

-

**"Effective implementation of ethical programs: theory and practice"**

Avshalom M. Adam ©

Presented at ***Twelfth Annual International Conference Promoting Business Ethics  
Hosted by St. John's University, New York  
October 26-28, 2005***

"We are free to choose right and wrong,  
or good and evil, provided we can tell them  
apart and have the courage and the means to do so." Mario Bunge, 1989

College of Management, Israel, School of Business Management. MBA Program

Address: 7 Brandeis Street, Tel Aviv 62001, Israel

Email address: [avshalom@colman.ac.il](mailto:avshalom@colman.ac.il)

[www.ethics.co.il](http://www.ethics.co.il)

## **"Effective implementation of ethical programs: theory and practice"**

### Abstract

What is the best process by which to implement ethical and compliance programs? That is, what are the best means for achieving the aims of inhibiting the criminal conduct and supporting the ethical conduct of organizational members? The US Federal Sentencing Guidelines (FSG) of 1991 required development of a compliance program in which the implementation process consisted of formal methods and the desired outcome was to inhibit criminal conduct. Research failed to support this approach. Furthermore, a clear failure of that approach is exemplified by the occurrence of several business scandals. The worst of these was the uninhibited criminal conduct of individuals in Andersen and Enron, notwithstanding the formal methods contained in these companies' ethical codes of conduct and ethical programs. These scandals caused investors, amongst other stakeholders, significant monetary losses and eroded market confidence. Restoring public trust, a necessary condition for a viable market, was a challenge partly met by legislators and regulators through enactment of the Sarbanes Oxley Act (SOX 2002) and modification of the FSG (2004), the latter requiring the establishment of a culture supportive of ethical conduct.

Given that events have demonstrated the limited utility of formal controls alone, it is necessary to reconsider the assumptions upon which the process of implementing compliance and ethical programs rests, in both theoretical and practical terms. (Clark and Leonard 1998) This paper aims to contribute to this process. It examines the formal, informal and personal methods available for establishing and implementing ethical and compliance programs. In particular, it considers what type and mix of methods are most likely to yield an effective implementation process.

## 0. Introduction

The Research Question (RQ) of this paper is: “What is the best process by which to implement compliance/ethical programs?” Previously, best implementation practice consisted of formal methods. This can be considered the ‘old standard answer’ (OSA) to the RQ and is the approach reflected in the received interpretation of the Federal Sentencing Guidelines (FSG) of 1991 (Izraeli and Schwartz, 1998). However, formal methods proved to be unable to inhibit criminal and unethical conduct, as exemplified by the market breakdown that followed the fiascos of Andersen and Enron. The recognition that what is needed is the creation of an organizational culture supportive of ethical conduct, and that formal methods alone are unable to achieve this, underlies the addition of informal methods to the list of requirements imposed by the revised FSG of 2004. This mix of formal and informal methods constitutes the ‘new standard answer’ (NSA) to the RQ. Theory and models supporting the use of such a mix of methods were developed in the late 1980s and early 1990s (Murphy, 1988; Treviño et al., 1998). However, since then few studies researching the impact of the different methods on the ethical conduct of organizational members have been conducted (Loufer and Robertson, 1997; Sommers, 2001; McKendall et al., 2002), and so it remains to be seen whether the new requirements will deliver the desired ends. Furthermore, despite this theoretical research and the changes made to the FSG, when implementing an ethical program, most organizations continue to rely principally on formal methods.

Research suggests that a third set of methods, the personal controls, may prove effective, however these have received little attention. Thus, overall we do not know which of the implementation methods are relevant to endeavors to positively impact the compliance and ethical behavior of organizational members, nor where the correct balance between the different methods lies. The inclusion or exclusion of methods from the mix and their correct proportions need to be further theoretically assessed and empirically tested, with this paper confining itself to assessment at the theoretical level.

