HEAD TO HEAD: A CONVERSATION ON BEHAVIORAL SCIENCE AND ETHICS

Head to Head: A conversation on behavioral science and ethics For anyone interested in improving the effectiveness of compliance & ethics (C&E) programs in organizations, this eBook is for you.

by JEFF KAPLAN *and* AZISH FILABI

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FORWARD

Companies are such fantastically complicated organisms, how could anyone hope to alter their inner workings in order to change the way they behave? Yet increasingly, this herculean task is being given to compliance and ethics (C&E) officers.

No longer can they just promulgate policies and procedures, measure the number of employees who received training, and then monitor a few key points in the workflow to document compliance with key regulations. Times have changed. In the wake of several series of scandals, from Enron through the Global Financial Crisis (GFC) and Volkswagen, regulators, researchers, and business leaders now recognize that compliance alone is not enough. An ethical culture is seen as necessary for companies, and executives can be held responsible for the failure to create and maintain such a culture.

This growing realization is why I, and a group of America's top researchers on behavioral ethics, created the non-profit research collaboration, Ethical Systems, launched in 2014. We saw a gigantic disconnect between the supply and demand for research on business ethics. Professors in business schools were conducting and publishing a great deal of research on the social and psychological factors that encouraged or discouraged ethical behavior in organizations, but the research was often divorced from the experience and needs of businesspeople. Businesses, on the other hand, and especially C&E officers, were facing increased pressures to measure and improve the ethical cultures of their organizations, and were doing so with little guidance from the academic community.

Ethical Systems is about building that bridge, and the eBook you are about to read is offered in that spirit.

Jeff Kaplan is an attorney with many years of experience helping companies develop comprehensive and effective C&E programs. Jeff long ago saw the power of behavioral science, and he provides behaviorally informed advice to his clients to improve outcomes. In 2011 he created an extraordinary blog to explain these connections at ConflictOfInterestBlog.com. Jeff also taught Professional Responsibility for more than a decade at NYU-Stern, making him a skilled teacher, explainer, and bridge builder. He was, naturally, one of the first people I invited to join Ethical Systems.

Azish Filabi is also an attorney but with a very different set of experiences. After two years in corporate law she joined the Federal Reserve Bank of NY, helping to run their internal C&E program while learning about the challenges the Fed faced in regulating financial institutions. In 2015, after eight years at the Fed—including the terrifying first years of the GFC, where she structured programs to address the crisis—Azish joined us as CEO of Ethical Systems. She has since mastered the behavioral science literature and led our organization skillfully in its many efforts to help companies benefit from that research. Jeff and Azish have now teamed up to share their accumulated insights on the nature of C&E programs, the challenges such programs face, and the opportunities for improvement. *Head to Head: A conversation on behavioral science and ethics* is a dialogue between them—it's a format that lets their separate areas of expertise emerge, and its conversational tone makes it easy and enjoyable to read.

This eBook is wise in its explorations of the complexities of C&E, and humble in its recognition that so much is still unknown –including the reliability of the research they cite. Companies are indeed fantastically complicated organisms, and human beings are imperfect reasoners, easily biased by social forces, self-interest, and group interest. If we're going to find effective ways to help companies improve their cultures, it's going to take a concerted effort, over many years, by many stakeholders.

Yet, we are making progress. This eBook is an invitation to join us on the journey.

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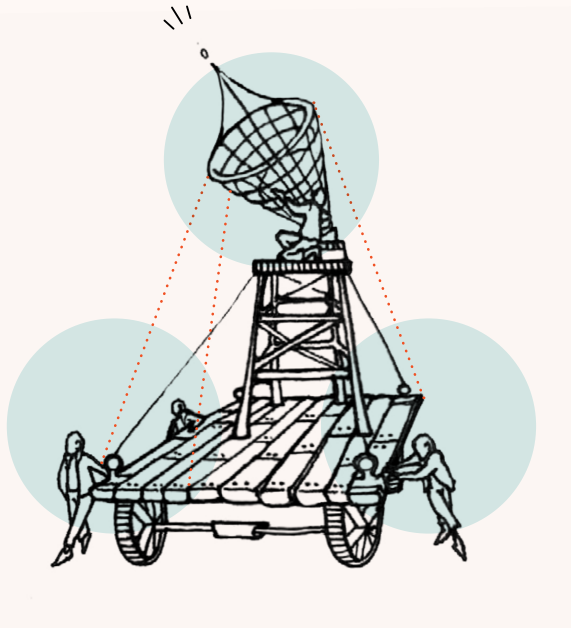
PREFACE—

AND AN INVITATION TO JOIN US



For anyone interested in improving the effectiveness of compliance & ethics (C&E) programs in organizations, this eBook is for you. The essential mission of effective C&E programs—to create policies, procedures and systems to prevent violations of law and ethics—is best served when C&E practitioners broaden their focus to behavior and culture in organizations, enhancing their approach to risk management. This eBook helps practitioners work towards that goal by integrating social and behavioral science research with the core elements of effective compliance programs.

The eBook is structured as a dialogue between Jeff Kaplan, Partner at Kaplan & Walker LLP, who has practiced and published in the C&E field since its inception in 1991, and Azish Filabi, formerly a lawyer and Ethics Officer at the NY Fed and now CEO of Ethical Systems, a non-profit research collaboration of business ethics professors and behavioral science researchers who have come together to use social science research to help improve business ethics.

A note on social science research: the scientific process involves the evolution of knowledge over time through the development of hypotheses, collection, analysis, and interpretation of data, peer review, publication, and on-going evaluation. Ideally, scientific conclusions are not only peer reviewed, but also replicable by peers. Replicability helps to establish the veracity of findings over time. Many of the research studies we reference throughout this eBook have not yet gone through extensive replication attempts. Thus, as you review the research, please keep in mind that they represent data points in a growing myriad of complex studies about human behavior and ethical systems design, and not prescriptive suppositions about how people are going to behave in those circumstances in the future.

We have called this *Part One* because we know there is much more to say about this topic. And because we want your help in finishing this project…or, at least, getting to the next level.

Whether you are a compliance and ethics officer or other type of practitioner, or are a researcher, we hope you will share your ideas and experiences in making compliance and ethics programs more behaviorally oriented – in the sense that we describe in this first volume. If we use your thoughts in *Part Two* we will, of course, give you credit in that volume (unless you would rather we not do so).

WHAT ARE COMPLIANCE-AND-ETHICS PROGRAMS?

JEFF KAPLAN

AZISH FILABI

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This eBook is about opportunities for promoting business ethics that lie at the intersection between corporate compliance and ethics ("C&E") programs on the one hand and behavioral ethics research on the other. Jeff, please start us off with a description of what is meant by C&E programs.

Thanks, Azish. Broadly speaking, C&E programs are a combination of policies, procedures and practices within an organization intended to promote law abiding and ethical behavior by the organization.

Can you elaborate on what you mean when you state "by the organization"?

"Organizations" as such are legal fictions and can act only through the actions of individuals, of course. This includes employees, directors and officers or third parties—such as independent agents. C&E programs help organizations prevent and detect wrongdoing by such individuals. It is in the "organization's," best interest to preserve the long-term value of the enterprise, while individuals who work for the organization may come and go.

You use the word "organizations," but often the discussion of C&E programs seems limited to for-profit corporations. Do other types of entities need C&E programs?

Yes—and many have them, but many more should and don't have any or don't have enough. This includes charities, universities and governmental bodies. Of course, the risks that such organizations face may be different, and in the aggregate less worrisome, than what traditional business organizations face, but entities of all kinds need to consider their C&E program needs.

We'll get into the detail in a moment but before we do please tell us a little more about what makes up a C&E program, particularly the types of policies, procedures and practices that constitute a comprehensive program.

Sure—and at the outset I should stress that there are many ways to organize that description. My approach is just one possibility.

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1 First, C&E programs need to be based on an understanding of risk. While there are some common risks all organizations face, there are many differences among types of risk.

2 Second, there must be assigned responsibilities for overseeing and managing the program. By overseeing I mean the C&E role of directors and other members of an organization's governing authority. Managing includes the work of C&E officers, among others, such as individuals whose principal duties lie elsewhere (e.g., members of a company's law, finance, audit, human resources, procurement and other departments).

3 Third, a program must be based on standards of conduct. Standards—which can be legal and/or ethical in nature—can include codes of conduct, values statements, policies, procedures and guidance documents.

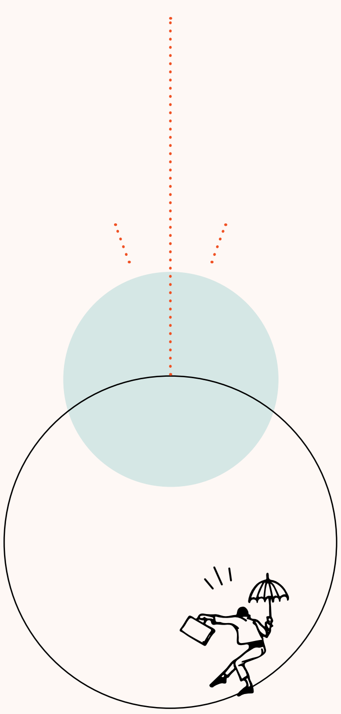
4 Fourth, those standards need to be communicated to employees and others for whom an organization may be responsible. Training is part of this picture, but so are other types of communication. As we'll discuss later, standards are also communicated through leadership behaviors and priorities.

