PROMOTING AN ETHICAL ORGANIZATIONAL CULTURE

Maurice Stucke*

Even its more stalwart defenders are concerned that capitalism is in crisis.[1] The crisis in capitalism might have come as a shock to some, but not to many middle- and lower-income households. Well before 2008, middle-class Americans saw little gains in income, despite gains in productivity.

After the economic crisis, there has been a significant erosion of trust. For seventeen years, the Edelman Trust Barometer has surveyed over 33,000 people across twenty-eight countries about their level of trust.[2] Its 2017 survey revealed what many already suspect: "trust is in crisis around the world."[3] Trust in four key institutions—businesses, governments, non-governmental organizations, and media—has declined broadly, "a phenomenon not reported since Edelman began tracking trust among this segment in 2012."[4] The biggest declines in trust were in

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* Professor, University of Tennessee College of Law; co-founder, The Konkurrenz Group. This article is adapted from the comments made at the Business Law: Connecting the Threads Symposium at the University of Tennessee College of Law.

[1] *See, e.g.*, Joseph L. Bower et al, *Occupy Wall Street Protestors Have a Point*, HARV. BUS. SCH. WORKING KNOWLEDGE (Feb. 15, 2012), http://hbswk.hbs.edu/item/6956.html?wknews=02152012; Joseph L. Bower et al, *Global Capitalism at Risk: What Are You Doing About It?*, HARV. BUS. REV., Sept. 2011, at 106, https://hbr.org/2011/09/global-capitalism-at-risk-what-are-you-doing-about-it; Frank Kane, *Capitalism Crisis a Big Part of Davos Forum*, THE NAT'L (Jan. 25, 2012), https://www.thenational.ae/business/capitalism-crisis-a-big-part-of-davos-forum-1.353328; "*Socialism" Not So Negative, "Capitalism" Not So Positive*, PEW RESEARCH CTR. (May 4, 2010), http://www.people-press.org/2010/05/04/socialism-not-so-negative-capitalism-not-so-positive/2/.

[2] *2017 Edelman Trust Barometer: Global Results*, EDELMAN 2, https://www.edelman.com/global-results/ (last visited Nov. 19, 2017).

[3] *2017 Edelman Trust Barometer: Global Annual* Study, EDELMAN, https://www.edelman.com/trust2017/ (last visited Nov. 19, 2017).

[4] *Id.*

the United States, followed by the United Kingdom and France. Besides a loss in trust, most people, including many wealthy and upper middle-class, believe that the system is not working.[5] Sixty-nine percent were concerned about widespread corruption.[6] Only thirty-seven percent viewed CEOs as credible, an all-time low in the survey.[7]

So why the loss in trust? One major factor is the rise of unethical and illegal behavior. Ethical business practices, as many in the 2017 Edelman Trust Barometer survey identified, are important ways to build trust in a company.[8] But few thought companies were performing well on the attributes of integrity or ethical business practices.[9] Unethical and illegal corporate conduct remains pervasive. The economic crisis heightened concerns of widespread unethical and illegal conduct among financial institutions.[10] Every month there appears another corporate scandal.[11]

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[5] *2017 Edelman Trust Barometer: Global Results*, *supra* note 2, at 5, 21 (including 48 percent in the top quartile of income).

[6] *Id.* at 26.

[7] *Id.* at 16. Most respondents in the G8 countries (Canada, France, Germany, Italy, Japan, Russia, the United Kingdom and the United States) and 15 other countries found the CEOs not credible, and all 28 countries saw a decline in those who viewed CEOs as credible from 2017 levels. *Id.* at 17.

[8] *Id.* at 45 (56%, which was on par with "pays its fair share of taxes"; the other top three attributes in building trust were "treats employees well" (62%); "offers high quality products/services" (59%); and "listens to customers" (58%)).

[9] *Id.* at 56 (39% thought companies were performing extremely or very well for integrity; 40% thought companies were performing extremely or very well for their ethical business practice).