The effective design and implementation of an ethical code of conduct, which is an important ingredient of any compliance or ethical program, requires clarity as to its content, namely, its values and rules of conduct. The first part of this paper therefore examines and discusses the term "ethics" and its relationship to "values" and "action", as well as the relations between ethics and morality. The second part of the paper discusses the individual's ethical decision-making process in the organization. It discusses what is required for an individual to make an ethical decision, in terms of personal virtue and knowledge and in terms of group dynamics and organizational context. Thus, this section defines the categories that compliance and ethical programs aim to influence. The third part of the paper surveys available methods for implementing the code of conduct, being those mandated by US law and regulations, namely the formal and informal methods, and those proposed by scholars, in particular, personal methods. In the fourth and final part of the paper, I re-assess the old and new standard answers to the RQ and suggest reconsidering the assumptions implicit in the NSA. I explore the assertion that best practice regarding the implementation process for an ethical program requires a cocktail of formal and informal methods, arguing that personal methods also need to be considered.

Since this paper aims to critically discuss the theory and regulations that guide practice with respect to the implementation process for compliance and ethical programs, its readership is theoreticians on the subject of ethical programs and the creators and implementers of such programs.

## 1. Values, Ethics, and Action

Designing an ethical code of conduct is the first step in its implementation. An ethical code of conduct should consist of organizational **values** and a set of rules of conduct, some ethical and others legal. In addition, the code should include statements reflecting organizational policy and organizational inspirational statements. The task of this section is to clarify these terms and the relationships between "values," "ethics" and "action" as a necessary step in designing a usable code.

Bunge (1989) undertook one of the few major studies offering a comprehensive answer to the question of the relationship between values, norms and action, and his study may therefore be instructive. I adopt the terminology he used with respect to an individual in that study and extend it to the organization. Thus, following Bunge's terminology, three types of value sets emerge: 'primary values' are those needed for the *survival* of the organization (i.e., its basic values); 'secondary values' are those needed to satisfy the legitimate wants of the organization; and 'tertiary values' are those that the organization aspires to for its prosperity. From each type of value set, a set of norms is designed to guide the actions of individuals. The hierarchy of the values is important. The extension of Bunge's typology from the individual to the organization is made with the caveat that the organization in itself is mindless: indeed the members of the organization are responsible for the valuation and evaluation of organizational basic needs, legitimate wants and aspirations.

In designing an ethical code of conduct, members of an organization need to select the values to be included. This choice should arise from a critical discussion between members of the organization aimed at identifying which of the organization's values are crucial for the survival of the organization, which reflect its aspiration for well being, and which serve to enable it to prosper in its niche. Whether or not the values are rooted in the basic needs, legitimate wants or aspirations of the organization is a question that should be examined and answered by

organizational members in the process of designing the code. Upon completion of this step, the organization will have determined its basic values, legitimate wants and aspirations in an ethical code of conduct, a text which will serve as a compass for its activity.

The next step is to develop appropriate rules of conduct. An organization is not an island in the sea, but rather an integral part of society. As such it may need to confine its aims if it is to employ its resources without inflicting harm on society. From a moral perspective, society cannot (and does not) remain passive to damages inflicted by organizations on its possible future. The moral principles of different groups comprise its social norms, which prescribe what the group considers to be the morally right thing to do. Rules of conduct proceed from morals, and thus the discipline of ethics, being the critical study of moral principles, is one that produces codes of conduct. For an organization faced with developing and implementing a code of conduct, an important consequence of this is that its choice of rules needs to be compatible with its chosen values. Where organizational members share, or partly share, cultural and organizational norms, the process of delineating the organization's basic values and agreeing how they should be expressed in rules of conduct is greatly eased. Regardless of the degree homogeneity pertaining to organizational members with respect to their basic norms, an important step in the design of the ethical code of conduct is to recognize the existing social norms that are embedded in the organizational culture and to examine whether or not they satisfy the chosen values. If not, a decision needs to be taken as to whether to include additional, previously unrecognized, values or to uproot these norms. Thus, the process of designing an ethical code of conduct impinges on the *awareness of organizational members* as to the element of choice in ethical conduct.

Choosing a set of values and devising compatible rules of conduct leads to the construction of an ethical code of conduct. Once extant, this code is an ideal which should serve to guide organizational members in terms of their conduct when confronted with an ethical dilemma.