5 Fifth, the program must offer ways for employees and others to seek guidance and report suspected violations. Helplines are the most prominent means of doing this, but organizations should provide other avenues for reporting as well.

6 Sixth, the C&E standards must be enforced through discipline for violations, and they should be promoted through the use of incentives. The realm of behavioral ethics—our focus in this dialogue—has a lot to say about incentives.

Finally, the organization must check to make sure that these various pieces are functioning as intended. This can be done in a variety of ways: C&E-related audits, monitoring, assessments, surveys, focus groups, exit interviews, among other things. It must also respond to any wrongdoing by identifying and fixing any flaws in the system. 7

So, those seven steps are to my mind the most important ones—although there are others, such as background checks.



A PAGE OF C&E HISTORY

JEFF KAPLAN **AZISH FILABI**

AF We'll indeed go deeper into the specifics of C&E programs, but before we do it may be helpful to spend a moment on the history of the field. Where do these programs come from, and what does that teach us about where they may be headed?

JK Oliver Wendell Holmes once said that a page of history can be worth a volume of logic, and that indeed may be the case here. Trying to reduce that history to less than a page, I would cite the following major steps:

1960

In the 1960s various large electrical contractors were prosecuted for anti-trust violations. This led to the creation of antitrust training and other compliance measures.

1970

In the 1970s a series of bribery scandals involving US companies led to the passage of the Foreign Corrupt Bribery Act—which were, in effect, certain compliance program requirements.

1980

In the 1980s procurement scandals in the defense industry led to C&E expectations involving government contracts.

All of this—which could be considered C&E "pre-history"—was important, but also limited to certain types of companies or certain types of wrongdoing.

1990

The modern era in C&E begins in 1991, with the advent of the Federal Sentencing Guidelines for Organizations ("FSGO") which strongly incented organizations to develop C&E programs by providing for large fines on business organizations convicted of federal criminal offenses but also offering leniency for companies with "effective" C&E programs. The FSGO provided official "guidance" on what the government considers effective.

2000

In 2002, the Sarbanes-Oxley (SOX) Act—which has various C&E-related requirements for public companies, such as encouraging internal reports of suspected wrongdoing—was enacted. In 2004, the FSGO's definition of an effective C&E program was expanded in many important ways (which we'll discuss in more detail later). In 2011, a working group of the Organization of Economic Cooperation and Development (OECD) issued an anti-corruption guidance document with strong C&E program expectations. This—along with other developments—has led what could be called the FSGO approach to promoting ethics and compliance, to be adopted around the world.

JK There's much more that can be said about this history, of course. But the main points are that a) the field is still

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JK pretty new—which offers both challenges and opportunities; and b) much of what has driven progress in the field is a reaction to wrongdoing and is law based—which also offers challenges and opportunities.

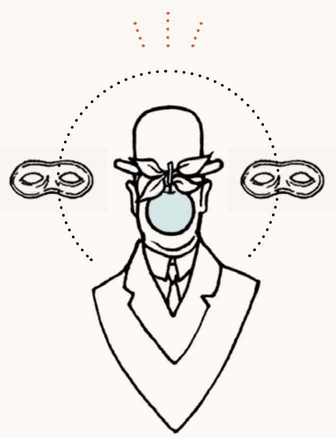
AF

THE ROLE OF CULTURE

When the FSGO were amended in 2004, the notion of culture was added to the definition of an effective program—specifically, in addition to having policies to prevent and detect violations of law, organizations are expected to "otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law." Please describe what is meant by culture in this and other similar contexts.

Organizational culture is one of the strongest drivers of behavior in companies, so it's no surprise that this concept is in the FSGO. It is a thread that weaves through all aspects of a firm's formal and informal systems, including decision-making, allocation of resources, rewards and punishment, compensation, innovation, and customer orientation. Even in cases where a company has not studied or tried to define its culture, the existing norms of behavior silently govern daily judgments and actions. The definition that I generally use is based on Linda Trevino and Katherine Nelson's book, *Managing Business Ethics*:

"organizational culture expresses shared assumptions, values and beliefs and is manifested in many ways, including formal rules and myths, norms of daily behavior, physical settings, modes of dress, special language, myths, rituals, heroes, and stories."[1]



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JK Culture does indeed seem all encompassing within an organization. How do formal and informal culture systems tend to work together?

AF

As Trevino and Nelson emphasize, the alignment of the formal and informal systems is one of the most important aspects of culture within an organization. For example, a Code of Conduct is a formal element of a company's culture, often seen as an expression of the values by which the company and its employees shall work and live. How the employees abide by those values and comply with the Code is the informal system at play.

A misaligned culture, for example, is one where the employees roll their eyes when they see another message from their CEO about the importance the company's values because most people believe that the company doesn't walk the talk. So it becomes important for a company to consider whether the formal and informal systems align because the formal program elements could inadvertently breed cynicism and reduce the legitimacy of the C&E program.

Also, companies don't exist in a vacuum—they are impacted by the culture of their industry, and the local and national culture of where they are located. The subsidiary of a U.S. company in Shanghai, for example, may be very different from its offices in Tokyo and it's headquarters in Missouri.

Every setting presents differing norms of doing business in that country or city.

For example, the employees of a company based in a country that is low (highly corrupt) on the Transparency International Corruption Perceptions Index[2] will face different behavioral and cultural challenges for compliance with anti-bribery rules than one that operates in a country where regulators have a more proactive anti-corruption enforcement regime.

This is not to say that all companies operating in low-enforcement environments will necessary break local laws—a company's culture can be so strong that their internal policies, procedures and informal norms of behavior will trump the national culture and environment in which employees are operating.[3] This is why it's important to conduct culture assessments, so that managers can tease out these nuances.

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JK Given how important culture is to the effectiveness of C&E programs, how are regulators thinking about culture these days?

AF

In recent years, regulators in the U.S. and abroad have begun to emphasize the role of culture in managing ethics and compliance programs.

The financial services industry regulators in particular have been urging companies to assess the role that their culture plays in the day-to-day management and decisions made.[4] The Office of the Comptroller of the Currency (OCC), for example, has integrated duties relating to oversight of corporate culture by the C-Suite into its *Comptroller's Handbook* on Corporate and Risk Governance, which serves as the guiding document for examiners overseeing regulated entities.[5] Also, since 2014, the NY Fed has held an annual conference with key leaders, regulators and advisors to the financial services industry to collectively tackle ethical culture reform in that industry.[6] While they are not supervising for culture, the conference and other public statements have shifted the dialogue within this industry towards an emphasis on how culture is integral to managing a company with a long-term perspective.

Beyond the financial services industry, the Securities and Exchange Commission (SEC) has addressed the need for business ethics more broadly as a cornerstone of the federal securities statutes.[7] Further, in 2012 DOJ and SEC collaborated on a publication, *A Resource Guide to the Foreign Corrupt Practices Act*,[8] which states:

"*…compliance begins with the board of directors and senior executives setting the proper tone for the rest of the company…. Thus DOJ and SEC consider the commitment of corporate leaders to a 'culture of compliance' and look to see if this high-level commitment is also reinforced and implemented by middle managers and all employees at all levels of a business…A strong ethical culture directly supports a strong compliance program…*"

For their part, federal prosecutors have for many years (since the 2004 amendments to the FSGO) considered as a mitigating factor whether organizations have a "culture that encourages ethical conduct."

My takeaway from this activity and efforts by regulators to promote ethical culture is the general recognition that the existing tools of law enforcement in the regulatory toolkit are not sufficient for the complex challenge of dealing with human behavior.

If an organization's culture is rotten, no matter how many regulatory enforcement actions are imposed against a company, compliance will always be fighting against the tide. This is where the social and behavioral science research can be helpful.

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JK This emphasis on culture presents a challenge to companies—given how broad and all-encompassing a topic culture is, how can companies better grasp and manage their internal cultures? How would they know whether they have "an organizational culture that encourages ethical conduct" per the FSGO?

AF It is a challenge, but not an insurmountable one. Many companies already recognize the importance of culture and regularly conduct employee engagement or compliance surveys. These approaches, however, are often not digging deep enough around behavior and ethics. Employee engagement, for example, is an outcome of culture not necessarily a driver of it. Given the emphasis by regulators on ethical culture, more companies are focusing on measurements specific to whether they have a "culture of ethics." This is where social scientists can add much value.

Academics have been developing measures of ethical culture for a few decades and validated tools already exist in peer-reviewed journals. The *Ethical Systems* website provides additional details on these tools and how companies can begin to measure their culture.

There is no one definition of an ethical culture. It will inevitably vary across companies and is an interplay of the formal and informal systems we talked about earlier.

What companies should begin with is studying the factors that are important components of a culture of ethics, which, according to the academic literature, includes not only tone at the top, such as ethical leadership, but also leadership throughout the organization by empathetic supervisors who are not abusive in their day-to-day communications and management style.

