CEP Magazine - January 2024

Sabine Clappaert (sabine.clappaert@fticonsulting.com) is Managing Director in the People & Transformation Practice for FTI Consulting in Brussels, Belgium.

Ilona Indra (ilona.indra@fticonsulting.com) is Managing Director in the People & Transformation Practice for FTI Consulting in Frankfurt, Germany.

Leading the way: Ethics and compliance as leadership responsibilities

By Sabine Clappaert and Ilona Indra

To thrive in a complex world of constant change and challenge, firms must continuously innovate by pivoting business models, creating disruptive products, and implementing new technologies. Keeping an organization innovative, aligned, and on course in these circumstances is no small feat. It requires a clear North Star in purpose and ethics as well as active, visible leadership to demonstrate what really matters and what is expected of everyone in the organization.

To successfully elevate ethics to be a strategic advantage, it must begin at the top. It must begin with ethics and compliance being owned by senior leaders as a leadership responsibility, and it must be part of strategic decision-making discussions.

> "The ultimate measure of a man is not where he stands in moments of comfort and convenience, but where he stands at times of challenge and controversy." – Martin Luther King Jr.

While many organizations equate ethics to compliance, that is not the case. Compliance relates to laws, which are a minimum threshold below which companies and people are punished, while ethics sets higher standards. While compliance is *extrinsically* driven, ethics is *intrinsically* motivated. It is a matter of doing the right thing against the background of one's own moral standard—often against the backdrop of evolving social expectations that may not yet have been reflected in legal frameworks (e.g., society's evolving expectations around environmental, social, and governance reporting or the evolving outlook of hybrid working).

Both compliance and ethics influence decisions, actions, and behaviors in organizations—sometimes, they conflict with each other. The key question for companies to consider is, what guidelines help us navigate complex situations, especially if there is a conflict between what is ethical and what is compliant?

Finding clarity in the tension between ethics and compliance starts with a clear understanding of "ethical leadership":

- Ethical leaders look beyond *what* must be achieved and consider *how* things should be achieved. Although ethical principles may vary in different cultures and companies, there are universally acknowledged ethical values, such as trustworthiness, respect, responsibility, fairness, caring, citizenship, honesty, modesty, and sustainability.[1]

- Ethical leaders are those who act both as a "moral person"—maintaining the universally acknowledged values in relationships with subordinates, peers, partners, and stakeholders—and as a "moral manager," demonstrating and reinforcing the desired appropriate behaviors across their organization.[2] *In times of challenge and controversy* (to return to the Martin Luther King Jr., quote), these leaders navigate complex situations by demonstrating consistent moral character and inspirational (and aspirational) organizational norms, standards, and behaviors. In doing so, moral leaders make ethics an explicit part of their leadership agenda and hold others in the organization accountable for applying the same standards.

Ethical leadership: Does it matter?

The research is clear: Ethical leadership influences both individual and organizational performance.[3],[4] First and foremost, ethical leaders are trusted as leaders. According to the research, trust is the overriding variable that gives room to the other important factors for optimum performance:

- **Healthy dialogues**: Trusted leaders promote healthy dialogue and conflict resolution in their teams. This means that concerns, questions, and criticisms are addressed openly, intending to find solutions. Companies where employees and managers have healthy dialogues make fewer mistakes, learn faster, and achieve higher performance levels.

- **Learning and development**: Employees who trust their leaders rely on their feedback, are more courageous, and have more confidence in themselves and their ability to learn and grow—a prerequisite for a high-performing organization.

- **Employee engagement**: Employees who trust their leaders are willing to go the extra mile, are less open to changing employers, and are more likely to promote their own employer to others.

At the same time, ethical leaders not only improve the performance of their organization but also decrease the risks their organizations face. They reduce an unhealthy focus on short-term gains, the likelihood of rogue decision-making, unethical behavior, willful noncompliance, and cutting corners.

How ethical leadership shapes your risk culture

Ethics and compliance are an integral part of any organization's success, but a healthy approach to risk can only thrive if it is fully embedded in the organizational culture.