[10] *See, e.g.*, MICHAEL D. GREENBERG, RAND CTR. FOR CORP. ETHICS & GOVERNANCE, PERSPECTIVES OF CHIEF ETHICS AND COMPLIANCE OFFICERS ON THE DETECTION AND PREVENTION OF CORPORATE MISDEEDS: WHAT THE POLICY COMMUNITY SHOULD KNOW 1–2, (2009); Blake E. Ashforth et al., *Re-Viewing Organizational Corruption*, 33 ACAD. MGMT. REV. 670, 670 (2008); Nico W. Van Yperen et al., *To Win, or Not to Lose, At Any Cost: The Impact of Achievement Goals on Cheating*, 22 BRIT. J. MGMT. S5, S5 (2011), https://www.rug.nl/staff/n.van.yperen/van_yperen_et_al_2011_bjm.pdf ("The

Paradoxically, the decrease in trust and increase in corporate crime have been accompanied by the growth in corporate compliance over the past twenty years.[12] Companies are investing more in compliance.[13] The Ethics and Compliance Officer Association, for example, grew between 1992 and 2012 from nineteen members to over 1,200 members "exclusively comprised of in-house compliance/ethics professionals."[14] Likewise, the Society of Corporate Compliance and Ethics, which certifies compliance/ethics professionals, has over 5,800 members

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numerous ethical scandals concerning high-profile firms and business executives but also outcomes of scientific research have raised many concerns about the emergence of unethical and irresponsible behaviour in organizations.").

[11] For a survey of recent unethical corporate behavior, *see* Hershey H. Friedman & Miriam Gerstein, *Are We Wasting our Time Teaching Business Ethics? Ethical Lapses Since Enron and the Great Recession*, (Sept. 14, 2016), https://ssrn.com/abstract=2839069.

[12] Press Release, Financial Executives International, FEI Survey: Average 2007 SOX Compliance Cost $1.7 Million, (Apr. 30, 2008), http://fei-kentico. financialexecutives.org/News-Publications/Press-Room/2008-press-releases/FEI-Survey-Average-2007-SOX-Compliance-Cost-$1-7.aspx#axzz4 wwwvEgkK (finding from its Sarbanes–Oxley compliance survey of 185 companies, whose annual revenues averaged $4.7 billion, that average compliance cost for Section 404 during fiscal year 2007 was $1.7 million); Peter J. Henning, *Lessons From the Glaxo Case in China*, N.Y. TIMES (July 29, 2013), http://dealbook.nytimes.com/2013/07/29/lessons-from-the-glaxosmithkline-case-in-china/ ("Over the last decade, since the passage of the Sarbanes-Oxley Act in 2002, publicly traded corporations have poured significant resources into their compliance programs to prevent wrongdoing, or to at least be an early warning system for what might become a problem.").

[13] Todd Ehret, *Compliance Job Market Shows Strength in AML and Financial Crime as Other Areas Slow,* REUTERS (Jan. 18, 2017), https://www.reuters.com/article/bc-finreg-compliance-market/compliance-job-market-shows-strength-in-aml-and-financial-crime-as-other-areas-slow-idUSKBN1522WG; Gregory J. Millman & Samuel Rubenfeld, *Compliance Officer: Dream Career?*, WALL STREET J. (Jan. 15, 2014), https://www.wsj.com /articles/the-business-of-risk-is-booming-1389832893?mg=prod/accounts-wsj.

[14] *The Federal Sentencing Guidelines for Organizations at Twenty Years: A Call to Action for More Effective Promotion and Recognition of Effective Compliance and Ethics Programs,* ETHICS RESOURCE CTR. 29 (2012), https://www.theagc.org/docs/f12.10.pdf.

comprised of both in-house and outside compliance/ethics practitioners.[15]

Policymakers are also seeking to incentivize companies to better comply with the law and develop an ethical organizational culture. Some statutes, for example, require public firms to disclose their compliance efforts.[16] For over twenty-five years the U.S. Sentencing Commission's Organizational Guidelines ("Organizational Guidelines") provide firms strong financial incentives to develop an ethical organizational culture.[17]

So, the current policies do not seem to be working. Ethics and compliance practitioners, in one 2017 survey, "indicate that changing behavior and preventing future misconduct are the most important objectives for training; yet few actually implement methods that accomplish

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15 *About the Society of Corporate Compliance and Ethics*, SOC'Y CORP. COMPLIANCE& ETHICS, https://www.corporatecompliance.org/AboutSCCE/AboutSCCE.aspx (last visited Nov. 20, 2017).

16 Sarbanes–Oxley Act Pub. L. No. 107-204, §§ 101(c)(2), 101(g)(3), 103(a), 302, 404, 406 (2002). Sarbanes-Oxley also directed the Sentencing Commission to review and amend the Guidelines to ensure they were "sufficient to deter and punish organizational criminal misconduct." *Id.* at § 805(a)(5).

