



Command, Control, Culture and Compliance

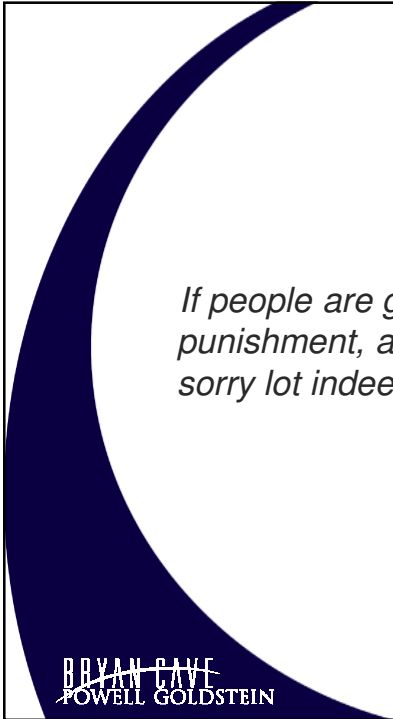
Behavioral Science Weighs in on Corporate Culture

Scott Killingsworth
Society of Corporate Compliance and Ethics
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*If people are good only because they fear
punishment, and hope for reward, then we are a
sorry lot indeed.*

— Albert Einstein

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Command and Control Compliance Model

- › Heavy reliance on monitoring, detection, punishment and deterrence
- › Relies more on rules than on empowerment and judgment
- › Aims to control or influence employee behavior mainly through negative and positive incentives
- › Based on assumption that humans behave in accordance with the rational choice theory of outcome optimization (classical economics)
 - › Reward for Noncompliant Behavior is compared to Risk
 - › Estimated Risk = Severity of Punishment x Probability of Detection

Does the incentive program promote the desired results?



Notice:
**The floggings will continue
until morale improves.**
-the Captain

Command and Control Limitations

- › Even if the rational-choice model is accurate, improving compliance rates via Command and Control has built-in limitations
 - › Sanctions must be proportional, or can become counterproductive – reporting of violations declines if punishment is unfairly harsh
 - › Very expensive to increase *perceived* likelihood that violation will be detected (“Cop on every corner” method)
- › Can undermine employee’s acceptance of personal moral responsibility
 - › Deterrence message is one of *pursuing self-interest* (avoiding punishment) rather than *doing the right thing*
- › Self-interested rational choices for individuals aren’t always good for the organization – some issues ought to be non-negotiable

Command and Control Limitations

- › Rationality is Overrated: In actual human beings, well-known cognitive biases distort risk/reward decision-making processes (See, e.g. *Predictably Irrational*, *Freakonomics*)
 - › We consistently over-value definite, near-term events – *such as the rewards of rule-breaking*
 - › We under-value uncertain, future events, even if catastrophic – *such as the risk of getting caught*
 - › People tend to ignore abstract or remote victims (e.g. stakeholders in an institution, “the planet,” future generations)
 - › Self-Serving Bias, Conformity Pressures, Motivated Reasoning also distort risk/reward and ethical judgments

Source: Messick and Bazerman, “Ethical Leadership and the Psychology of Decisionmaking,” *Sloan Management Review*, Winter 1996; Kim, “The Banality of Fraud: Re-situating the Inside Counsel as Gatekeeper,” *Fordham Law Review*, Vol. 74, No. 983, 2005.

Command and Control Limitations

- › Hidden costs of strong Command-and-Control Focus:
 - › Mistrust of employees communicated through multiple channels
 - › Projection of negative expectations may inhibit employee self-regulation
 - › Adversarial relationship with employees – Resentment
 - › “Atrophy of competence” – if you insist on thinking for your employees, they get out of the habit of thinking for themselves, sense of personal responsibility decreases
- › Bottom Line: Command-and-Control alone is an inefficient (and therefore expensive) way to influence behavior
 - › Example: Only 5% of variance in drug violations is attributable to the risk of punishment...and *how much* do we spend on drug law enforcement and punishment?