2. The individual's ethical decision making process and the organization.

Ethical problems arise when there is a conflict of interests or of values. For example, there may arise a conflict between personal interests and the interests of the organization regarding the use of organizational resources, or between the organization's value of honest reporting and its value of maximizing shareholder value. The ethical code of conduct should function as a guide to action, as well as enabling organizational members to avoid conflicts of interest. In situations where conflict is unavoidable, the code needs to provide mechanisms or guidance as to how to resolve the conflict. The question then is: How can knowledge of the code aid the decision making process for organizational members?

In answering this question, I adopt Ryle's theory of "Knowing How and Knowing That" [1946] and follow the interpretation given to that theory by Hattiangadi (1987). While the latter claims that a good deal of our skills do not depend on propositional knowledge, I assert that a good deal of our skills do not depend on prescriptive knowledge. Phrased in these terms, I contend that understanding of the ethical code of conduct needs to be at a level sufficient to enable every organizational member to **know that** a specific problem has an ethical dimension, while **knowing how** to resolve the problem needs to be part of the organizational members' skills.

However, it is clear that individuals often know right from wrong, yet still fail to make the right choice or, if they do, fail to act on it. How, then, should one bridge the gap between knowing that a certain issue is an ethical issue and how it needs to be resolved versus actually choosing to do the right thing and acting on that choice.

At times, choosing the right action may require having the personal courage to do the right thing regardless of possible personal cost, organizational role or even organizational consequences (where the organization's actual values differ from its professed values and/or from society's values). Courage is an acquired, rather than an innate, virtue that, like other personal virtues, will be present to different degrees in different individuals. Yet, the organization has an important role to play in encouraging or inhibiting the manifestation of personal virtues, including courageous

acts. The use of a set of rules of conduct could encourage correct behavior by organizational members, so long as an attempt has been made by the organization to implement it, i.e., to shape **the form** of the desired organizational norms and **the ideal** which the norms subsume. Under such circumstances, the individual will be better equipped to make the right choice in a conflict of interest situation, and to act on that choice.

From this discussion it emerges that there are three factors pertaining to the individual's ethical decision making process that determine his/her capacity to behave in line with an ethical code. These are: a) **moral awareness**, i.e., knowing that a certain issue is ethical; b) **moral judgment**, i.e., knowing how to undertake an ethical decision making process; and c) **ethical behavior**, that is, knowing how (having the capacity) to undertake ethical actions (Treviño and Youngblood, 1990; Treviño and Nelson, 2004), this last factor being dependent on personal virtues such as courage and the organizational context. In developing an effective implementation process for an ethical program, we seek to influence these three factors. This can be achieved through two sets of parameters, external and internal, that potentially impose different constraints on each factor. **External parameters** are "group and organizational pressures" and "organizational culture". **Internal parameters** are "individual's differences" and "cognitive bias" (Laufer and Robertson, 1997, Treviño, et al, 1998; Treviño and Nelson, 2004).

In the next section, the methods available for use in creating an effective implementation process for an ethical program are discussed, with a view to determining whether, at the theoretical level, the FSG 2004 and SOX 2002 are capable not only of leading to the inhibition of criminal conduct, but also of supporting ethical conduct, in the organizational context.

### 3. Formal, informal and personal methods

Casell et al (1997) suggest a conceptual model of corporate codes and organizational behavior which present the ethical program and its impact on the ethical decision process through the constraints imposed by organizational formal and informal controls on the individual's ethical



decision making process. In this section I will present briefly this conceptual model in the context of American law and regulations.