> "Organizational culture is the manifestation of all the factors that influence the way people think, behave and make decisions—individually and collectively—in a company." – FTI Consulting

Three perspectives need to be considered when thinking about ethical leadership and its influence on organizational culture: the individual perspective, the perspective of the people in the organization, and the perspective of the organization as a "living" system. A systematic approach to all three perspectives will help improve a company's risk culture.

How ethical considerations shape leaders

A leader's personal leadership style is essential in shaping their personal and professional leadership "brand." At its foundation, acting ethically builds credibility—personally and professionally. This is important because credibility is a prerequisite to building and maintaining relationships, earning the trust of others, and garnering support when needed. For many companies, having strong personal ethics is crucial in hiring and promotion

decisions.

How ethical leaders create followers

Ethical leadership creates a ripple effect throughout the organization. The day-to-day mindsets and behaviors of leaders shape how the people they are surrounded by act and behave. Because company culture is built over time on seemingly trivial everyday behaviors, even one leader displaying unethical behavior can have a ripple effect of unwanted behavior across the organization. If a leader cuts a corner, others may also decide to do so. If a leader ignores a policy or talks about compliance in a derogatory manner, others may follow their example. Effective, ethical leadership is about predictability. What mindsets, behaviors, and decision-making can an organization count on from its leaders? Is it consistent and predictable? Is it ethically sound?

How ethical leadership influences an organization's risk culture

Every company has a risk culture that defines how risks are dealt with unconsciously. In this context, most companies will move somewhere between the two extremes of absolute risk avoidance and full risk-taking. When leaders have strong personal ethics and adhere to the universally accepted values of honesty, respect, and transparency, naming the issue and talking about it openly becomes a normal part of the culture. The less often companies talk about risks and how to deal with them, the greater that risk will become. Companies with a healthy risk culture talk about risks and think strategically in their leadership teams about whether to take the risk or not.

Ethical leadership allows the North Star to deal with risks appropriately. Applying this thinking, the myth that "ethics puts the organization at a commercial disadvantage" can be quickly dispelled because the opposite is true: Applying ethical leadership minimizes risks. In this understanding, ethical leadership as well as compliance are strategic enablers of business, as both help to consider long-term consequences of risky, noncompliant, or unethical behavior. A solid reputation is vital for a company to thrive, and there are many examples of companies that have ruined their reputation—wiping out a significant part of their business—by acting unethically or outside the law. Ethical leadership also helps prevent problems, including large fines and legal action from regulatory bodies in the aftermath of a scandal, security breaches, or low employee morale and poor performance resulting from a toxic work culture. On a positive note, it also helps build a strong reputation with investors, employees, and communities alike, and contributes to attracting top talent, business partners, and investors.

What can stand in the way of a healthy risk culture?

As stated earlier, ethical leadership can help develop a healthy risk culture. But simply reviewing and communicating corporate values is not enough. In our experience, this is precisely where many companies start: they revise their corporate values and code of conduct and communicate this widely internally. Often, they also manage to ensure the so-called "tone from the top," at least for a while. What is often overlooked is the fact that a suitable corporate culture—in this case, the appropriate risk culture—must be developed for the company. For this, three questions should be answered.

What defines a business-enabling healthy risk culture for our organization?

It sounds obvious but is often given too little attention: Perfect culture does not exist. The culture that fits and enables one organization may hinder and stifle another. The same holds true for a healthy risk culture. It must fit and enable the organization, support its specific objectives, and consider its unique challenges.

How can we shape our risk culture?

To define their ideal compliance culture, organizations must first know what defines their risks and compliance culture *today* (not on paper, but in real-life, day-to-day decisions and behaviors of their leaders, people managers, and employees) and understand where the pressures are coming from to take risks or disregard compliance requirements.

How can you measure risk culture?