Moreover, organizational justice and whether the organization treats its employees fairly tend to be high markers of ethical culture. Other culture components companies should promote are trust and integrating ethics into personnel-related decision-making, including hiring, compensating, promoting and firing of employees. And finally, having a "speak up culture" is vital, as it is often the front line of defense for a company that wants to make a sincere effort to manage ethics.

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JK Azish, so far we've focused on one of the two main parts of our dialogue: C&E programs, and how to integrate ethical culture as a program element. Can you introduce the other—behavioral ethics? What is meant by it, where does it come from?

AF Behavioral ethics is the academic study of ethical behavior, using the tools and techniques of the social sciences—that is, psychology, sociology, and behavioral economics, among others. Behavioral business ethics challenges the assumption that business scandals are invariably the result of companies having hired "bad" people who intended to commit fraud or other wrongdoing within their respective organizations. Behavioral ethicists study the situations, mindsets and influences that impact everyday decisions and actions, as well as the psychological processes that are likely to encourage unethical behaviors.

This behavioralist approach began roughly in the mid-1990s and has been gaining steam since the 2008 financial crisis as instances of corruption and fraud continue to erode trust in business and institutions.

I think the best way to begin to understand behavioral ethics is to read about three seminal social psychology studies from the 1970s:

1. the Stanford prison experiment by Philip Zimbardo
2. the Stanley Milgram experiment
3. the Princeton Good Samaritan Study

I won't go into the details, but the takeaway from that Prison experiment[9] was that students who were asked to role-play prison guards and prisoners as part of the study were so influenced by the circumstances of their "role" that the guards engaged in abusive and harassing behaviors—so much so that Zimbardo had to abort the experiment because it became too damaging to participants.

The Milgram experiment[10] demonstrated the power of obedience to authority by creating circumstances in which most participants would blindly follow orders, even to the extent of harming another person.

The Good Samaritan Study was an experiment conducted among students at the Princeton Theological Seminary wherein participants completed a questionnaire and then were told to "hurry," to varying degrees (slow, medium, fast), to another building where they were to give a talk on the parable of the Good Samaritan. On their way to the other building, there was a person (an actor) hunched over in plain sight in need of help.

The results showed that even among these Seminary students, only one in 10 of those who were in a rush (the "fast/hurry" situation) actually stopped to help the person in need, compared to nearly two-thirds of those who were in no hurry (in the "slow hurry" situation) who did stop to help. This goes to show that even "good" people are not immune from the pressures of life, and can become less benevolent under time constraints.

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JK That's powerful stuff. How are researchers applying these insights to businesses?

AF Behavioral ethicists continue to conduct experiments to better understand individual decision-making when it comes to ethics, and what influences their decisions. The research covers a broad range of topics from conflicts of interest, ethical leadership, and employee voice (and how to encourage speaking up about misconduct).

On a more macro scale, these researchers are contributing to the C&E community by helping define what it means to have an ethical culture, and how C&E programs can contribute to the development of such cultures at organizations—as well as how to integrate behavioral considerations into the various C&E program components discussed above (such as risk assessment and training). This eBook is a contribution towards helping readers put these behavioral issues in context.

BEHAVIORAL ETHICS AND COMPLIANCE—AN OVERVIEW

JEFF KAPLAN

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AF

Jeff, given your knowledge of behavioral science, what do you see as the potential connections between C&E programs and behavioral ethics?

JK

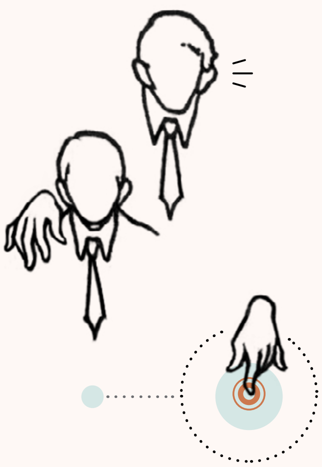
They should be viewed on two levels. The first might be called specific behavioral C&E lessons, meaning enhancements to the various C&E program elements listed earlier using ideas from behavioral ethics. This is what most of the remainder of our dialogue is about but it is important to set expectations realistically here, which Prof. Donald Langevoort does in an article published last year on this topic[11]:

"To be clear, [behavioral compliance] is not some new or different brand of compliance design, but rather an added perspective. Just as compliance requires good economics skills, it requires psychological savvy as well, to help predict how incentives and compliance messages will be processed, construed and acted upon in the field… The behavioral approach to compliance offers some concrete interventions to consider, but is mainly about doing conventional things (communication, surveillance, forensics) better."

Scott Killingsworth has made a similar point, in speaking about the behavioral ethics driven practice of "nudges":

"Nudges are a nice addition to the compliance toolbox, but it's a big toolbox for good reason. No single tool does the whole job. Every tool—policies, controls, monitoring, training, audits, deterrence—has its strengths and all have their limitations."

I think they are both correct. But, there is more to the behavioral C&E story than doing conventional things better. There is a second level.



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So, the second level is general behavioral C&E lessons?

JK

Yes, and this is what makes behavioral C&E more than the sum of its parts. To my mind the challenge to having effective C&E programs in organizations is more about the "will" than the "way." The different program elements—e.g., risk assessment, training, auditing—generally do not require a great deal of highly technical know-how to be done in an effective manner. Rather, they are largely a matter of common managerial sense.

What is lacking in many business organizations is a notion that C&E is truly necessary. After all, if we are as ethical as we think, then it would be just a matter of finding the right punishment against the wrongdoers and the power of logical thinking will do the rest. Behavioral ethics shows us why that assumption is ill-founded.

Indeed, going back to the page of history we discussed, before the Sentencing Commission chose its current C&E-program-based approach to preventing corporate crime it considered applying an "Optimal Penalties" strategy.

The Commission's ultimate rejection of that approach—which was premised on a hyper-rational ("Chicago School") view of how business crime occurs—in favor of one that promotes strong C&E programs can be seen as an early (albeit presumably intuitive) official endorsement of the behavioral science based view of human nature.

Looked at in this way, all C&E professionals can be seen as practicing behavioral ethics, just as Moliere's Bourgeois Gentleman came to see that he had been speaking in prose all along.

JEFF KAPLAN

JK Scott Killingsworth has made a similar point:

"Business leaders need to know that compliance is not all about rooting out a few inherently 'bad apples' but is more about creating an environment where good apples are less likely to rot, and will have an opportunity to thrive. The growing body of solid science in this field provides the kind of compelling, objective evidence that can persuade boards and executives to support ethical culture efforts based on principles more ambitious than 'hire good people.' That support—both in terms of leaders' commitment of their own time and energy and in terms of institutional resources—is a prerequisite for any meaningful program of culture change."[12]

AF

RISK ASSESSMENT

JEFF KAPLAN

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AF: Let's turn to the specific uses, Jeff. When you listed the various main C&E program elements, risk assessment was first. What is risk assessment and is there a reason for listing it ahead of the others?

JK: Risk assessment is in some ways the most challenging aspect of C&E, and it comes from two different sets of expectations.

The first is SOX—and the notion that business organizations should have a good understanding of their risks, meaning not just C&E-related ones but also technology-based, operational, financial and other major risk areas. This is often referred to as an ERM—for Enterprise Risk Management—approach. The second is the FSGO approach (as it was based on the 2004 revisions), which provided that in designing and implementing all aspects of a program an organization should do so with an assessment of risk in mind.

I should stress that while both approaches contemplate some stand-alone process, a good deal of actual risk assessment comes from everyday work life—and particularly those in controls-related functions (such as law, compliance, finance, audit) being alert to risks and using that information to design, operate and continuously improve various forms of C&E mitiga-tion—such as training.

AF: Where does behavioral ethics fit into approaches risk assessment?

JK: There are two main ways. One is helping those involved in assessment have a better understanding of behavioral risks—meaning an understanding based on behavioral science. That might be considered a "substantive" use. The other is more procedural in nature—as in, using what science tells us about

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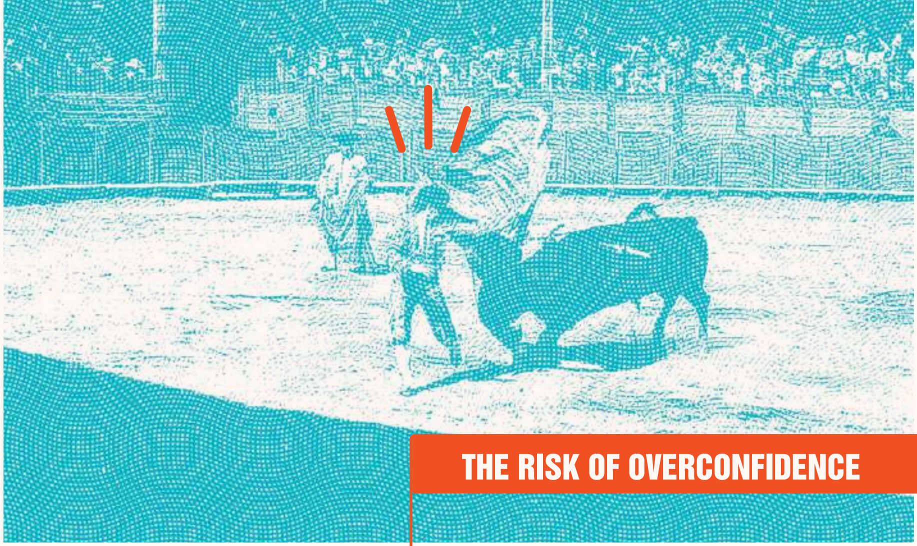
JK human behavior to design better internal procedures that promote better outcomes.

