A Focus on Ethics: The Inadequate Solution

Business control … A new "core competency" for today's organizations

Research shows that ethics training doesn't work. Organizations today must embrace a best-practices "business control" process to ensure both ethical and cost-controlled behaviors.

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A BizControl Solutions White Paper

It is almost impossible to pick up a business publication and not find an article talking about corporate ethics. For example, St. Louis-based Edward Jones agreed to refund $25 million in sales fees to 28,000 customers billed for funds that had stopped charging the fees. This is the same Edward Jones that had to pay a $75 million settlement to the Securities and Exchange Commission in 2004 for steering clients into funds where it received compensation without telling clients about it. In between, Edward Jones was fined $300,000 by the NASD for making faulty disclosures on municipal bond transactions, a mistake affecting 86,000 transactions worth $1.6 million. It was also fined $200,000.00 by the NASD for encouraging reps to recommend margin loans to public customers.

Is this a series of bad luck events, is it that Edward Jones can't learn anything, or is it the result of leaders asleep at the switch? Regardless, what should organizations facing repeated problems like Edwards Jones do about them?

With individuals such as Jeffrey Skilling, former CEO of Enron, serving a 24-year jail term, the topic of leadership and ethics is a major concern for organizations. What does it take to ensure that leaders at all levels of an organization behave in an ethical and legal (and cost-efficient) fashion? There are currently four points of view.

1. Leaders Need Ethics Training

The most common view is that the solution to our current problems begins with educating future leaders and training current leaders on ethics. Publications such as the *Journal of Business Ethics Education* from Senate Hall Academic Publishing and positions such as the Bill Daniels Distinguished Professor of Business Ethics at Wyoming University all promote the idea that ethics is a learning issue.

In support of this, as one of its accreditation standards, The Association to Advance Collegiate Schools of Business (AACSB) requires that, "Ethics education is called for in the general knowledge and skills portion of the standards for undergraduates, and in the management-specific portion of the standards for undergraduate and master's students." Although the AACSB stops short of requiring a specific course in business ethics due to the difficultly in defining what a "course" is and what it should contain, it does offer numerous association conferences on business ethics education.

2. Ethics are a Hiring Trait

A second viewpoint is that honesty isn't something that leaders develop. It is part of their personal philosophy. The idea here is similar to Robert Fulghum's rules in *All I Need to Know I Learned in Kindergarten:* "Play fair" and "Don't cheat."[6]

In human resources, we are taught to "train for skills, hire for traits." So if good ethics is something simple we learned in kindergarten and accepted it or not way back when, then it is a trait—not a skill that can be trained. You either have it or you don't. You're either honest or you're not.

Therefore, training is a complete waste of time, with the unethical person thinking "What a joke!" through the whole session.

3. Ethics Can Be Legislated

Another viewpoint is that ethics can be legislated. This is the idea behind the Sarbanes-Oxley Act of 2002 (SOX), which requires all publicly-traded companies to submit an annual report of the effectiveness of their internal accounting controls to the SEC. It provides for civil and criminal penalties for violations, and makes corporate leaders personally responsible for ethical violations. The thought is that if leaders are threatened with jail, they will behave ethically. Unfortunately, executives are still going to jail.

4. It's Not about Ethics, It's about Business Controls

This is a revolutionary approach to ethics that is totally counter to #1 and #2, and barely compatible with #3. This viewpoint is that ethics is not the issue, because dishonesty is a given in our society.

For example, in a survey of 4,500 high school students, Donald McCabe of Rutgers University found that more than half admitted to plagiarizing from the Internet, 74 percent admitted they had cheated on tests, and 97% admitted to cheating on homework.

And business schools, with the AACSB ethics requirement, do not offer much more hope for future executives. In a survey by Pennsylvania State, Rutgers, and Washington State universities of 5,331 students at 32 graduate business schools in the United States and Canada, 56 percent of business students admitted cheating. So much for our future corporate leaders…

The solution involves a new concept called "business controls." This is a level above traditional financial or operations control, and the concepts and techniques need to be understood by all supervisors and managers in an organization. "Business control" is a new organizational core competency. Leaders need to move from reactive controls that address problems to proactive controls that prevent them.