Most companies understand the importance of a healthy risk or compliance culture but often perceive culture as something unmeasurable. However, a culture of compliance can be measured, and doing so enables a company to take action to improve compliance culture based on prescriptive data about what is driving cultural strengths and weaknesses. Even though about half of compliance professionals conduct general employee pulse surveys, comprehensive cultural assessments focused on compliance are rare, suggesting that a deeper assessment could help shed light on some of the compliance challenges that organizations have not yet been able to identify.[5] A specialized assessment is needed that explores not only awareness of policies and where to find them, knowledge of the ethics hotline and the effectiveness of compliance training sessions, but also employees' perceptions of the performance of their leaders, managers, peers, and themselves regarding ethical behavior, communication, and accountability for ethical and compliant business interactions.

But even if the desired risk culture is clearly defined, it is not yet a reality. There will be barriers at individual and organizational levels that need to be addressed. This can only be achieved through targeted enablement and permanent monitoring of whether barriers exist and, if so, to what extent.

At the individual level, the focus should be on psychological factors: What personality profile prevails in the company? When individuals are recruited or promoted, is care taken to ensure that they have the right set of values, that they are aware of their responsibility for ethically correct behavior, and that they have a healthy relationship to power and influence?

At the organizational level, other questions should be critically examined because their answers influence the behavior of employees and managers: How aggressive are the company's financial goals? Can they be realistically achieved? How strong is the competitive pressure, and to what extent does this cause ethical issues to be relegated to the background? How hierarchical is the company? Which is more appreciated: following hierarchical ways or sharing concerns across hierarchical levels? What is the decision-making process and culture: shared and aligned or alone and in sidebar conversations?

The symbiotic relationship between ethical leadership and compliance is undeniably crucial in today's complex business environment. When ethics and compliance merge as the guiding North Star for an organization and its leaders, they evolve into a potent strategic advantage. The key to unlocking this advantage lies in the open discussion of risks and the deliberate, thoughtful decision-making processes surrounding them. By fostering a corporate culture grounded in strong ethical shared values, quality relationships, and transparency, organizations can build a strong reputation, become more attractive to investors and top talent alike—and lead to higher customer loyalty.

The views expressed herein are those of the authors and not necessarily those of FTI Consulting Inc., its management, subsidiaries, affiliates, or other professionals.

Takeaways

- Leaders are the moral compass of their organizations. Leaders are the role models employees look to for the values and behaviors that are acceptable—and those that are not—in their organization.

- Without a culture of trust, frank conversations about risks are not possible, and employees will not openly flag concerns or misconduct.

- Ethical leadership is the foundation of a healthy risk culture in which risks are openly discussed and strategically approached.

- There is no such thing as a standard healthy risk culture. Companies need to define their specific business-enabling healthy risk culture and regularly assess it via a comprehensive culture assessment.

- When ethics and compliance merge as the guiding North Star for an organization and its leaders, they evolve into a potent strategic advantage.

1 Mark S. Schwartz, "Universal Moral Values for Corporate Codes of Ethics," *Journal of Business Ethics* 59, no. 1/2 (June 2005): 27–44, https://www.jstor.org/stable/25123538.

2 G. James Lemoine, Chad A. Hartnell, and Hannes Leroy, "Taking Stock of Moral Approaches to Leadership: An Integrative Review of Ethical, Authentic, and Servant Leadership," *Academy of Management Annals* 13, no. 1 (January 2019): 148–187, https://journals.aom.org/doi/full/10.5465/annals.2016.0121.

3 Thomas W. H. Ng and Daniel C. Feldman, "Ethical leadership: Meta-analytic evidence of criterion-related and incremental validity," *Journal of Applied Psychology* 100, no. 3 (May 2015): 948–965, https://psycnet.apa.org/record/2014-49328-001.

4 Ann C. Peng and Dongkyu Kim, "A meta-analytic test of the differential pathways linking ethical leadership to normative conduct," *Journal of Organizational Behavior* 41, no. 4, (May 2020): 348–368, https://doi.org/10.1002/job.2427.

5 FTI Consulting, "Compliance Leadership Redefined," blog, January 25, 2023, https://fticommunications.com/compliance-leadership-redefined/?topic_origin=compliance.