AF

The substantive and procedural categories are useful frameworks to keep in mind. I'll describe the results of some behavioral ethics experiments and ask for your suggestions on what they might mean for C&E programs—risk assessment or otherwise.

First up is a study about overconfidence. This study replicates decades-old findings that the average person is significantly overconfident when making numerical estimates. It also provides some evidence that when assessing risk, people take into account the probability of a negative event more than the impact of the event.



THE RISK OF OVERCONFIDENCE

The study authors recruited 204 project managers to complete an online survey, which asked them to make judgments about risks, completion times, and budgets relating to assembling a piece of IKEA furniture, as well as scenarios in connection with a fictitious company. Consistent with previous research, the average respondent was shown to be significantly overconfident; when asked to provide an 80% confidence interval on an estimate of the time needed to assemble a piece of IKEA furniture, only 26.5% of the intervals contained the empirically determined assembly time.

Moreover, this overconfidence led to overly optimistic risk assessments, as determined by questions relating to the participants management of risks in connection with the design and production of wooden toys for the fictitious company. Specifically, the authors determined that in some cases, while the project managers were making accurate assessments of the probability of a risky outcome, they weren't taking into account the impact of those outcomes.

For example, in one scenario, the project managers were provided with the following background information and asked to assess the probability and the impact of the risk that the entire product would have be re-designed: "Over the past several years, around 40% of all newly developed products had to be changed in order to fit technical requirements." The more overconfident project managers were more likely to rate the impact of this risk (and others) as being very low. Since derailments of this sort are what cause so many projects to fail to meet their stated objectives, the authors conclude that the empirically verified overconfidence (ascertained via the IKEA question), which is correlated with low ratings of risk impact (ascertained statistically by comparing the survey responses), is one of the main causes of project failure.

TAKEAWAY

Recent research continues to replicate decades-old findings that the average person is significantly overconfident when making numerical estimates. Further, there is some preliminary evidence that when assessing risk, people take into account the probability of a negative event more than the impact of the event. Risk assessments should consider both aspects—in some circumstances, it may be valuable to explicitly call attention not only to the likelihood of an event, but also to potentially negative impacts.

Fabricius, G., & Büttgen, M. (2015). Project managers' overconfidence: how is risk reflected in anticipated project success? *Business Research*, 8, 239-263.

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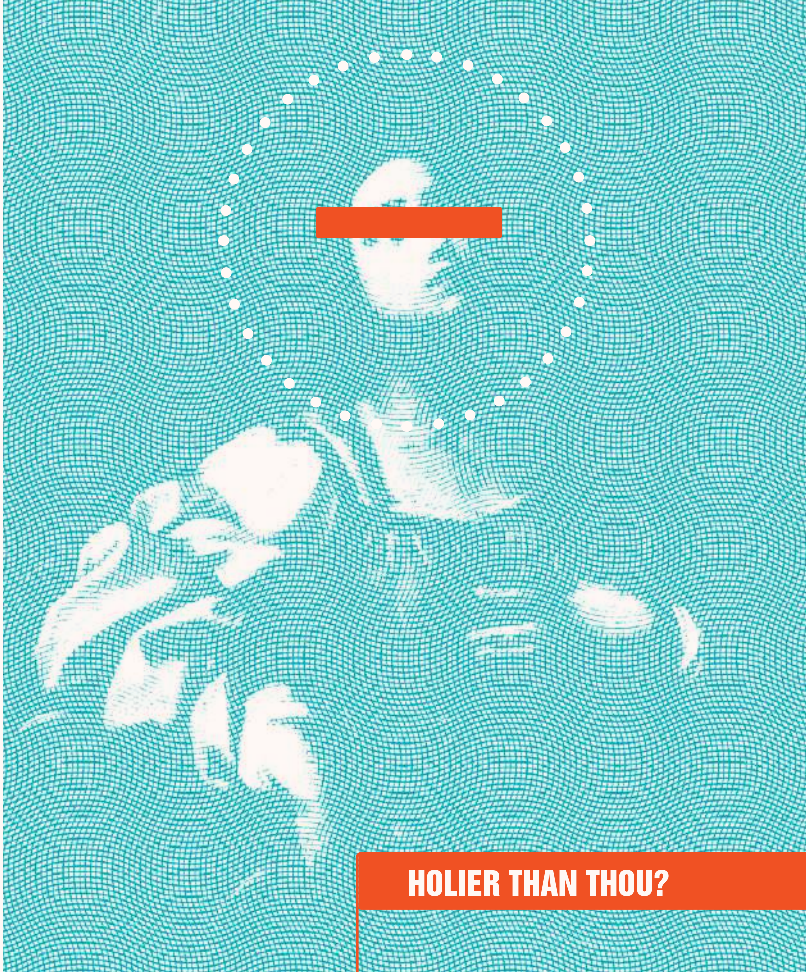
JK This should be very helpful in the sense that while assessing the impact of a risk is a necessary and important part of any risk assessment, under either the ERM or FSGO approaches, what to do about this dimension is not obvious. This study should provide support for C&E professionals looking to find other ways to measure impact in risk assessments. For many companies, surveys of employees work better with risk likelihood than do such surveys vis-a-vis impact.

For instance, when assessing antitrust (also known as competition law) risk, it makes sense that surveys and other wide reaching information collection devices could capture with reasonable accuracy the likelihood of a violation, as it is based on factors that respondents are likely to have good information about (e.g., contacts with competitors). However, these same individuals are less likely to have a basis for assessing the impact of an antitrust violation.

AF Moving to the second study, Ethical Systems collaborator Nicholas Epley discovered that people over optimistically predict their own future moral behavior but accurately predict the not-so-moral future behavior of others. He called this the "holier than thou" effect (see textbox for details). This finding, in effect, should put us on notice that we are unlikely to have an accurate view of how we will act when faced with ethical dilemmas, and often are likely to be overconfident about our ability to respond appropriately. How do you recommend C&E officers integrate this finding into their work?

For those conducting risk assessments, the path suggested by this research is clear: to the maximum degree possible, one should structure the inquiry so that it is not seen as asking about the interviewee's own risks but those of others. And, in providing information



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about others, at least in the aggregate, employees of an organization will likely be helping you analyze risks that in fact involve themselves.

HOLIER THAN THOU?

People often think they are more selfless, kind, and generous than their peers. This tendency, known as "holier than thou", has been frequently observed. For many years, however, theorists debated why this tendency exists. Some think it's because people are overly cynical about others but have more accurate impressions of their own generous behaviors. Others suggest that people have accurate impressions of others, but simply overestimate how charitable they themselves are.

To test these theories, the authors conducted four studies. They found that people overestimated how likely they were to buy a daffodil to support the American Cancer Society (Study 1), to cooperate in a prisoner's dilemma (Study 2), to donate part of an experimental participation fee to charity (Study 3), and to shackle themselves rather than a partner to a longer and more unpleasant experimental task (Study 4). Therefore, they concluded that people overestimate the likelihood that they would act in generous or selfless ways, whereas their predictions of others are considerably more accurate.

TAKEAWAY

As people consistently, and grossly, overestimate the likelihood that they themselves would act in a selfless and altruistic manner, this tendency can carry over to their work life. For instance, they may overestimate how ethical they are and fall into behavioral blind spots as a result. Managers should be aware of this tendency and discuss it with their employees through education or training programs.

Epley, N., & Dunning, D. (2000). Feeling "holier than thou": are self-serving assessments produced by errors in self-or social prediction?. *Journal of personality and social psychology*, 79(6), 861.

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That's great advice—a simple change in practice that could have far reaching effects. In other areas of behavioral ethics, the research shows that powerful people—that is, people who are, for example, higher in the hierarchy in seniority in organizations, may be more likely to behave in unethical ways, such as cheating or parking illegally. How can these findings relating to the corrupting influence of power be integrated in risk assessments?

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It is indeed interesting that social scientists now have data to show that powerful people may create greater ethics risk than the rest of us. Of course, the logic of this has been recognized since Lord Acton said in the 1880s that "Power tends to corrupt and absolute power corrupts absolutely."

But in many companies that recognition has not found its way into the assessment and mitigation of risk. Indeed, it is not uncommon—in my experience—to see the inverse—many companies don't include members of the C-Suite in the assessment of risks. The studies you described should help C&E professionals undertake the commonsensical but also controversial step of focusing—at least somewhat—risk assessments on powerful persons in the organization.