17 U.S. SENTENCING GUIDELINES MANUAL ch. 8, introductory cmt. (U.S. SENTENCING COMM'N 2016), https://www.ussc.gov/sites/default/files/pdf/guidelines-manual/2013/manual-pdf/2013_Guidelines_Manual_Full; Hon. Patti B. Saris, Chair, U.S. Sentencing Comm'n, Comments at the 12th Annual Compliance & Ethics Institute, (Oct. 7, 2013), http://www.ussc.gov/Guidelines/Organizational_Guidelines/Special_Reports/saris-remarks-annual-compliance-and-ethics-institute.pdf (noting the Commission's goal "that organizations would come to view this organizational guideline scheme as a powerful financial reason for instituting effective internal compliance programs that, in turn, would minimize the likelihood that the organization would run afoul of the law in the first instance"); CORPORATE LEGAL COMPLIANCE HANDBOOK § 1.04 (2013), 2013 WL 6846847 (concluding that "[t]he combination of the *Caremark* decision, the Sarbanes-Oxley Act, and the revised Sentencing Guidelines now make it more than just a good idea for a corporate board to ensure that its company has an effective compliance program").

that goal."[18] Most employees surveyed "see the need for and have positive views of ethics and compliance training, but far fewer find it applicable and believe they learned something new during their training."[19]

Given the crisis in trust, policymakers and companies should start with humility. They should not assume that the current approach is working (or will work). Instead pragmatism and experimentation are in order. Policymakers must inquire how companies can promote an ethical organizational culture. What steps should companies take? What can policymakers do to promote these efforts? Flowing from Professor Marcia Weldon's presentation,[20] my comments briefly outline four issues.

First, how many of you think you are an ethical, good citizen? Now think of one or two reasons why you are an ethical, good citizen. How many of you thought, "Because I obey the law"? Probably few, if any. We expect more from ourselves than simply complying with the law. Why then should we hold companies to that minimum? Thus, being an ethical and good corporate citizen entails more than simply complying with the law. We expect companies to comply with the law, but that, by itself, is not sufficient to promote an ethical organizational culture. More is required than compliance training.[21]

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[18] *Ethics & Compliance Training: What Gets Results,* ETHICS RESEARCH CTR. 3 (2017), https://higherlogicdownload.s3.amazonaws.com/THEECOA/11f760b1-56e0-43c6-85da-03df2ce2b5ac/UploadedImages/research/E&CTrainingFinalExecutiveSummary.pdf.

[19] *Id.*

[20] *See* Marcia Narine Weldon, *Corporate Governance, Compliance, Social Responsibility, and Enterprise Risk Management in the Trump/Pence Era*, 19 Tenn. J. Bus. L. 275 (2017).

[21] Milton C. Regan, Jr., *Risky Business*, 94 GEO. L.J. 1957, 1966 (2006) (arguing that "legal compliance is a matter not of obeying commands with intrinsic normative value, but adding the prospect of liability to the scales when weighing the costs and benefits of different courses of action. This instrumental approach to rule compliance is insufficient to ensure robustly ethical conduct because its motives for compliance are relatively shallow and contingent.").

Second, if you were paid to attend religious services, would you become more ethical? Most of us would likely say no. So, should we expect extrinsic financial rewards to promote an ethical organizational culture? Currently, the Organizational Guidelines offer a significant discount off a corporate fine for companies with effective ethics and compliance programs. If a qualifying company is later convicted of a crime, the federal court, in following the Organizational Guidelines, would lower its culpability score by three points, thereby significantly reducing the organization's criminal fine.[22]

The idea of an incentive came up when the Sentencing Commission deliberated over how to sentence organizations. The Commission sought advice from experienced white-collar attorneys. The attorneys raised the incentive, in recommending "a very flexible set of non-binding 'policy statements' that called for substantial fine reductions if the organization had instituted an effective compliance program to prevent law violations and otherwise acted responsibly."[23] (The Department of Justice, in contrast, proposed a "modest" discount for an effective compliance program.[24]) The Commission staff thought "that organizations could be induced to behave legally and responsibly by, in effect, 'offering' them the promise of substantial fine reductions if the entity had instituted effective measures to prevent and detect violations (i.e., the violation occurred in spite of reasonable preventive efforts and was promptly reported and addressed)."[25] But if the organization acted "'negligently'

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[22] *See* U.S. SENTENCING GUIDELINES MANUAL § 8C2.5(f)(1) (U.S. SENTENCING COMM'N 2016), https://www.ussc.gov/guidelines/2016-guidelines-manual/2016-chapter-8 (explaining that "an effective compliance and ethics program" will lower the overall culpability score).

[23] John R. Steer, *Changing Organizational Behavior – The Federal Sentencing Guidelines Experiment Begins to Bear Fruit*, U.S. SENTENCING COMM'N, 5 (2001), http://www.ussc.gov/sites/default/files/pdf/training/organizationalguidelines/selectedarticles/CorpBehavior2.pdf.