Sources: Treviño, Weaver, et. al; Stansbury and Barry, Ethics Programs and the Paradox of Control, Business Ethics Quarterly Vol. 17 No. 2 (2007); MacCoun, Drugs and the Law: a Psychological Analysis of Drug Prohibition, 113 Psycholog. Bull. 497 (1993); Ayers and Braithwaite, Responsive Regulation: Transcending the Deregulation Debate (1992)

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Command and Control Limitations – The Effect of Framing

- › The worst of all worlds: a weak Command-and-Control system
 - › Strong sanctions work better than weak sanctions
 - › BUT: In some contexts, *no sanctions* also work better than weak sanctions
 - › Weak or rarely applied sanctions communicate lack of seriousness on the part of management
 - › Weak sanctions and weak or nonexistent values message *encourage economic, risk/reward framing of issues* (since the stakes are low), rather than ethical framing
 - › In risk/reward market framing, everything is up for grabs if the price is right: there are no absolute rules of behavior
 - › If the dominant message is values rather than deterrence, people feel trusted, assume personal responsibility, and frame issues more in terms of “the right thing to do,” where absolutes abound

Sources: Tenbrunsel and Messick, Sanctioning Systems, Decision Frames, and Cooperation, 44 Admin. Sci. Q. 684 (1999); Ariely, “The Cost of Social Norms,” chapter in Predictably Irrational (2008).

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Values-Based Approach – The Paradigm Shift

- › Traditional Command and Control Paradigm:
 - › Prevent bad employees (5%? 20%?) from breaking rules
 - › Forcibly raise employee behavior up to Company standards -- impose Company values upon recalcitrant employees
 - › Business and rules-based framing
- › Values-based, Self-Regulatory Paradigm
 - › Harness the positive values of good people (80%? 95%?)
 - › Make sure *Company* is seen as measuring up to *employee's* values
 - › Ethical framing
 - › To win loyalty – and voluntary adherence to rules – show that you *deserve it* – Walk the talk

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Thought Leaders and Pioneering Researchers

- › Tom Tyler (“Why People Obey the Law,” 1990
“The Ethical Commitment to Compliance:
Building Value-Based Cultures,” 2008)
- › Lynne Sharpe Paine (“Managing for
Organizational Integrity,” 1994)
- › Linda Treviño, Gary Weaver and team
(“Managing Ethics and Legal Compliance: What
Works and What Hurts,” 1999; “Managing Ethics
in Business Organizations,” 2003)

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Values-Based Approach: Motivating Compliance via Positive Culture

- > Culture = Engaging Employee Values so that Employees *Identify Positively with the Organization* and Behave Accordingly
- > “Your values are what you do when you think no one is looking”
 - > When employee embraces Company values, compliance is *voluntary* and doesn’t depend on monitoring, detection and fear of punishment
- > Two Large-Scale Studies of Rule Adherence in the workplace:
 - > Value-based factors (legitimacy and value congruence) explained 81-87% of variance in compliance behaviors
 - > Fear of Punishment and Hope for Reward explained 13-19%

Source: Tyler, Deinhart, & Thomas, “The Ethical Commitment to Compliance: Building Value-Based Cultures”, California Mgmt. Review, Vol. 50, No. 2 (2008), 31.

Comparative Effectiveness of Values-Based Programs, Compliance-Based Programs, and Cultural Factors

- > “**What Works and What Hurts**”: Large-Scale study of 7 Compliance Outcomes:
 - > Reducing unethical conduct
 - > Reporting misconduct
 - > Increasing awareness of ethical issues
 - > Increasing advice-seeking on ethical issues
 - > Increasing employee commitment to employer
 - > Comfort delivering bad news
 - > Better ethical decision-making
- > Measured effect of values-oriented compliance programs, compliance (deterrence) based programs, and ethical culture factors

Source: Treviño, Weaver, Gibson and Toffler, “Managing Ethics and Legal Compliance: What Works and What Hurts”, Cal. Mgmt. Rev., Vol. 41, NO. 2, 131 (1999)

Comparative Effectiveness of Values-Based Programs, Compliance-Based Programs, and Cultural Factors

