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CONFERENCE PROCEEDINGS

# Corporate Culture and Ethical Leadership Under the Federal Sentencing Guidelines

## What Should Boards, Management, and Policymakers Do Now?

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A RAND LAW, BUSINESS, AND REGULATION CENTER

This report was funded with pooled resources from the RAND Center for Corporate Ethics and Governance, a research center within RAND Law, Business, and Regulation, a division of the RAND Corporation.

**Library of Congress Cataloging-in-Publication Data** is available for this publication

ISBN: 978-08330-7695-3



Published 2012 by the RAND Corporation
1776 Main Street, P.O. Box 2138, Santa Monica, CA 90407-2138
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# SUMMARY

In 1991, the U.S. Sentencing Commission (USSC) expanded the Federal Sentencing Guidelines to provide a consistent set of penalties to deter and justly punish organizational crime. The sentencing structure was also intended to encourage positive behavior—specifically, the establishment of effective compliance programs within firms. In principle, such programs offer a primary internal line of defense for corporations in detecting and preventing corporate and workplace misconduct that might otherwise lead to criminal prosecution.

In the two decades since 1991, there have been multiple amendments to the Federal Sentencing Guidelines for Organizations (FSGO). One of the most notable was a 2004 addition that set out a corporate obligation "to promote an organizational culture that encourages ethical behavior and compliance with law." Ultimately, one of the chief aims of the FSGO has been to encourage basic cultural change within organizations, with the goal of reducing both criminal and ethical risk.

This focus on organizational culture as an antecedent to misbehavior highlights a subtle but important thread in compliance and ethics (C&E) practice. A narrow view of compliance within corporations can too easily focus on simply parsing and following the law, including implementing controls to ensure that relevant laws are understood and obeyed. Critics have described this as a "check-the-box" approach, cautioning that it does not address the fundamental drivers of organizational behavior and that it can contribute to a false sense of security. By contrast, an emphasis on corporate culture goes well beyond the technical exercise of interpreting and following legal rules. The aim is to foster a fundamental understanding of the collective behavior and values of the people who make up the corporation and to ensure that they are aligned with the corporation's ideals of honesty and fair dealing. In this way, the corporate culture becomes broadly preventative of misconduct and violations of the law.

For chief ethics and compliance officers (CECOs), corporate board members, and C-suite executives, the emphasis on culture in the FSGO raises a set of challenging operational questions. For example, how can management intervene to modify organizational culture, and what are the various roles and responsibilities of senior executives and directors in this regard? The questions differ somewhat for policymakers: When the guidelines identify the pursuit of an ethical culture as one criterion for an effective C&E program, what exactly does that mean? And how far can the USSC and policymakers usefully go in using law enforcement and regulation to promote corporate intangibles, such as culture and ethics in the workplace?

It was in this context that RAND convened the May 16, 2012, symposium "Corporate Culture and Ethical Leadership Under the Federal Sentencing Guidelines: What Should Boards, Management, and Policymakers Do Now?" The objective was to stimulate a broad conversation about organizational culture following the 20th anniversary of the FSGO, as well as to explore the business and policy ramifications of efforts to build better ethical cultures in corporations. The symposium also built on previous RAND-hosted roundtable meetings that focused on the

roles of corporate boards, CECOs, and internal whistleblower mechanisms in helping firms address C&E challenges. The May 2012 symposium brought together a group of two dozen senior thought leaders from the ranks of public company directors and executives, CECOs, and stakeholders from the government, academic, and nonprofit sectors. Discussions focused on practical steps that can be taken to strengthen corporate ethical culture and the unique roles of directors, CECOs, top executives, and government policy in pursuing that end.