[24] *Id.*

[25] *Id.* at 5–6.

with regard to its legal risks, its punishment upon conviction would be much greater."[26] As its Vice Chair stated, the Sentencing Commission

> hoped that organizations would come to view this guideline scheme as a powerful financial reason for instituting effective internal compliance programs that, in turn, would minimize the likelihood that the organization would run afoul of the law in the first instance. And, if and when a corporate crime was committed, perhaps through the actions of a rogue, lower level employee, the sentencing guideline incentives would drive the corporate actor toward swift and effective disclosure and other remedial actions. Although those immediate objectives were bold advances in their own right, the Commission's vision for its organizational guideline structure was even more ambitious and forwarding-looking. The Commission hoped this punishment scheme initiative would help contribute, over time, to a more healthy, values-based way of doing business in America.[27]

When my wife Elizabeth and I began our research, we thought the federal courts might be dispensing this incentive like candy on Halloween. What amazed us was how infrequently—less than 0.0873 percent of organizations sentenced—the federal courts found the defendant's ethics and compliance efforts to be effective.[28] So our research ex-

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[26] *Id.* at 6.

[27] *Id.* at 8–9.

[28] Maurice E. Stucke, *In Search of Effective Ethics & Compliance Programs*, 39 J. CORP. L. 769, 783 (2014).

amined whether extrinsic financial rewards can promote an ethical organizational culture. To preview our research, we'll use our youngest daughter's response. Before we headed to a compliance industry conference, our youngest daughter asked about our topic. We replied: "Whether extrinsic financial rewards were effective in promoting an ethical organizational culture." She looked at us dumbfounded. So, we tried another route. "Let's say we were to pay you to read books. Would that foster a love of reading?" As she was an avid reader, the question, we thought, was rhetorical. She thought for a minute, and said, "Yes, it would. What if I read two shorter books? Is that the same as reading one longer book? If I read a kindergarten book, does that count the same as if I read *Moby Dick*?" Her response resembles our findings: companies will ask the Department of Justice ("DOJ") and Securities and Exchange Commission ("SEC") what they will need to do to get the extrinsic reward. And that has fundamental problems, as a checklist approach does not promote an ethical organizational culture.

The third issue is what can the agencies do to promote an ethical organizational culture? The SEC and DOJ cannot tell companies specifically how to promote an ethical organizational culture. Nor should they tout the Organizational Guidelines' extrinsic reward. The available information—economic logic, sentencing data, behavioral insights, survey results, and (most importantly) the persistence of significant corporate crime—indicates that the current extrinsic, incentive-based approach to compliance is ineffective. An extrinsic, incentive-based approach can actually encumber an ethical organizational culture. So, if the current approach is not working, what will work? We advance an intrinsic, ethics-based approach to compliance. Here, the expectation is that a firm seeks an ethical organizational culture for its own end or for a strategic competitive advantage. An intrinsic, ethics-based approach is already in the Organizational Guidelines but is de-emphasized. As we'll explore in our forthcoming book, it should be given greater emphasis by policymakers and enforcers.

A fourth issue is the intersection between artificial intelligence and ethics. We are seeing this issue as firms shift toward pricing algorithms.[29] What happens when these pricing algorithms can reach the same anticompetitive outcome as when executives fix prices in a smoke-filled hotel room? What are the executives' obligations when their algorithms independently learn the optimal strategy of tacitly colluding? Should we hold executives accountable for the behavior of their algorithms? If so, under what circumstances and what legal standard should be employed? This is an open field currently.

So, my aim here is to identify the underlying problem: why, despite the great interest by policymakers (and often the companies themselves), haven't more firms developed an ethical organizational culture? Firms have many independent reasons to prevent and detect criminal conduct and promote an organizational culture that encourages ethical conduct and a commitment to comply with the law. Nonetheless, many firms' efforts remain ineffective, and corporate crime persists.

The situation may appear bleak for policymakers. Neither market forces nor higher fines will yield an ethical organizational culture. Nor will the Organizational Guidelines' extrinsic, incentive-based approach likely promote an ethical organizational culture. Indeed, as we have seen, the incentive-based approach is likely contributing to the persistence of ineffective compliance.

So, if the Organizational Guidelines' current approach is not working, the debate turns to what should policymakers do next. An alternative approach—an intrinsic, ethics-based approach toward compliance—exists, is gaining traction in the compliance industry, and should be given greater emphasis by policymakers and companies.

[29] ARIEL EZRACHI & MAURICE E. STUCKE, VIRTUAL COMPETITION: THE PROMISE AND PERILS OF THE ALGORITHM-DRIVEN ECONOMY 15 (Harvard Univ. Press 2016).