- > Values-Based Programs positively influence all 7 outcomes, and are more effective than Compliance-Based Programs on all 7
- > Compliance-Based Programs also improved the 7 outcomes
- > Cultural Factors are more important and influential than compliance program elements or orientation:
 - > Ethical leadership
 - > Fair treatment of employees
 - > Rewarding ethical behavior
 - > Open discussion of ethical issues

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Source: Treviño, Weaver, Gibson and Toffler, "Managing Ethics and Legal Compliance: What Works and What Hurts, Cal. Mgmt. Rev., Vol. 41, NO. 2, 131 (1999)

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Values-Based Approach -- Legitimacy and Culture

- > What Drives Voluntary Adherence to Rules (Tyler)?
 - > Company is perceived as a *legitimate* source of authority: employee believes its rules ought to be followed
 - > Company's values and policies are perceived as congruent with employee's moral values
 - > These factors are more influential than likelihood of detection or punishment
- > So, how can we promote these perceptions?
 - > "When managers say 'ethics,' employees hear 'fairness'."

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Sources: Tyler, Deinhart, & Thomas; Treviño, Weaver, Gibson & Toffler

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Values-Based Approach -- Legitimacy and Culture

- > Fairness Perceptions and Ethics Outcomes (Treviño and Weaver)
 - > Measured effects of employee perceptions of company's overall fairness towards employees
 - > Fairness strongly correlated with **less** observed unethical conduct and with **more** reporting of infractions
- > Ethics program follow-through on reports and infractions also strongly predictive of both incidence of misconduct and reporting
 - > But the higher your fairness score, the less ethics program follow-through matters
 - > If you're perceived as fair, employees trust that you do the right thing whether they hear about it or not

Source: Treviño and Weaver, "Employees' Fairness Perceptions and Ethics-Related Outcomes in Organizations," chapter in Managing Ethics in Business Organizations (2003)

Values-Based Approach -- Legitimacy and Culture

- > Leading criteria for legitimacy of authority (Tyler):
 - > Procedural fairness in decision-making
 - > Quality of interpersonal treatment of employee
 - > Trust of supervisors and management
 - > "Tone in the middle" as well as at the top
 - > What you do trumps what you say
- > These factors exert more influence than:
 - > Fairness of actual decision outcomes
 - > Whether outcomes are favorable to employee
 - > Rewards of employment: salary and incentives
 - > Risk of punishment

Source: Tyler, Deinhart, & Thomas

Values-Based Approach-- Legitimacy and Culture

- > What is Procedural Fairness?
 - > Opportunity for input from affected persons
 - > Understandable, articulated rules and processes
 - > Consistency over time and across similar cases
 - > Objectivity as opposed to ad hominem and ad hoc
 - > **Same rules for everybody**
 - > Communicate reasons for decisions

Values-Based Approach-- Legitimacy and Culture

- > What Makes for Quality Interpersonal Treatment?
 - > Respect employees' rights: *necessary but not sufficient*
 - > Courtesy and dignity – respect the person
 - > Employee feels trusted
 - > Listen
 - > Communicate reasons for decisions
- > Trust: Managers at all levels must earn employees' trust
 - > Actions speak louder than words (or Codes of Conduct)
 - > Treatment of employees is primary
 - > Interactions with third parties are noticed too

Consistency is Crucial

"It takes many good deeds to build a good reputation, and only one bad one to lose it"

-Benjamin Franklin

Does the Company Measure up to Employees' Values? Corporate Body Language

- > Guaranteed ways to sabotage your values message:
 - > Unscrupulous or opportunistic dealings with suppliers, customers, investors or the public
 - > Cut corners on obligations
 - > Differences in public and private statements – hypocrisy
 - > Different rules for top performers
- > These negatives are all very memorable and strongly influence employee perceptions

Danger, Will Robinson!



