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Understanding and measuring ethical culture

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Promoting ethical culture in firms through the adoption of effective ethics and compliance programs has been a cornerstone of the United States Federal Sentencing Guidelines for Organizations, introduced in 1991 by the federal Sentencing Commission. Firms can alleviate the harshest aspect of criminal liability by showing adherence to these guidelines, and thus mitigate the potential range of fines imposed on them in the event of wrongdoing. Providing incentives for companies to self-regulate has fueled widespread adoption of ethics and compliance programs. Yet, wrongdoing still persists. Three recent, and major, corporate scandals highlight culture as a root cause for those ethical collapses (see details in the following reports: Barclays, 2013^[1]; Well Fargo, 2017^[2]; and Uber, 2017^[3]). This raises questions about the balance between those programs that focus on formal elements of an ethics and compliance program vs. those that effectively improve their organizational culture to drive ethical outcomes. Elements of the policies and procedures necessary to create an effective compliance program have been well-articulated, but a lack of equivalent guidelines in relation to the ethical culture has left organizations struggling to figure out what ethical culture means and how it should be measured. The measurement and improvement of ethical culture is not only important to fulfill regulatory mandates but also because empirical studies show various positive effects of ethical culture, including reduced misconduct, increased willingness to report observations of misbehavior, improved employee wellbeing, and innovation.

Ethical culture

Ethical culture can be defined as a set of experiences, assumptions, and expectations of managers and employees about how the organization prevents them from behaving unethically and encourages them to behave ethically, according to Muel Kaptein, a professor of business ethics and integrity management at Rotterdam School of Management. Ethical culture is also part of the ethical context that incorporates multiple components, including formal and informal systems. Formal systems are the tangible organizational elements pertaining to ethics that are purposefully designed and implemented (e.g., ethics programs), whereas informal systems are the unwritten policies, practices, and values that are relevant to ethics (e.g., ethical culture or climate). Ethical culture is less visible than the formal elements of ethics programs (e.g., code of ethics, helpline, training), because it is rooted deeply within the organization and the mind-set of its employees; therefore, it is more difficult to assess.

What to measure?

Ethical culture

In order to measure ethical culture, it is important to review how the construct that comprises the shared ethical assumptions, values, and expectations among employees and managers has been studied. David Mayer^[4] carried out a literature review that found a multitude of approaches to conceptualizing and operationalizing ethical culture that, in his view, lead to inconsistency and problems of construct validity, because it is difficult to say if

they are all tapping the same construct. We highlight here the three primary measures and conceptualizations in the business ethics literature: ethical values^[5] (Hunt et al. 1989), ethical organizational culture index^[6] (Treviño et al., 1998), and corporate ethical virtues (CEV) model^[7] (Kaptein, 2008).

Hunt and colleagues highlight in their conceptualization that an important aspect of an organization's ethical culture is its ethical values, and their model is based on a five-item measure of ethical culture that focuses on managers. Treviño and colleagues propose the Ethical Culture Index (a 21-item measure), which is centered in aspects of the ethical environment, obedience of authority, and code of ethics implementation, which differentiates this conceptualization from the other two by combining informal (e.g., values, behaviors) and formal (e.g., code of ethics) systems to define ethical culture.

Kaptein develops the CEV model drawing from Solomon's virtue-based theory of business ethics that suggests that individuals and organizations possess virtues or conditions that foster ethical behavior and prevent unethical behavior. The CEV model is a 58-item measure of ethical culture with eight ethical virtues or dimensions. First, clarity of ethical standards refers to concrete and understandable expectations. The second and third virtues reflect managerial behavior: ethical role-modeling by supervisors and senior management. The fourth virtue in the CEV model is feasibility, the opportunity or ability to behave ethically based on resources available (e.g., time, information, equipment). Fifth, supportability refers to creating a shared commitment to ethical behaviors through fair treatment and mutual trust in the workplace. Sixth, transparency acknowledges that unethical behaviors and their consequences should be perceptible to all members of the organization. Seventh, discussability is the opportunity to raise and discuss ethical issues. Finally, the virtue of sanctionability refers to the likelihood of employees and managers being rewarded for ethical behavior and punished for behaving unethically.