Several major themes emerged from these discussions. First, the FSGO focus on corporate ethical culture reflects a policy goal to cultivate shared values, behavior, and collective responsibility within organizations rather than simply encouraging compliance with the law as a purely technical and procedural exercise. Second, there are different ways to interpret "corporate ethical culture," and firms must overcome or sidestep problems in moral philosophy that might otherwise paralyze practical C&E efforts. For example, one way to make a firm's ethical culture more concrete is by focusing on employee behaviors and other factors that tend to interfere with employee perceptions of commitment, integrity, and transparency in the corporate workplace. Overcoming these barriers offers an avenue for a firm to align its values with workplace behaviors and to energize protective behaviors on the part of both employees and management. A third broad symposium theme highlighted the various practical steps that C&E programs, senior executives, corporate boards, and policymakers can take to contribute to stronger ethical cultures within corporations. Prominent among these is the simple recognition that ethical culture is, in fact, an important priority, that a strong ethical culture is desirable both intrinsically and for its value in limiting reputational risk and cultivating shareholder trust, and that efforts to build a stronger ethical culture may be closely linked to both effective C&E programs and stronger and more empowered CECOs.

**INVITED REMARKS FROM FIVE PANELISTS**

The initial session of the symposium was dedicated to remarks from five panelists who represented expert viewpoints on compliance law, corporate ethical culture consulting, and the C&E function within firms. Their remarks were based on invited white papers distributed in advance of the symposium. The white papers, listed here, are reproduced in Appendix C of these proceedings.

- Jeffrey M. Kaplan, a partner at the law firm Kaplan & Walker LLP, "Semi-Tough: A Short History of Compliance and Ethics Program Law"
- David Gebler, president of Skout Group, LLC, a corporate consultancy, "The Start of the Slippery Slope: Why Leaders Must Manage Culture to Create a Sustainable Ethics and Compliance Program"
- Patrick Gnazzo, principal of Better Business Practices LLC, and Keith Darcy, executive director of the Ethics and Compliance Officer Association, "Preventing Corporate Crime: What Boards and Management Should Do Next to Support Ethical Culture and Stronger C&E Programs"

- Joseph Murphy, director of public policy at the Society for Corporate Compliance and Ethics, "Over 20 Years Since the Federal Sentencing Guidelines: What Government Can Do Next to Support Effective Compliance and Ethics Programs."

**HOW MUCH PROGRESS HAVE COMPANIES MADE IN MEETING THE CULTURAL GOALS SET OUT BY THE FEDERAL SENTENCING GUIDELINES FOR ORGANIZATIONS?**

The second session of the symposium featured a moderated discussion addressing a series of basic questions about the nature and extent of corporate progress in fulfilling the ethical culture mandates in the FSGO. The session opened with some observations about the importance of ethical culture as an adjunct to a corporation's formal compliance efforts. Participants noted that there is no simple set of controls that can fully prevent rule-breaking in a large organization and that "culture" represents a shared commitment to good behavior that goes beyond the technical exercise of simply parsing and obeying the law. It was also observed that every employee in the corporation, "from the shipping clerk to the lead director," has a role to play in contributing to this kind of culture. One participant cited an example in which an executive secretary received an anonymous package of stolen trade secrets from a corporate competitor and immediately took it to the general counsel—without reading the contents or passing the package to her own supervisor. The participant stated that this was both the right thing to do and a decision that helped safeguard the company from potentially significant exposure during the subsequent outside investigation. It also reflected the influence of a strong culture and shared ethical commitment within that company. A question was then posed: How can corporate leaders go about cultivating these sorts of shared values and commitments within their own organizations?

Participants in the session expressed a range of opinions about the extent to which the FSGO had been successful in prompting real improvements in corporate cultures. Some argued that considerable progress had been made by companies in meeting specific compliance program standards under the FSGO and that this progress, together with the new focus on culture, has had a positive (though difficult to quantify) impact on the field. Others expressed more mixed views. One observed that high-profile corporate efforts to suppress and punish internal whistleblowers continue to abound despite the FSGO, adding that such actions run counter to efforts to develop stronger ethical cultures. Another participant suggested that many chief executive officers and boards continue to prioritize short-term performance, a move that often fails to accommodate initiatives to foster stronger cultures. In such cases, related structural problems in governance and performance incentives can undermine the impact of the FSGO. Still other participants observed that it is difficult even to analyze a specific corporation's "culture," and, consequently, the influence of the FSGO in contributing to more ethical environments is difficult to quantify. Several participants also noted that an indeterminate but significant number of firms have fallen short of implementing rigorous compliance programs based on FSGO standards. In turn, such firms are unlikely to have experienced much of an impact on their cultures as a result of the FSGO.