#### A. The Formal Methods and the OSA

Though the US Federal Sentencing Guidelines (FSG) of 1991 discussed only a compliance program, practitioners in business ethics, businesses and the courts interpreted 'compliance program' as 'ethical program'. Indeed, so much so, that the terms have become interchangeable (in contrast with that interpretation, the FSG 2004 explicitly prescribes a compliance program and an ethical program as two distinct entities). The United States Federal Sentencing Guidelines of 1991, Chapter 8, set out seven requirements for due diligence in developing an effective compliance program:

1. Establishing compliance standards reasonably capable of preventing criminal conduct;
2. Assigning a specific high-level individual with responsibility to oversee those compliance standards;
3. Exercising due care to ensure that discretionary authority is not delegated to an individual with a propensity to engage with liability;
4. Taking necessary steps to communicate compliance standards and procedures to all employees, with a special emphasis on training and the dissemination of manuals;
5. Taking reasonable steps to achieve compliance with written standards through monitoring, auditing, and other systems designed to detect criminal conduct, including a reporting system free of retribution to employees who report criminal conduct;
6. Consistently enforcing the organization's written standards through an appropriate disciplinary mechanism, including, as appropriate, discipline of individuals responsible for failure to detect an offense;
7. After an offense is detected, taking all reasonable steps to respond and to prevent future similar conduct.

In practical terms, this has been translated into the following set of formal methods:

- a.) Design an ethical code of conduct;
- b) Appoint an ethical officer to coordinate the implementation process for the code
- c) Institute a mechanism to screen out applicants for senior/important positions who have a criminal record.
- d) Institute communication, training and courses on the subject of ethics,
- e) Develop monitoring and auditing mechanisms, and an anonymous help line for reporting misconduct without retribution; and
- f.) Design enforcement and disciplinary mechanisms for a variety of formal methods in the organization (see Harrington 1991).

The SOX Act 2002, Sec. 406, seeks to ensure that senior managers, particularly financial officers, conduct themselves:

- (1) Honestly and ethically, particularly in handling actual or apparent conflicts of interest;
- (2) Provide full, fair, accurate, timely and understandable disclosure in the periodic reports required to be filed by their issuer; and
- (3) Comply with all applicable government laws, rules and regulations.

This requirement for disclosure constitutes an additional formal method. However, its application is widened beyond senior management by the NYSE (New York Stock Exchange) and NASD (), which expand the requirement to all employees of traded corporations.

#### B. The Informal Methods and the NSA

The revisions made in the FSG of November 2004 require, in addition to a compliance program, the development of an ethical program. In addition to inhibiting criminal conduct, the ethical program also requires the organization to create an organizational culture that specifically supports ethical conduct. Cultures cannot be created solely by paper trails. Creation of organizational cultures means the creation of social norms, which are also influenced by informal methods. Thus, formal methods and informal methods are required to meet the new law. The

literature suggests (Casell et al., 1997; Treviño, 2004, Adam and Rachman-Moore, 2004) that the informal methods able to impact on ethical culture are, for example, the “social norms of the organizational members” and “the example set by the manager”.

#### Personal Methods

In the ethical decision making process, the individual can control, to some extent, the impact of the formal and informal controls on the choices s/he makes and on his/her actual conduct. The individual who does so is said to invoke personal controls. Thus, the output of the ethical decision-making process is a function of the relationship between formal, informal and personal controls. Now, I make two assertions. The first is that the output of the individual's decision making process, given the presence of formal, informal and personal controls, may occur at two levels: a.) the choice made; and b) the action taken. The second is that character development, cognitive bias, or the personal idiosyncrasies of an individual are crucial to the ability of that person both to make the right choice and to act on it in the ethical decision-making process.

Furthermore, personal methods, then, relate to the use of the personal values of organizational members, which may influence the behavior of other members and of the organization as a whole, and vice versa. Implicit in these methods is the assertion that an individual is able to effect a change in the organization (Greenberger and Strasser 1986) and, in the reverse manner, that the interface of each member of an organization with its processes underpins individual behavior (Casell et al., 1997, 1085). Similarly, scholars such as Murphy, 1988 and Treviño et al, 1990 hypothesize that personal controls, biases and personal differences may be reshaped in the organization by the organization.

#### 4. Discussion: Answering the RQ.

At present, as previously stated, we do not know where the correct balance lies between formal, informal and personal methods for implementing compliance and ethical program. Indeed, we do

not yet know which of these methods are relevant to endeavors to positively impact either the ethical choice or the ethical behavior of organizational members.