Analysis

The push to start training everyone on ethics appears to be the wrong approach. For example, two priests in Florida were arrested for stealing over $8.6 million from their parish. It's hard to imagine better ethics training than they had.

A consultant commented that he had attended one of the nation's most prestigious ethics training programs at the University of Chicago while he was a high-level financial executive with a major chemical company. The problem was that he couldn't tell anyone because it was sponsored by the accounting firm Arthur Anderson, which was later disgraced.

The series of articles about Edward Jones seems to suggest that organizations don't always learn from their mistakes. And as the above studies on student cheating show, the increased focus on ethics in school isn't having the desired effect. Tomorrow's leaders seem to have no reservations about cheating today.

A young HR professional observed, "In my current position as a hiring screener for a large public relations firm, it's my job to assess candidates based upon their backgrounds and my impression of them. My experience is that employees walk in with their values established. Knowing my peers, a job—or some training class—isn't going to change their basic personality. Training isn't the answer.

"Hiring honest people also has its problems. In my previous job as a shopping mall store manager, I was taught a rule of thumb that 15 percent of people are honest all the time. For example, if you give them too much change back, they'll correct you and hand it back. So you have to have policies to control your shrinkage without insulting them, because they are honest.

"At the other end, five percent of people are dishonest all the time. They're out to steal everything they can from you, and you have to have methods in place to stop them or catch them.

"The other 80 percent are honest or dishonest to the extent they think they'll get caught. As my district manager said, 'If there's a camera in the corner blinking, they won't take anything. But if there's an armored car overturned in the street and money is blowing all over, they be diving for it and run off.' For this group, policies need to be there in order to help them be honest."

If the solution is to hire honest people, then this means you have to hire only the 15-percenters. Assuming that you could actually figure out who's who, this group may be too small to find everyone you need. It's going to be impossible to hire only honest people.

So can ethics be legislated with the fear of punishment causing leaders to be honest? Kathleen F. Brickey, James Carr Professor of Criminal Jurisprudence at the Washington University School of Law, observed, "Many critics of Sarbanes-Oxley see its reliance on increased penalties as perhaps the weakest link in the chain, reasoning that the threat of imprisonment has no deterrent value for corporate executives no matter what the maximum is." The question is whether it is possible to deter greed, and whether the chance of actually going to jail is seen as high enough to matter.

The widespread stock option backdating scandal has shown that current laws and regulations aren't stopping leaders from trying to "beat the system." Literally hundreds of top executives were in no way concerned about the ethics of backdating or deterred by the legal risks, and now many of them have been forced to resign. A quarter of these resignations have been General Counsels, the supposed legal and ethical experts in organizations, who supposedly should have known better.

Now, with both of SOX's authors leaving Congress, there continues to be talk about the high cost of compliance on companies. While SOX supporters point out that there needs to be some way to hold executives accountable for their actions, Sox is seen by many to be ineffective and overkill—as the continuing run of scandals suggests.

The reason is that SOX doesn't help leaders do anything right. It only punishes them if they do something wrong. And it says nothing about effectiveness. You can totally mismanage your company, but as long as you report your terrible results accurately, you are in ethical and legal compliance.

The only alternative left is to change the way organizations run their business. This means changing management processes from the board level down to front-line supervisors.

It means establishing a special business controls team to identify, analyze, and fix control problems throughout the organization. It means training leaders not on ethics, but on business control principles such as the seven hallmarks of an effective control and how to design compensating controls. It means preventing control problems rather than recovering from them.

Conclusion

Ethics training doesn't work. Hiring only honest people is basically impossible. And threatening leaders with fines or jail time hasn't seemed to scare them. The only option left is to run the business differently.

A business control approach becomes the "blinking light on the camera in the ceiling" for an entire organization, controlling the 5-percenters who always cheat and influencing the 80-percenters who are willing to. It makes it harder for executives to get away with ethical violations in their organizations, and helps keep innocent middle managers from being drug into situations where they don't understand what they're being asked to do.

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BizControl Solutions specializes in helping organizations develop a new "core competency"—*business control.* Using a set of proven best practices, BizControl Solutions provides a complete process map for minimizing risks of being out of control and for lower unnecessary costs.