Other behavioral ethics findings that seem relevant for us to discuss include those relating to a phenomenon called conformity bias—which is a fancy way to say that people are likely to do what their peers do, particularly if they feel a group affinity with them. This can be a powerful driver of behavior, and some of the lab studies by Francesca Gino and others have studied this tendency relating to the probability of cheating, and how peers judge cheating based on who the victim is (if the victim is not "one of us" then it's more acceptable to the group).

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I would think that these behavioral findings could really help C&E professionals, particularly in larger organizations, think about group dynamics and ethics risk?

JK

Yes, I agree, these findings about the circumstances that increase the likelihood of cheating could help leaders better understand hot spots for risk. One step in this direction—which potentially covers a lot of ground—is to include a conformity bias perspective in C&E risk assessments.

For instance, where, based on the findings of a risk assessment, the victims of a particular type of violation are likely to be seen more as out-group members than in-group ones, that may suggest the need for extra C&E mitigation measures (of various kinds) to address the risk area in question.

Similarly, risk assessment surveys should (as many, but not all, currently do) target regional or business-line based employee populations that may be setting a bad example for other member employees.

Additionally, one should—for the purposes of identifying conformity based risks—consider whether for some employee populations the most relevant in-group is defined less by the culture in your organization but rather by that of members of their industry, as industries (as much as companies or geographies) can have unethical cultures (as suggested in this Economist story[13] on the LIBOR manipulation scandal).

More broadly, just as the sufficiency of internal controls (policies, procedures, etc.) need to be assessed in any analysis of risk, so do "inner controls," which is another way of thinking about how various behavioral ethics related factors diminish or enhance the risk of C&E

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violations. That is, the weaker the inner controls (based not only on conformity bias but other psychology-based risk causing phenomena, behavioral or otherwise), the greater the need for traditional internal controls.

CONFORMITY BIAS: IS MISCONDUCT CONTAGIOUS?

Dishonesty is prevalent in society and many people are exposed to it daily. The researchers in the following study investigated whether mere exposure to the dishonest behavior of others can impact our behavior? They conducted two experiments and found that people's reactions depended on factors such as the social context in which they were exposed to such behavior, as well as the saliency of the dishonest behavior. The researchers also found that an individual's calculation with respect to the costs vs. benefits of cheating (and the likelihood of being caught) were not very relevant.

The participants in the experiments were asked to solve simple math problems in the presence of others. In some of the conditions, participants were given an opportunity to cheat and earn undeserved money. The researchers also hired actors for some of the conditions who posed as a participant and sometimes wore a t-shirt representing the same university as others (in-group) and other times wore a t-shirt representing a rival university (out-group). The researchers found that if the participants observed cheating by an in-group peer, then it increased the likelihood of unethical behavior by others in the room. However, observing an out-group peer reduced the likelihood of cheating.

In a second series of experiments, the in/out group factors were removed and the researchers instead hired an actor to pose as a participant who, after the instructions were provided, raised his hand and asked “So, is it ok to cheat?” and the experimenter responded “you can do whatever you want.” The actor otherwise behaved in the exact same way as the other participants, thus raising the saliency of cheating but not creating any social norms around cheating. The result was that there was less cheating among the entire group. One conclusion is that increasing the saliency of cheating makes people pay attention to their own standards about cheating and such awareness decreases their likelihood to cheat.

TAKEAWAY

Peer influence is an important factor in unethical behavior. The relatively minor acts of individuals within the same “in group” (such as a team or company) could impact other people's propensity to behave unethically. To combat this the possibility of contagion, managers should help to build an overall ethical culture — one bad apple could spoil the barrel.

Gino, F., Ayal, S., & Ariely, D. (2009). Contagion and differentiation in unethical behavior the effect of one bad apple on the barrel. *Psychological science*, 20(3), 393-398.

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JK You mention the LIBOR Scandal and the challenges of ethics for Wall Street firms. I wonder whether their challenge is particularly acute given the role of money in their day-to-day business—in addition to compensation, for many people at these firms their job is to manage and otherwise deal with money and to help others (and themselves) make as much money as possible. There is some evidence that shows that mere exposure to money increases the likelihood of unethical decision making. The researchers in particular believe that exposure to money could trigger individuals to have more of a "business frame" and therefore be subject to ethical fading. I would think this has powerful implications not just for Wall Street, but for all businesses, particularly given the motivating role of compensation in business?

AF Yes, I agree, this has various implications for business ethics. First, as you suggest, financial services firms generally face relatively high C&E risk. While that may not come as a revelation for some due to the large degree of regulation, this research shows a different—less obvious—level to it. Second, organizations that deal with such firms should consider this heightened risk in conducting their own assessments of third party risk.

Next, for all businesses this behavioral finding suggests the need to focus risk assessments on internal functions that deal with money in a major way, both staff (e.g., treasury) and line (e.g., sales).

Finally, this research may support an approach to internal communications that reduces emphasis on money. Of course, the profit motive is not going to be abolished. But behavioral ethics research—when interwoven with applica-

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ble law and sound compliance practices— does suggest that aspects of that motive be factored into risk assessment. AF

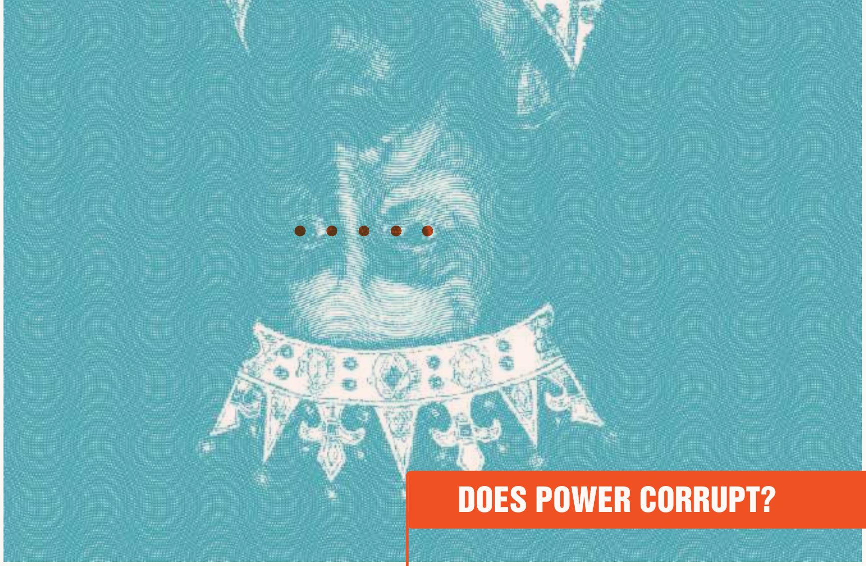
DOES MERE EXPOSURE TO MONEY BRING OUT THE BAD IN ALL OF US?

Researchers have examined the effect that exposure to money has on the likelihood of people to behave unethically. In one study, the authors found that people primed with money (e.g., reading descriptions related to money, such as “She spends money liberally”, versus other descriptions “‘She walked on grass”) were more likely to demonstrate unethical intentions (e.g., steal copy paper from workplace) than those in the control group. In a second study, they showed that when participants were primed with money, they were more likely to adopt a business frame of mind, rather than non-business frame. In a third and fourth study they found that money cues triggered a business decision frame (e.g., how people make decisions under business contexts), which led to a greater likelihood of unethical intentions and behavior.

TAKEAWAY

Mere exposure to, or thoughts of, money can increase the odds of unethical behaviors. Companies should consider the implications that exposure to money may have on employee intentions and behavior. Organizations should be aware of the potential environmental or contextual cues that influence employees’ unconscious unethical behavior. Leaders should also proactively attempt to influence employees’ perceptions of business so as to broaden their construal of business as one with a higher purpose of serving customer needs, rather than an activity narrowly concerned with the bottom line and cost–benefit concerns.

Kouchaki, M., Smith-Crowe, K., Brief, A. P., & Sousa, C. (2013). Seeing green: Mere exposure to money triggers a business decision frame and unethical outcomes. *Organizational Behavior and Human Decision Processes*, 121(1), 53-61.



DOES POWER CORRUPT?

Many have long believed that people who come to power are likely to become corrupted due to their position of power. Anecdotally, we hear about politicians who use public funds for private gain despite their stance on government ethics rules. The researchers in this study wanted to experiment whether these hypotheses are true, and particularly whether gaining power is likely to increase one's moral hypocrisy, which they define as people who publicly uphold strict moral norms, but who privately violate their own espoused standards in private.

In their first experiment, they prime a sense of power in the participants by asking one group to recall an experience of high power, and another group to recall one of low power. Then they asked them to engage in a simple dice-rolling task, in the privacy of their own cubicle, the results of which could lead them to win up to 100 Euro. What they found was those that had a sense of high power did indeed claim a higher reward than the low power participants.

Next, in a subsequent experiment, the researchers involved participants in a role-playing exercise, where each was given a position in a government agency, ranging from Prime Minister to civil servant. The PM was told that s/he could control and direct the civil servants. They then asked participants for their opinion on how acceptable it is to violate rules in connection with a range of moral dilemmas, including under reporting income on your taxes if you earned it during your spare time, to whether someone who needs a bike and can't afford it can take a bike they found that appears to be abandoned. With each dilemma, they divided the participants into a group who had to judge whether it is ok for themselves to engage in these transgressions, or whether it is acceptable for other people to do so. What they found consistently in the results is that high power participants judged more harshly the acceptability of these behaviors when asked about other people. The lower-powered individuals were more lenient on these transgressions when asked to judge other people.