The symposium discussion generated several points of agreement among participants:

- Effective C&E programs and strong organizational cultures are deeply connected.
- In some important and practical ways, corporate ethical culture can be measured.
- Corporate boards have a central role to play in building stronger ethical cultures.
- Top executives also have a key role in building stronger ethical cultures.
- Culture is the "missing link" that drives employee behavior, including the decisions of internal whistleblowers to come forward or stay silent.

**WHAT ARE THE BARRIERS TO ACHIEVING STRONGER ETHICAL CULTURES AND MORE EFFECTIVE C&E PROGRAMS IN FIRMS, AND WHAT SHOULD BOARDS, MANAGEMENT, AND POLICYMAKERS DO NEXT?**

Participants in the final session of the symposium engaged in a more in-depth discussion on improving ethical culture and C&E efforts within firms, identifying tangible next steps to those ends. The session opened with some reflections on the high-profile breakdown of the ethical culture at WorldCom more than a decade ago, which ultimately led to the collapse of that company. Participants noted that the deficiencies at WorldCom did not stem from an isolated accounting problem or single rogue executive but, rather, a more entrenched set of shortcomings that involved multiple gatekeepers and executives who did not carry out their responsibilities. Other contributing factors included a lack of transparency and information-sharing between senior management and the board, the corrosive influence of excessive greed among some top executives, and a collective failure to carry out the company's fiduciary duty to shareholders. The problems at WorldCom were described as "cultural" (in the sense that they were deep and widespread), reflecting a lack of "tone at the top," and perverting controls and corporate governance mechanisms that, on paper, should have helped to prevent the breakdown. The discussion touched on the policy response to the company's collapse as well: The subsequent Sarbanes-Oxley (SOX) legislation included multiple provisions designed to address specific problems that were revealed by the scandals at WorldCom. Without commenting directly on the success of SOX, participants suggested that progress in addressing the deeper cultural challenges illustrated by WorldCom's failure would likely require a new and different type of commitment from boards and management.

Much of the discussion addressed how to facilitate this kind of cultural change within corporations and how to overcome existing corporate barriers. Some participants questioned how law and policy might be used to try to promote these ends and whether it would be appropriate to expand or refine the FSGO. Other strands of the discussion focused more on specific actions that boards and senior management could take to foster stronger cultures within their organizations. It was noted that a significant part of the challenge lies simply in convincing top executives and boards to *want* to advocate for stronger ethical cultures. Participants agreed that the ties between a deficient ethical culture and lapses in compliance, and between lapses in compliance and reputational risk, are an important part of the calculus in making the case for stronger C&E programs to executives and boards. Participants also observed that a central challenge involves overcoming the perception among executives, boards, and policymakers that ethical culture and behavior are either easy or prohibitively difficult, to cultivate within an organization. In the end, the discussion emphasized the need to identify some concrete steps to overcome both forms of inertia. One participant noted that corporate boards and executives too often believe that "tone at the top" is about talk rather than action and lack insight into specific interventions that might support better culture: "If you are not managing culture, then culture is managing you."

The session's discussion highlighted the following areas of agreement among participants:

- An independent, empowered CECO is a key ingredient in achieving a stronger ethical culture.
- Performance incentives offer a critical tool for driving ethical culture as a priority within organizations.
- Companies need to commit to periodic self-assessments of ethical culture as a part of their C&E programs.
- Policymakers should reward companies for implementing superior C&E programs and cultures while punishing deficiencies.
- Boards and executives need to grapple with the value proposition for a strong ethical culture.
- Firms need to overcome a legalistic, check-the-box view of compliance.