Group Dynamics, Commitment and Framing

- > People use groups to support and nourish their identities, and favorable self-concepts
 - > **Identification with the group promotes commitment and cooperation**
- > Fair and respectful treatment tells employees that they are important and valued, encourages identification, commitment, and cooperation with the group
- > Pride in the group also encourages identification
- > Social/Group norms can govern behavior more effectively than market norms
- > Social vs. market framing: People will do things for free, for social reasons, that they won't do for money; and social sanctions can trump economic ones
- > The power of social PLUS ethical framing: "Around here, we do what's right."

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Sources: Tyler and Blader, "The Group Engagement Model: Procedural Justice, Social Identity and Cooperative Behavior, Personality and Social Psychology Review, 7: 349 (2003); Ariely, "The Cost of Social Norms," chapter in Predictably Irrational (2008).

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Promoting Employee Commitment

- > Positive: Employee commitment to the employer strongly linked to:
 - > Management's actions show character and integrity
 - > Management welcomes those seeking advice about reporting policy violations
 - > Training on guidelines for acceptable behavior
 - > **9 Ethical Culture measures** in the What Works/What Hurts study
- > Negative:
 - > Culture: The less ethical the work environment, the less likely employees will go above and beyond job requirements or use extra effort
 - > Program Focus:
 - > The more prominent sanctions and incentives are, the more likely they interfere with ("crowd out") employees' intrinsic motivations and commitment
 - > Focus on unquestioning obedience to authority undermines commitment

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Sources: McDowell, "The Hidden Bonus in 'Doing the Right Thing,' Directors' Monthly, Sept. 2006, at 13 (Deloitte Consulting research); Treviño, Weaver, Gibson and Toffler; Frey, Not Just for the Money (1997); accord, Ethics Resource Center 2009 National Business Ethics Survey Supp. Research Brief, "Ethics and Employee Engagement."

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Committed Employees Boost Compliance

- › Benefits of Committed Workforce
 - › Voluntary rule adherence
 - › Less need for surveillance/monitoring
 - › More likely to report suspected violations or other bad news, rather than turn a blind eye
 - › Less accommodating environment for rule-breakers – more “eyes on the street”
 - › Significant increase in voluntary actions to benefit the organization
 - › Psychopaths less likely to climb the ladder of success high enough to do catastrophic damage

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Sources: Tyler, Dienhart, and Thomas; Ethics Resource Center, 2009 National Business Ethics Survey, Supplemental Research Brief on Ethics and Employee Engagement

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Culture and Reporting of Misconduct

- › 34% of fraud discovery comes from tips; employees furnish 64% of all tips and another 18% are “anonymous”
- › **What Works/What Hurts:** Each of 11 ethical culture measures was a better predictor of increased reporting than were program orientation or formal program characteristics
 - › Cultural factors had an even stronger relationship to perception that “it’s OK to deliver bad news”
- › **ERC Fellows:** Increased reporting significantly correlated with each of ethical leadership, strong ethical environment, and strong organizational support for the employee
- › **NBES 2009:** In strong ethical cultures, reporting of observed misconduct was 26% higher than in weak ethical cultures

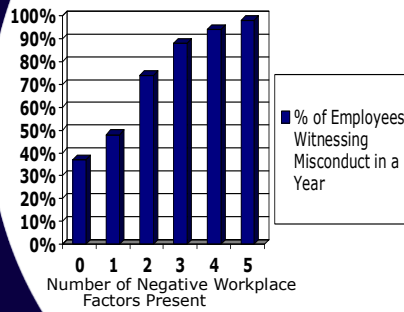
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Sources: 2006 AFCE Report to the Nation on Occupational Fraud & Abuse; Treviño, Weaver, Gibson and Toffler; Shapiro, Treviño, De Celles, ERC Fellows Reporting Project, 2006; Ethics Resource Center 2009 National Business Ethics Survey Supp. Research Brief, “The Importance of Ethical Culture: Increasing Trust and Driving Down Risks”

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Culture and Incidence of Misconduct



Sources: Treviño, Weaver, Gibson and Toffler; Ethics Research Center, 2007 Business Ethics Survey

- > 9 positive ethical culture factors each significantly correlated with decreased observation of rule-breaking (What Works/What Hurts)
- > Ethics Resource Center identified 5 “Negative Work Environment” factors:
 - > Success is rewarded regardless whether achieved through questionable means
 - > Mistrust of top management’s promises and commitments
 - > Mistrust of supervisors’ promises and commitments
 - > Dissatisfaction with information from top management
 - > Dissatisfaction with information from supervisors
- > Strong correlation between presence of these negative factors and workplace misconduct

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Wow! Is it really that simple? (Of course not.)