TAKEAWAY

Beware of the corrupting influence of power. In these experiments, researchers concluded that the powerful judge their own transgressions as more acceptable than others, thus acting hypocritically. In organizations, this can have the effect of more senior people may break rules not just because they are unlikely to get punish, but also because they feel entitled to it.

Joris Lammers, Diederek A. Stapel and Adam D. Galinsky, Power Increases Hypocrisy: Moralizing in Reasoning, Immorality in Behavior, *PSYCHOLOGICAL SCIENCE* Vol. 21, No. 5, pp. 737–734.

TRAINING & OTHER COMMUNICATIONS

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AF: Let's turn to another program element—training and communications—how would you describe this part of the C&E landscape.

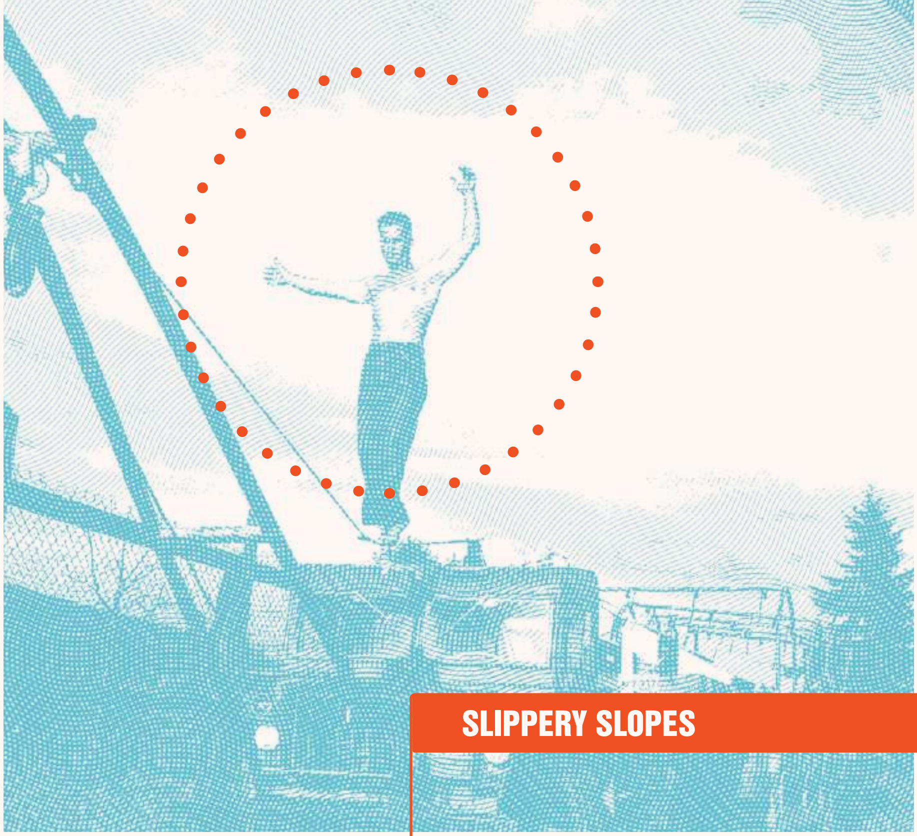
JK: This is what most C&E officers spend most of their work time doing. It is also where they most often hear the call for new approaches to what is often seen as a stale function in some companies.

Training is generally done both by on-line programs to reach broad audiences and in-person for higher risk employee populations—with the latter provided typically by the C&E officer, by other staff and sometimes by line managers as part of "train the trainer" campaigns. Each type has its own benefits and challenges. Other communications (meaning non-training) typically include emails, posters (particularly around the help-line and other reporting options) and Company newsletter stories about C&E.

AF: This seems like an area where behavioral ethics would have lots to offer C&E programs.

JK: It is indeed that, and—as is the case with risk assessment—the possibilities involve both substance and process.

AF: Let's start with the substance. Several behavioral studies show that people are more accepting of immoral behavior if it develops gradually than if it develops suddenly. This is commonly known as a "slippery slope," and what these studies show is that it is a significant risk factor.



SLIPPERY SLOPES

The researchers in this experiment conducted four lab studies in which participants were shown images of jars of pennies and asked to estimate how much money was in each jar. They would be paid 8% of the estimate, but only if the estimate was approved by another participant, who would receive 4% of the estimate if they approved it. After a first phase where all the participants were estimators, all the participants became approvers, and they had to judge anonymous estimates that had been made by the experimenters, unbeknownst to the participants, allowing the researchers to artificially suggest higher estimates. In one condition, the estimates increased abruptly from $10 to $14 over a single round—thus creating an opportunity for participants to receive more money for accepting a higher estimate, even if they didn't genuinely believe it was accurate. In the other condition, the estimates increased gradually, over multiple rounds.

The results showed that in the gradual condition, participants were much more likely to accept the higher rewards. The mean rate of approval was 54% in the gradual condition, and only 24% in the abrupt condition. Throughout the four studies, each of which replicated the slippery slope effect, the authors manipulated certain variables to rule out alternative explanations. Each of these was successful.

TAKEAWAY

There is strong evidence that people are more accepting of immoral behavior if it develops gradually than if it develops suddenly. When monitoring ethical practices in a business or organization, it may be useful to take note of gradual changes that may have occurred, and ask, "if these changes had occurred abruptly, would it have seemed just as acceptable?"

Gino, F., Ayal, S., & Ariely, D. (2009). Contagion and differentiation in unethical behavior the effect of one bad apple on the barrel. *Psychological science*, 20(3), 393-398.

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How can C&E officers integrate these findings into training programs—or, for that matter, other C&E program elements?

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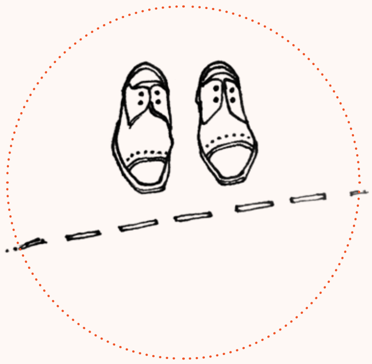
I think that the outcomes of the slippery slope experiments should be discussed in training, at least at a high-level—particularly when training managers. It can be presented as part of broader message that managers need to be not just personally honest but alert to ethically risky situations.

This message can be supplemented based on the experience and perceptions of prosecutors. For instance, a top enforcement official of the SEC has said:

"*Where we find fraud, there are often early warning signs that may have suggested a corporate compliance culture that is not meeting appropriate standards. … Risk-taking in the area of legal and ethical obligations invariably leads to bad outcomes. Any company or person prepared to come close to the line when it comes to legal and ethical standards is already on dangerous ground. Tolerating close-to-the-line behavior sends a terrible message throughout an organization that pushing the envelope is acceptable.*"[14]

Similarly, former New York federal prosecutor Preet Bharaha said:

"*A single-minded focus on remaining an inch away from the legal line is just asking for trouble. It's a dangerous thing to walk the line—and to train others to do it. Walking the line is like a driver constantly trying to game just how close to the legal alcohol limit he can come without getting a DUI. Now, one can do that. But how long do you think before that driver gets pulled over? How long before that driver blows the legal limit? And how long before that driver hurts someone on the highway?*"[15]



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JK In addition to using this information in training, it can inform other aspects of a C&E program—including:

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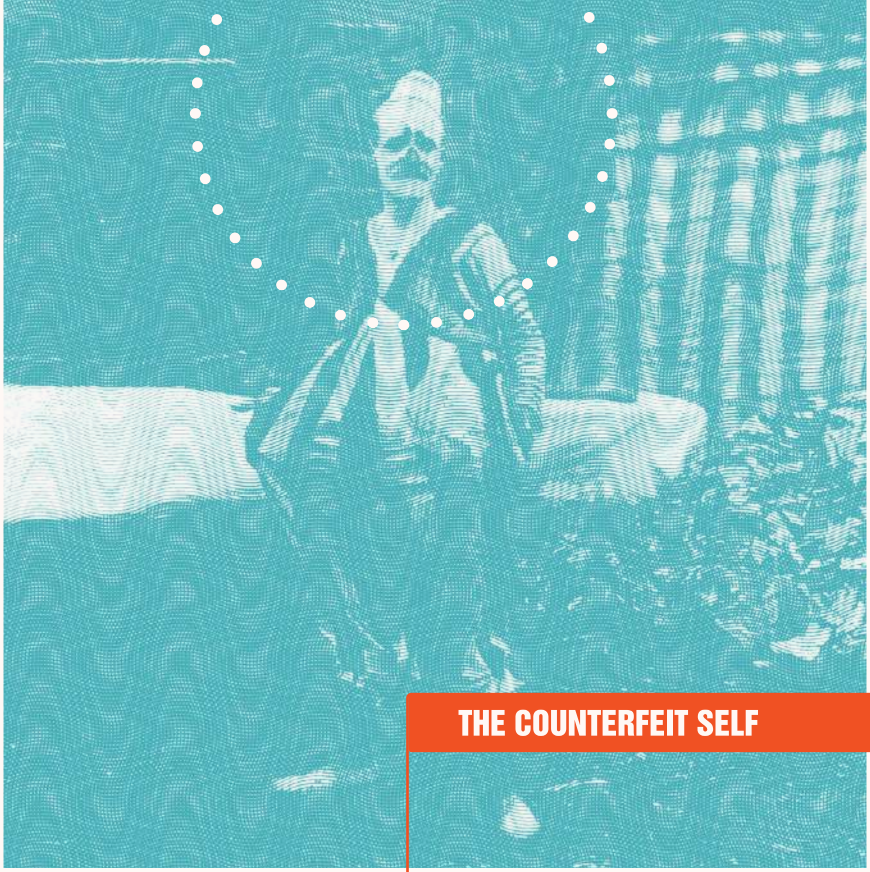
RISK ASSESSMENT