In the real world, the use of formal methods alone has proven ineffective, as described earlier, and in works such as (McKendall et al. 2002)

The likely effectiveness of informal methods can be inferred from two seminal pieces of research, and are discussed in a third. The first work is that of Zimbardo (Haney et al. 1973), who observes that when an individual is assigned to a role, s/he conforms to that role and to its associated culture. This is in reference to the well-known Stanford university "imaginary prison" experiment. That experiment ended prematurely, as the total identification of the participants with their roles created an unbearable "prison like" atmosphere, with the participants' actions reflecting the demands embedded in the requirement of their roles in that "imagined prison" culture. A possible implication of this study is that managers, as role models, shape the required conduct of organizational members.

The second study is that of Milgram (1974), who observes that the obedience of individuals to authority figures may be central to what they do, in that the majority of the participants in an experiment complied with the order from authority to inflict pain on others. Milgram's study indicates that authority figures, such as managers, may play a major role in establishing the conduct of organizational members, in that their requests will likely be followed obediently. It further suggests that an effective means of teaching new rules of conduct may be through the simulation of possible real problem situations.

The third study of Treviño and Nelson (2004) references these studies (the experiments of Zimbardo and Milgram) to examine the impact of organizational culture and leadership on the management of the ethical conduct of the individual. They assert that the organizational culture is often what allows or disallows unethical conduct, this may be traced back to a classic article titled

“Bad Apples in Bad Barrels”, where ‘bad apples’ refers to individuals in the organization who are corrupted in the organizational context, hence, ‘bad barrels’ refers to the corrupted organizational culture (Treviño and Youngblood, 1990).

These conclusions are backed up by recent exploratory research (Adam and Rachman-Moore, 2004) in which the methods used in the implementation process of an ethical code of conduct in a business organization were studied, together with their perceived impact on organizational attitudes. The majority of employees surveyed reported that informal methods, such as the example set by the manager and the social norms of the group, most contributed to their ethical conduct. Only a minority of employees considered the formal methods of training and courses to be influential regarding their ethical conduct (observation to the contrary, see Adams et al 2001) and rare were the employees who deemed enforcement (another formal method) effective.

This study (Adam and Rachman-Moore, 2004) also touched on personal methods, with some employees citing their own personal values as being the decisive influence on their ethical behavior. Interestingly, these employees had the lowest levels of commitment to organizational values (Fritz et al 1999), which may indicate that some ‘apples’ are not corruptible in bad ‘barrels’. Viewed less positively, it also indicates that some corrupt employees are likely to remain impervious to the positive ethical influence exerted by their organization through formal and informal methods. The only remedy for such individuals would be the use of personal methods aimed at reshaping their undesirable ethical values and biases. Such methods are not generally deliberately employed at this time. However, they should be considered. The FSG 2004 requires that organizations create an organizational culture supporting the ethical conduct of the individual in the organizational context. This requirement goes considerably beyond merely requiring organizations to develop a culture in which ethical conduct goes unhindered. Thus, in a culture that supports ethical conduct, special focus must be placed on the individual’s ability and competence to distinguish between right and wrong and to act on that distinction in the organizational context. This requires the use of personal methods. These methods, which

influence the individual's level of understanding and his/her values and biases, can assist individuals to acquire the virtues necessary to uphold the code of ethics and/or behave ethically.

From this discussion it emerges that, while current practice continues to emphasize formal methods, the methods likely to influence the greatest number of employees are actually informal, particularly, the example set by the manager and the organizational social norms. Formal methods will likely need to be retained for those employees who consider them effective, and because the paper trail that they create is probably the only way to reassure stakeholders that the organization takes its ethical responsibilities seriously.