- > Fair and respectful treatment, ethical management and supervisors, values-based messaging, open door policy, etc. go a long way for “good people” and many who are more susceptible to temptation
- BUT:**
- > Not everyone is alike, and some temptations are stronger than others
 - > Around 5% of every population operates without a conscience (psychopathy, antisocial personality disorder) and do not take values, group membership, or loyalty into account in their decisionmaking
 - > Monitoring, detection and discipline are essential
 - > Sentencing Guidelines and other regulatory incentive programs require robust command-and-control elements
 - > Command-and-Control elements, if not the dominant features of the compliance program, reinforce the culture message and improve results

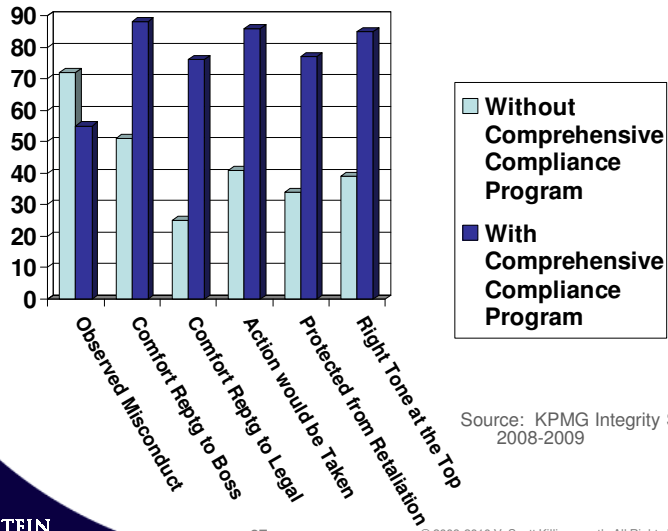
Source: Lupfer and Kambil, “Managing the Bad Apples and Protecting the Barrel, Deloitte Idea Labs monograph (2009)

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Selected Metrics with and without a Comprehensive Ethics and Compliance Program



Source: KPMG Integrity Survey 2008-2009

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Complementary Effects of Culture and of Compliance Programs

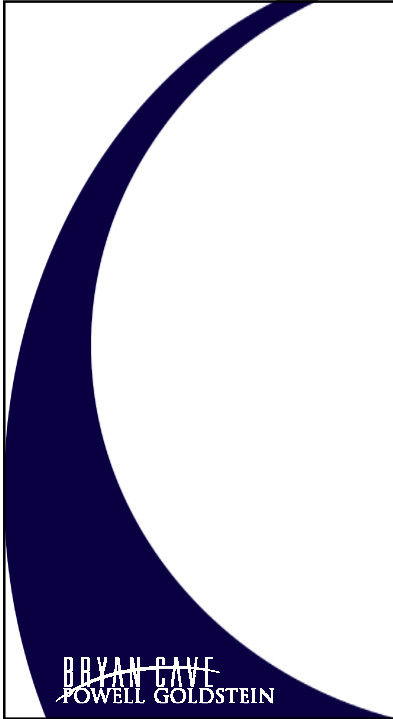
- > Culture strongly influences *incidence* of misconduct:
 - > Employees of companies with weak ethical culture are nearly 3 times as likely to observe misconduct as employees of companies with strong ethical cultures
 - > Values-based factors explain >80% of employee compliance; fear of punishment or desire for reward explains <20%
- > Compliance Programs further boost *reporting* of misconduct:
 - > The presence of a comprehensive compliance program can nearly *double* reporting, if ethical culture is otherwise strong

Sources: Ethics Research Center, 2007 Business Ethics Survey; Tyler, Deinhart, and Thomas

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