As discussed earlier, one of the dimensions of risk assessment is determining risk impact. What the slippery slope literature suggests is that the impact of a small violation may be greater than is obvious at the outset and risk assessors should heed these early warning signals. How one factors that into any given risk assessment methodology is an interesting question—and I'm not suggesting it becomes part of an actual assessment formula. But it should be part of what is reported to management with the assessment results so that they know that it is not just the "big ticket" assessment items that they should worry about.

ENFORCEMENT

Enforcement, which we'll also discuss more later, plays a role too in determining what is an appropriate response to a violation that seems minor, companies need to take the slippery slope effect into account. Punishing small violations, in proportion, could lay the groundwork for avoiding larger transgressions that could crop up at a later.



THE COUNTERFEIT SELF

People sometimes purchase counterfeit brand products (e.g., fake Louis Vuitton bags). By doing so, people are able to signal positive traits (e.g., wealth, taste) to themselves and others. This study tested whether there is a subsequent ethical consequence and found that wearing counterfeit products cause people to engage in more dishonest behavior, generating in them a feeling of a counterfeit self that leads them to behave unethically.

In the first study, participants were led to believe they had a preference for counterfeits (fake brand name sunglasses) or were randomly assigned to wear them. Subsequently, they were asked to engage in a simple mathematical task. These who were led to believe they preferred the counterfeits cheated more by over-claiming their performance on the task. A second study showed that the effects of wearing counterfeit sunglasses also extended to people's perception of others—those wearing counterfeit products are perceived to be more unethical. Finally, researchers investigated the underlying mechanism. Participants completed the same task as in Study 1, and then researchers surveyed the participants' feelings of inauthenticity. The researchers found that wearing counterfeit products engendered feelings of inauthenticity, which resulted in a greater degree of unethical behavior.

TAKEAWAY

Subtle environmental cues, like wearing counterfeit brands, can impact people's behaviors. Although people can buy counterfeits for less money they may in fact be paying a price in terms of their long-term morality.

Gino, F., Norton, M. I., & Ariely, D. (2010). The counterfeit self the deceptive costs of faking it. *Psychological science.*

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Let's discuss a line of experiments that may go more to the process side of training and communications. Research shows that simply making ethics more salient—that is, reminding people of morality and ethics—can impact behavior. It works best though if the reminder is done as close as possible to the time that someone is making a decision. For example, having people attest to the accuracy of a disclosure form via their signature before they complete the form has shown to elicit more honest disclosures. How would you advise C&E officers to consider more timely ethics communications?

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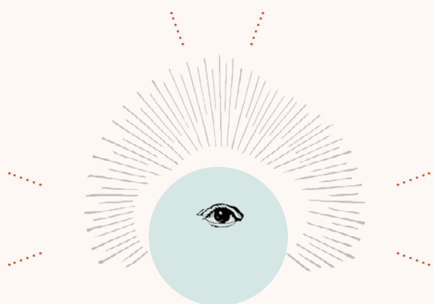

These experiments can be very helpful when it comes to making training and other communications more effective. Just-in-time C&E communications have, in some ways, been around for a long time but only to a very limited degree. Opportunities for new or enhanced just-in-time communications exist for many C&E areas including (but definitely not limited to): anti-corruption—before interactions with government officials and third-party intermediaries; competition law—before meetings with competitors (e.g., at trade association events); insider trading/Reg FD—during key transactions, before preparing earnings reports; protection of confidential information—when receiving such information from third parties pursuant to an NDA; conflicts of interest—around procurement decisions; accuracy of sales/marketing—in connection with developing advertising, making pitches; and employment law—while conducting performance reviews.

Of course, with some of these risk areas it is easier to know when to communicate than with others. And with some it will be easier to automate such knowledge than others, e.g., tying communications to events on an

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employee's calendar such as travel. But all companies should, in my view, explore implementing the "just-in-time" C&E communications that might make most sense for them.

A SMALL ETHICS NUDGE: PEOPLE SHOULD SIGN BEFORE FILLING OUT A FORM

If you're completing a form and attesting to the honesty of your disclosure by signing it, do your responses change based on when you sign a form? The authors of this study experimented with whether asking people to sign at the beginning of a form, rather than the end (which is traditional), provides more honest disclosures by the person completing the form.

The researchers conducted several studies, both in the lab and in a company. In the lab, the participants were first asked to solve a series of simple math tasks, under time pressure. The more math problems completed, the more money they would get from the task. The money received would be based on their self-report of how many they completed. After the math tasks, the researchers asked participants to report their income (i.e., amount received from the math tasks) on a form that resembled a basic IRS 1040 tax form (with some additional complications in the disclosures, such as how many minutes it took them to commute to the lab, which could be a deduction on the form). The experiment provided three conditions, one in which participants signed before completing the form, one in which they signed after, and one which did not require any signature. The researchers found that signing before reporting promoted honesty, whereas signing afterward was the same as not signing at all.

In a later study with an insurance company, researchers asked customers to report the current odometer mileage of their cars. The lower the odometer reading, the less the customer would have to pay for insurance. The researchers required that the customer sign either at the end of the form (the standard disclosure) or at the beginning. They found customers who signed at the beginning of the form to be more truthful and reveal higher usage than those who signed at the end.

TAKEAWAY

A small nudge can go a long way to increase honesty. Managers should consider minimal interventions, like the one presented in this study, that can make ethics more salient for individuals.

Shu, L. L., Mazar, N., Gino, F., Ariely, D., & Bazerman, M. H. (2012). 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,* 109(38), 15197-15200

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Are there other touchpoints between behavioral ethics and compliance training and communications that you would suggest for further consideration?

JK

The possibilities—while not infinite—are considerable, as virtually any of the experiments we are discussing could be the subject of C&E training or communications to support the notion that "we are not as ethical as we think," which, in turn, helps make the case for strong C&E programs. Moreover, because the behavioral ethics studies are widely seen as interesting, they can help make C&E training and communications more engaging—and hopefully more memorable than they otherwise might be. And—particularly as C&E programs become "old news," keeping employees' interest will be a considerable challenge at many companies.

AF

Scott Killingsworth has also written about the intersection of behavioral science research and C&E communications.[16] Scott's article in the *Georgetown Journal of Legal Ethics* identifies so well how all actions from a company, ranging from it's formal communications and Codes to the behaviors of leaders and incentive and compensation structures, should be considered as part of a compliance communication plan. "In some cases", he writes, "the message may have more of an impact than the incentive itself." Drawing from the organizational behavior research, this is an important point because it highlights the complexity of managing compliance, but also the need for all the organizational programs to work together to communicate a coherent message. I imagine that is very hard to do perfectly all the time.

JK

Yes, that's right, we do need to view communications very broadly and consider whether all parts of the company are sending consistent messages, both explicitly and implicit messages. This goes to the heart of aligning formal and informal systems within organizations,

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JK as we discussed earlier in reference to work done by Linda Trevino and others on defining ethical culture for companies. Also, this reminds me of an anecdote that Professor Don Langevoort wrote about in his 2015 *Behavioral Ethics, Behavioral Compliance* paper. He writes about a case study of a financial services firm that tried to regulate the practice of churning (substituting an old policy for a new one, just to generate fees) by their insurance brokers by instituting a heightened compliance review of policy substitutions within 90 days of each policy issued. This well-intentioned review process had a counter-intuitive effect because the brokers took it as a message that on the 91st day they could churn out a new insurance policy. Perhaps the message received by employees was that the review is "mere window dressing that was designed to appease regulators," as Langevoort describes.[17] So the rate of churning went up at that firm. A good story to keep in mind about the need for implicit messages to be integrated within the firm's broader culture.

AF That tie-in to culture seems essential. Scott recommends addressing these challenges by first getting a "checkup" on the organization's culture, as perceived by employees, and then working closely with top management from the Board to the CEO to address gaps. Among other recommendations, he suggests consistent repetition of core values messages, as well as the power of recognizing ethical behaviors. Even if done just privately in management discussions, recognizing employees who have demonstrated behavior that is consistent with the company values goes a long way. Recognizing C&E behavior as part of performance reviews and promotion decisions sends an even stronger message.