Bridging the gap between the requirements of the ethical code of conduct and the organization's social norms, if there is a gap (Sims and Keon 2000), may be achieved using formal and informal methods. However, personal methods also have an impact (and, potentially, a decisive impact) to the extent that the organization's attempt to bridge the gap is filtered and interpreted by organizational members. Thus the attempt to inhibit an illegal act and support ethical conduct may prove to be a tricky task, since no theory provides a framework that bridges the gap. The philosophical answer proposed here is partial, and relates to the formation of norms, the example set by the manager and character development. Perhaps a way to bridge the gap between the values of the organization and its members, limited, as it is, to the utilization of formal and informal methods, could be to impact on personal controls. However, impacting personal controls is likely to prove controversial, in that developing the personal character of members of the organization is not perceived to be the business of the organization. Doing so would raise questions as to whether we expect the trainer or manager to reshape the personal identity of individual members of an organization and to what extent an organization is justified in using methods aimed at affecting changes to personal identity.

## References

- Adam, A. M., & Rachman-Moore, D. 2004. 'The methods used to implement an ethical code of conduct and employee attitudes', *Journal of Business Ethics*, 54, 225-244.
- Adams, J. S., A. Tashchian and T. H. Stone: 2001, 'Codes of Ethics as Signals for Ethical Behavior', *Journal of Business Ethics*, 29( 3), 199-211.
- Bunge, Nario: 1989, *Treatise on Basic Philosophy. Volume 8: Ethics: The Good and the Right*. Dordrecht: D. Reidel Publishing Company.
- Casell, C., P. Johnson and K. Smith: 1997, 'Opening the Black Box: Corporate Codes of Ethics in Their Organizational Context', *Journal of Business Ethics* 16, 1077-1093.
- Fritz-Harden, J.M., R. C. Arnett and M. Conkel: 1999, 'Organizational Ethical Standards and Organizational Commitment', *Journal of Business Ethics*, 20, 289-299.
- Haney, C.C., Banks and Zimbardo, P; 1973. 'Interpersonal dynamics in a simulated prison', *International Journal of Criminology and Penology*, 1: 69-97.
- Harrington, S.J.: 1991, 'What Corporate America Is Teaching About Ethics', *The Executive*, 5, 21-32.
- Hattiangadi, J.N. 1987, *How Is Language Possible?* Open Court: La Sellas, Illinois.
- Izraeli, D., and M. Schwartz: 1998, 'What Can We Learn from the Federal Sentencing Guidelines for Organizational Ethics?', *Journal of Business Ethics*, 17, 1045-1055.
- Laufer, W. S. and D. C. Robertson: 1997, 'Corporate Ethics Initiatives as Social Control', *Journal of Business Ethics*, 16, 1029-1048.
- McKendall, M., B. DeMarr and C. Jones-Ridders: 2002, 'Ethical Compliance and Corporate Illegality: Testing the Assumption of the Corporate Sentencing Guidelines', *Journal of Business Ethics*, 37, 367-383.
- Milgram, s.: 1974, *Obedience to Authority: An Experimental view*. NY: Harper & Raw.
- Murphy, P. E.: 1988, 'Implementing Business Ethics', *Journal Of Business Ethics*, 7, 907-915.
- Paine, L. S.: 2003, *Value Shift: Why Companies Must Merge Social and Financial Imperatives to Achieve Superior Performance*. NY: McGraw-Hill.
- Ryle, G.: 1946, 'Knowing How and Knowing That', *Presidential Address, Proceedings of the Aristotelian Society XLVI*.
- Sims, R.L., and Keon, T.L, 2000, 'The Influence of Orgaizational Expectations on Ethical Decision Making Conflict', *Journal of Business Ethics* 23, 219-228.
- Somers, M. J.: 2001, 'Ethical Code of Conduct and Organizational Context: A Study of the relationships between Codes of Conduct, Employee Behavior and Organizational Values', *Journal of Business Ethics*, 30, 185-195.
- Treviño, L.K., and K. A. Nelson: 2004, *Managing Business Ethics*. 3<sup>rd</sup> ed. New York: Wiley. 2004.

Treviño, L.K., K. D. Butterfield and C. McCabe: 1998, 'The Ethical Context in Organizations: Influences on Employee Attitudes and Behaviors', *Business Ethics Quarterly*, 8, 447-476.

Treviño, L. K. and S. A. Youngblood: 1990, 'Bad apples in bad barrels: A causal analysis of ethical decision-making behavior', *Journal of Applied Psychology* **75**, 378-385.