questions confronting

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[1] https://hbr.org/2017/09/we-shouldnt-always-need-a-business-case-to-do-the-right-thing

[2] https://www.edelman.com/trust2017/

[3] http://oecdinsights.org/2016/12/09/the-economy-of-influence-integrity-for-inclusive-growth/

business leaders today. Organizational culture is determined by complex interactions between systems, norms, and values. All influence staff behavior.

In today's climate of hyper-transparency and polarized public debate, staying below the radar on ethics issues may appear the best strategy for corporations, but this can run the risk of ethical commitments being dismissed as empty rhetoric. As one interviewee commented: "It is not difficult to commit to ethics and sustainability when it is cheap and easy. The question is, will you still do it when it hurts?"

Three departments are involved in the conversation around how to build sustainable, ethical, corporate cultures:

- **Human resources (HR)** focuses on organizational development, which includes frameworks to measure and build positive culture. These efforts, however, tend to focus on employee engagement and retention, diversity, and inclusion, rather than explicitly promoting integrity. Because HR teams also act to translate an organization's strategic goals into metrics and performance targets, they frequently find themselves acting more as implementers of the culture set by senior leadership than as drivers of change.

- **Compliance** predominantly views corporate ethics as a matter of preventing employees from committing fraud, corruption, and other kinds of white-collar crime. Having realized that systems-and-control processes are not effective in a vacuum, the compliance profession is considering how to incorporate "cultures of compliance." But its responsibility for enforcement and investigation may limit its ability to provide ownership and oversight for more positive, motivational aspects of organizational culture.

- **Sustainability** views corporate "values" and "purpose" as a foundational aspect of its work but struggles to drive a common understanding of what these terms mean. How should a company go about creating "purpose"? A recent EY survey[4] of 1500 business leaders found that "only 15 percent of companies believe their main role is to maximize shareholder value, in comparison to 73 percent that believe it is to embrace a strong corporate purpose. … According to the research, two-thirds of executives are profoundly rethinking business purpose as a result of the disrupted environment, and 52 percent of those are moving in the direction of this wider concept of purpose."

If you are confused, you are not alone. While companies widely acknowledge the need to refocus on core values, reputation, and trust, there is no commonly recognized path. Conclusive success stories are lacking. Compliance efforts tend to focus on the "sticks" of meaningful oversight and punishment of wrongdoers, but professionals increasingly concede that more is needed. Sustainability teams aim to provide "carrots" in motivation and inspiration, though results on the effectiveness of this approach have been mixed.

We find more energy focused on the need for a fundamental rethink about the interaction between the corporation and society than the provision of concrete guidance on how to proceed. No single department owns organizational culture, but there needs to be considerably more collaboration between functions, under clear leadership and direction from the top.

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[4] https://www.edie.net/news/7/EY--Corporate-purpose-crucial-in-uncertain-global-economy/#.WVzrofF3YBc.twitter

## THE ROLE OF HUMAN RESOURCES

The qualifications and core expertise needed for a structured consideration of organizational culture most commonly reside in the HR function. The organizational psychology field has developed a number of frameworks to measure and evaluate culture. While some BSR member companies have worked to incorporate this expertise into such functions as ethics and compliance, this remains a relatively unusual approach.

HR has direct influence over diversity and inclusion initiatives, leadership development, and issues of incentives and performance management—all areas critical in building ethical, sustainable organizational culture.

Interviewees in our recent ethical culture study[5] agreed that pressuring individuals to meet high sales targets—and rewarding this without regard to 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 and translated by HR into performance-management systems. The problem? Sales-based compensation targets set without regard to conditions in the local environment are distinctive red flags for corruption.

Organizations that take an intentional approach to curb the unintended consequences of incentive systems will improve ethical culture. Still, gaining insight into how pressure and anxiety affect a team requires open discussion and a willingness to share concerns—and failures.

Diversity initiatives must focus on inclusion to be effective. Employees need to be able to "bring their whole selves to work," not feel it necessary to downplay or hide aspects of their social identities in order to successfully fit into the organizational culture. A culture of inclusion reduces dissonance between personal and organizational values.

Approaches that encourage employees to reflect on and prioritize personal values and characteristics in the workplace can be effective at ensuring that individuals feel confident to speak up when concerned about behavior around them. Leaders can help create conditions for inclusion,[6] which may mean giving employees the option to opt out of specific tasks or projects that make them uncomfortable, even if this has commercial consequences.