ENFORCEMENT

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AF We have thus far been discussing parts of C&E programs that—while challenging on both conceptual and practical levels—do not involve the "tough stuff," meaning dealing with suspected or proven violations. To kick off this part of the discussion, can you give us a thumbnail sketch of relevant issues with respect to internal investigations and enforcement?

JK This is often the part that matters most, at least when measured by the consequences of getting it wrong. More specifically, companies need to enforce their C&E standards in a reasonably vigorous and fair way. The failure to do so can lead to more wrongdoing—and less internal reporting to a company's helpline or similar resource. This is because procedural fairness relating to enforcement of the company Code of Conduct can signal to employees whether speaking up about ethics will be taken seriously—and internal reporting shortfalls can be calamitous.

AF It also sounds like an area where behavioral ethics would have a lot to offer. So let me go over a few concepts that seem promising in that respect, particularly research relating to "motivated blindness," which derives from motivated reasoning, a psychological notion which describes the tendency for people to seek out information that confirms their beliefs, or benefits them, while dismissing contradictory information. In other words, if we are in a circumstance where, for example, we have recently advocated for hiring a new employee who then engages in misconduct, we are motivated to ignore or justify any infractions that could counteract our initial judgment in hiring the employee.

JK The possibility of motivated blindness is relevant to two distinct elements of a C&E program: resolution of conflict of interest issues and decisions involving possible investigations of and discipline for violations of legal or ethical

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JK standards. Focusing on the latter point, this research underscores the importance of the Sentencing Guidelines expectation that organizations discipline employees not only for engaging in wrongful conduct but "for failing to take reasonable steps to prevent or detect" wrongdoing by others—something relatively few companies do well (and some don't do at all).

To meet this important expectation, companies may wish to consider taking the following measures:

- build the notion of supervisory accountability into their policies—e.g., in the managers' duties section of a code of conduct
- speak forcefully to this issue, and the underlying behavioral science research, in C&E training and other communications for managers;
- train investigators on the notion of managerial accountability and address it in the forms they use so that they are required to determine in each case whether a manager having been asleep at the switch led to the violation in question
- publicize (in an appropriate way) that managers have in fact been disciplined for supervisory lapses
- have auditors take these requirements into account in their audits of investigative and disciplinary records

AF

You also mentioned internal reporting. This is an important part of the culture of an ethical organization, particularly because research shows that most misconduct is discovered by internal reports by employees (followed by inter-

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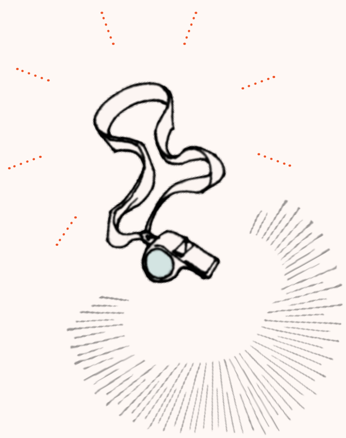

There needs to be a recognition that there is a "larger loyalty" that you want employees to keep in mind when they observe misconduct. Based on the Waytz and Dungan research you mention, we can better understand the powerful psychological conflict facing many potential whistleblowers. The struggle is often between doing what they believe is fair (by seeking a remedy for the wrongdoing) versus what is seen as loyal, both to their colleagues and to their employer. This can often be seen as a classic ethical dilemma of "choosing between two rights."

C&E practitioners have long looked for ways to do this type of reframing of loyalty within organizations. For instance, years ago I helped to develop a short C&E training video that sought to evoke feelings of a larger loyalty by showing the faces of colleagues laid off in the wake of an accounting scandal that could have been, but

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nal audit).[18] Of course, companies want to avoid the external whistleblowing scenarios and to instead create internal cultures that will encourage employees to feel safe to speak up if they see wrongdoing. Speaking up, however, is one of the most difficult decisions that many employees confront. They often choose not to do it. There's the psychological difficulty of putting yourself out there, the risk of losing your job if you do, and also the willingness to act in a way that is disloyal to friends and colleagues at work by telling on them *(See the Waytz and Dungan research in text box below)*.

Given these psychological dynamics, how would you advise C&E officers to rise to the challenge of effectively promoting internal reporting of suspected violations or company policy?

JK wasn't, stopped in the early stages by a potential whistleblower, and I imagine that other training programs have taken a similar approach. As you mentioned earlier, Scott Killingsworth's paper on compliance communications strategies can help companies transcend the "us-versus-them" mindset which is harmful from a compliance perspective. The approach that Scott promotes is to reinforce the intrinsic motivation most people have to act ethically, and a values-based compliance program should seek to engage employees at that higher level. This, he suggests, can be done by creating a trust-based culture as well as framing issues in terms of values and positive group norms (e.g. "the majority of employees don't cheat"), rather than using the language of risk and reward.

A related facet of promoting a larger loyalty is by striving—through various measures—to maintain "organizational justice" at a company. Linda Trevino and Gary Weaver have written about based on an empirical study of four large corporations, "when employees perceive general organizational justice and ethics program follow-through, there is less unethical behavior and a greater willingness to report problems.[19]" The authors state, and I agree, that when ethics programs appear as mere "window dressing" to respond to public relations concerns, employees perceive the program as disconnected from everyday business activities and therefore the program is less effective. To spur the type of loyalty to the organization that will promote use of helplines and other means of reporting ethical concerns, company leadership needs to not only talk the talk, but walk it as well.

AF It seems like strengthening internal culture can go a long way to helping employees be more likely to speak up when there are problems—both around ethics

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but also other operational concerns. Speaking-up is of course also important for innovation, as it brings out new ideas. There was a literature review in 2009 by Abhijeet Vadera, et. al., that studies the existing research and data on the individual and organizational antecedents of whistleblowing that supports your advice that strengthening organizational justice and culture is among the most important factors that influence employees. The other factors include leadership, employee perceptions of general support, organizational type (more prevalent in the public sector than private companies or non-profit sectors), and of course the risk of retaliation. Interestingly, the research hasn't yet found patterns relating to an individual's gender, age, tenure, or other factors, such as their commitment to their job or organization.

TO REPORT OR NOT REPORT?

Whether to report another person's unethical behavior to a third party—to engage in internal reporting or whistleblowing—often presents a dilemma. One the one hand, whistleblowing promotes justice and fairness. On the other hand, it can also be perceived as disloyal. This paper tests whether the fairness–loyalty tradeoff indeed predicts people's willingness decision to report.

In their first study, the researchers assessed individual differences in the way people value fairness versus loyalty and how that relates to whether they would report another person's unethical behavior to a third party. They found that participants whose preference is for fairness over loyalty were more likely to engage in whistleblowing (e.g. an employee who steals $1 from a restaurant's tip jar).

In the second study, the researchers experimentally manipulate endorsements of fairness versus loyalty by asking participants to write a few sentences about why it is more important to be just/fair than to be loyal or why it is more important to be loyal than to be fair. They found that participants who were assigned to the fairness condition were more likely to engage in whistleblowing.

In a third study, they first asked participants to recall an incident when individuals engaged in an unethical behavior. They next asked participants to write about why they decided to report or not report that person's behavior. Participants then reported whether their decision was driven by fairness or loyalty. They found that people recall their decisions to report unethical behavior as driven by the fact that they value fairness, whereas people recall decisions *not to report* unethical behavior as driven by loyalty.

In a fourth study using an online marketplace, participants were first asked to engage in a recalling task, similar to Study 2. They were then asked to review a prior participant's essay, which was poorly written, and recommend whether that person should be blocked from future studies. Researchers found that those who had endorsed fairness (versus loyalty) were more likely to recommend that researchers should block that previous participant from future studies.

TAKEAWAY

Moral behavior appears to be influenced not simply by the moral norms that people hold but by how people *trade off* different moral norms. In this case, the whistleblower's dilemma is a tradeoff between fairness and loyalty, and in these studies researchers found that those who value fairness (either inherently or through experimental activation) are more likely to engage in internal reporting.

"The Whistleblower's Dilemma and the Fairness-Loyalty Tradeoff," Adam Waytz, of Northwestern University, and James Dungan and Liane Young, both of Boston College, examine the powerful psychological conflict facing many potential whistleblowers

WHAT'S NEXT

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JK There's a lot more that could be said about what behavioral ethics means for these—and other—aspects of corporate compliance, but this seems like a good point to take a break, and to open this project up for feedback and other ideas from readers. In particular, we hope to hear about other C&E program uses of behavioral ethics findings—both findings we have summarized in this eBook and others of which you may be aware.

AF We also are interested in any areas that you think should be the focus of additional research that you think would help the C&E community, both related to behavioral ethics and otherwise. For example, does the C&E community find useful the continued efforts at articulating the business benefits of a strong ethical culture? On the behavioral research, for example, is there value to measuring the impact of formal communications from leadership and its impact on employee behavior?

CONTACT US

Please send us your ideas. Consistent with our mission at Ethical Systems, we will work with the academic research community to cultivate original research and develop further resources to help build the case for business ethics.

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