Individual ethical responses (intention and behavior)

Individual ethical responses such as ethical conduct are important elements to measure the outcomes of ethical culture. Although following the code of conduct and complying with the law are the basis of ethical conduct at work, many agree that reporting unethical behavior is a higher moral example of ethical conduct, because the reporter risks potential retaliation without seeking personal benefits. Reporting unethical behavior can be measured through actual instances of reporting or intention to report. For example, a company can count the number of actual helpline reports or gather survey data regarding intention to report unethical behavior among employees. Research has shown a clear disparity between actual and intention to report,^[8] which confirmed that intention is not the same as behavior, and future research should take this into account. It is noteworthy to add that ethical responses are individual, but culture is collective in principle. As a result, ethical responses involve the interplay between personal traits and the informal and formal systems of the ethical context. In this respect, the literature on whistleblowing has largely studied the personal and situational factors influencing intention to speak up when observing unethical behavior.

Ethical culture may influence intention to report unethical behavior (i.e., internal whistleblowing) of employees and managers. Companies promoting ethical culture are likely to have employees more committed to report unethical behavior and conduct themselves ethically than companies with unethical cultures. But intention and actual reporting are not only influenced by situational factors that a company can improve when developing an ethical environment, but are also affected by personal factors such as tenure, gender, age, religion, or education level.^[9] New hires, for instance, are less likely to report something that does not feel right because they are still getting to know the company and the way it does business, and their levels of trust may be limited compared to more tenured employees. Or employees who are up for promotion would rather prefer not to speak up, anticipating that the report may not help his/her application.

Individual behavior can also be affected by regional or national factors, such as cultural background or regulatory environments. For example, the same multinational company may foster ethical culture across all locations, but it is likely that improving a speak-up culture among employees will be more difficult in countries where there is no whistleblowing legislation, and reducing sexual harassment will be more challenging in countries where gender equality is not a priority. Similarly, a company will struggle to encourage employees to speak up in regions where unemployment is higher than in regions where alternate employment is available, given that reporting on the behavior of peers or superiors, even internally, almost always involves career risk.

In addition, research has shown that formal systems, such as the existence of an ethics program, can also affect ethical responses in many ways. The adoption of codes of ethics, ethics training, or compliance helplines can be key elements in individual ethical responses of employees regarding reporting unethical behavior.

Corporate reputation

Ethical culture can be a critical ingredient of corporate reputation. According to Fombrun and colleagues,^[10] corporate reputation is the sum of internal and external perceptions of stakeholders such as customers, employees, suppliers, regulators, and shareholders. For organizations, good reputation offers license to operate and improve market share, employer branding, and brand awareness, just to mention a few advantages. On the contrary, bad reputation mostly jeopardizes the success and, eventually, the survival of companies in many ways: decreasing profits, increasing marketing and legal costs, or limiting talent acquisition. The paradox is that companies' ethical cultures are only known to the public when they are blatantly unethical. This is because usually only internal stakeholders (e.g., employees, managers, or shareholders) are aware of the ethical culture of a company. But when corporate misconduct hits the headlines, others learn about the scandal, and catastrophic consequences may follow in terms of reputation (e.g., Enron, Uber, Volkswagen, Barclays). Although Enron ended up filing bankruptcy due to the lack of public trust, Uber's CEO had to leave the company among concerns about senior management's stance on ethics and integrity, and Volkswagen and Barclays faced enormous fines.

There are two ways to resolve this reputational paradox, and both include measurement and communication. First, more transparency can reward companies, thus creating better reputations when warranted. Second, regular and comprehensive audits of the ethical culture (and also the formal systems) can support companies to secure their ethical reputation and avoid scandals by detecting risks and establishing controls and remedies. For assessment to be effective, it is necessary to include multiple stakeholders and a representative sample of the staff (e.g., locations, departments, hierarchical levels). In doing so, customers, suppliers, and other external stakeholders will notice the commitment of the company toward ethicality.

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