Efforts to instill a sense of safety will enable team members to share challenges and concerns, knowing their voices will be heard, and to take cooperative action to solve them. This is a huge factor in driving innovation; risk aversion and fear of failure undermine creativity and experimentation.

## THE ROLE OF ETHICS AND COMPLIANCE

Concern over corporate conduct and misbehavior isn't new. A shift from self-regulation to external oversight followed corporate price-fixing and bid-rigging scandals in the 1960s. The organizational compliance function is generally agreed to have emerged in 1990 in the wake of the 1987 Federal Sentencing Guidelines. Initial compliance focused on programmatic aspects, but a spate of corporate scandals in the early 2000s prompted the specification that companies are expected to "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."

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[5] 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

[6] http://www.triplepundit.com/special/fostering-diversity-and-purpose-at-work/bring-your-whole-self-to-work

Norm generation and creation of an ethical culture have since been explicit goals for most corporate compliance programs. However, most compliance teams focus on policies and processes as a way to drive culture. As regulation became more aggressive, regulators tended to seek and reward examples of aggressive enforcement inside companies.

As a recent paper persuasively argued,  the consequences of this shift have been mixed. Compliance teams have gained visibility and resources. But the compliance team has come to be seen as an internalized law enforcement function that responds to external pressure from government regulators and the public—and tends to be staffed by lawyers and former regulators. Moreover, "In order to avoid application of the criminal law, companies have adopted compliance programs that are motivated by and mimic that law. … Criminalized compliance regimes are inherently ineffective because they impose unintended behavioral consequences on corporate employees. Employees subject to criminalized compliance have greater opportunities to rationalize their future unethical or illegal behavior."[7]

The 2008 financial crisis decisively exposed the limits of that approach. Whatever caused the financial system to collapse was not a shortage of lawyers, accountants, and compliance officers among banks. Regulators thus refocused on "cultures of compliance" and "conduct risk." As a prominent ethics and compliance expert told us, "The focus on culture is dominant. If the culture and values are right, everything will be OK."

In response, compliance leaders have acknowledged the shortcomings of an approach based on identifying and sanctioning "bad apple" employees and begun mulling the behavioral aspects of organizational culture. Amid a wealth of research[8] on how employees are motivated, socialized into the organization, and ultimately able to rationalize and justify wrongdoing when it is facilitated by the overall environment, there has been increasing focus on the interaction with corporate strategy—particularly the role of unrealistic performance incentives in driving wrongdoing. Research[9] shows that "business settings that are perceived as highly competitive are riddled with prompts that facilitate unconscious cultural resistance to the implications of any strong emphasis on ethics and compliance."

In addition, compliance teams increasingly need to consider areas of "soft law" and business partner expectations such as human rights frameworks, supplier codes of conduct, collective action agreements, and standards like those of the Electronic Industry Citizenship Coalition. Some teams are recruiting and hiring specialists in organizational development and behavioral change.

The compliance and ethics function's very role is being reconsidered. An external expert told us: "A seat at the table is the biggest trend. Compliance has gone from being seen as a cost center to a business advantage. (What is the) correlation between ethics and compliance and business advantage? Transparency, open culture, and innovation."

All this calls for a redefinition of the remit and skillset needed on a compliance team, even as it continues to pursue its core preventative function.

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[7] http://scholarship.law.nd.edu/ndlr/vol92/iss3/5/

[8] http://www.ethicalsystems.org/

[9] http://scholarship.law.georgetown.edu/facpub/1799/

## THE ROLE OF SUSTAINABILITY

Sustainability teams grapple with the "carrots" of values, social responsibility, inclusivity, and protecting the environment. To be sure, supply chain efforts in particular often focus on audits and other compliance mechanisms to drive progress, but the field of sustainability consciously positions itself as broader and ambitious, not driven exclusively by process and metrics.

Many individuals we interviewed explicitly framed their work in sustainability as supporting organizational culture and values. External experts agreed that the positive frame characterizing sustainability efforts can play a key role in driving positive organizational culture.

Offered one transparency specialist, "Values are also important. Are you walking the talk? What are the consequences if you don't support the values? Impunity degrades the culture. The board should consider the big picture of values and ethics and how they interact with company culture."

Other senior sustainability leaders made similar arguments. One suggested, "Sustainability allows a more entrepreneurial culture, questing to a different future. There is a strong link to purpose and how we deliver purpose."

Another contended, "Ethical culture is the foundation of all our efforts. It's a specific culture: You either like it or you hate it, but I have found people who are passionate about the mission, love the culture of integrity, and know you can do big things here. The company as a whole has to have a very deliberate, continuous effort for a common culture."

Sustainability teams tend to toggle between core "business case" arguments and arguments about ethics, values, and corporate purpose, which can lead to confusion as to what constituency they are responding to—and what concerns they seek to address. The work can be dismissed as window-dressing. That's unfortunate, because sustainability is as important as compliance in creating a culture of integrity. Employees look to see whether corporate values statements are more than words on a website. How a company responds to stakeholders and societal pressure is crucial. Sustainability teams can contribute significantly to cultural transformation by providing substance for a meaningful commitment to corporate values. A senior sustainability leader from an extractives company described the relationship between his work and the wider organizational culture as follows:

"We are most powerful when we're really concrete about how we're going to do things. There is fatigue with nice words in reports. We are much more interested in targets—how they're set, and what they achieve. Examples include community targets around reporting, local content, and reducing community complaints. Ethical behavior, company strategy, and reporting all come together."

## THE PATH FORWARD

Ethical concerns over business practices are not going away. The transformation of the transparency environment and an exponential growth in data leaks and hacks mean that companies now need to behave as if everything they say or do might become subject to public scrutiny. This includes internal emails, lobbying and political advocacy efforts, and efforts to avoid tax burdens via offshore investment structures. Companies must also struggle to manage their reputations amid a public debate that has grown more diffuse and fragmented. It no longer suffices to treat reputation management as primarily an issue of communications and public relations.

This means that company leaders need to consider ethical issues from a strategic perspective, making special effort to behave in a way that is consistent with their statements of purpose. Codes of conduct and values statements should be backed with meaningful commitments, resources, and processes. Particular attention needs to be paid to potential contradictions between what a company says and what it does. For example, an avowed commitment to human rights should amount to more than a policy statement; it should be accompanied by efforts to understand and address impacts, engage with the supply chain, and (most importantly) disclose and address ongoing challenges. No company is free of such conflicts. A focus on only good news and progress will rightly be greeted with skepticism.

As organizations grow increasingly globalized, networked, and diffuse, leaders need to pay particular attention to ethics. A significant challenge here is that ethics are highly personal and culturally specific. Still, the emergence of core frameworks, such as the IFC Performance Standards, UN Global Compact, and UN Sustainable Development Goals, can ease the way for companies attempting to balance top-down direction with local relevance. Sustainable business links economic development, opportunity, and empowerment for all, and there has been some success in reaching a global consensus as to what this looks like. Companies struggling to make sustainability resonate in a globally integrated way can now refer to these core frameworks for guidance, which suggests that an approach to ethics best begins at the strategic, corporate level.

Once an ethical direction and strategy are set, human resources, compliance, and sustainability will find it easier to collaborate effectively. There are many paths to success here. Some companies we work with have added behavioral specialists to compliance teams. Others are ensuring that sustainability considerations are fully incorporated into product design and go-to-market strategies. Others still are considering ethics holistically, via governance structures that combine risk, internal audit, compliance, sustainability, and government affairs. Since no single department has full oversight of ethical issues, collaboration and dialogue are key.

Finally, a far greater focus on culture and behavior has become essential to any business aspiring to operate ethically. This necessitates taking a good look at power and impunity, psychological safety, diversity and inclusion, incentives, and values. The enterprise must also engage externally in order to comprehend stakeholder concerns and perceptions. The pursuit of business ethics is no longer only about protecting the organization from regulatory scrutiny. Today, it means fostering a broad culture of integrity.

## 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.

## ACKNOWLEDGMENTS

The authors wish to thank the 70 experts in corporate integrity, sustainability, ethics and compliance who contributed their insights for this paper.

## ABOUT THIS REPORT

Despite a growing focus on organizational culture, many companies still compartmentalize their efforts to build cultures of integrity. This paper summarizes conclusions from an extensive literature review and interviews with 70 experts and corporate leaders in sustainability, ethics, and compliance. No single department can own responsibility for installing and maintaining an ethical culture in an organization. Human resources, ethics and compliance, and sustainability teams need to work toward common goals and values set by a corporation's senior leadership.

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