review

Regulating for ethical culture

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abstract

Recent cases of corporate fraud have heightened regulatory interest in leveraging organizational culture to encourage ethical behavior. Policymakers in government and industry wish to use culture to enhance the enforcement-based approaches that they have historically relied on, but they want guidance on how to proceed. In this article, we review the organizational behavior literature on ethical culture. We define the components of ethical culture in organizations and summarize research into how to assess and strengthen it. We demonstrate that assessment must be an integral part of regulatory efforts to strengthen ethical culture, and we recommend that policymakers encourage industries to use standardized, validated measures to further policy goals.

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The 1980s are generally remembered as a boom time on Wall Street, with rising market indices and plenty of fraud. The movie *Wall Street* encapsulated the period in the character of Gordon Gekko, with his "greed is good" mantra. The era also brought the savings and loan crisis, which required costly government bailouts of financial institutions, some of which had engaged in pervasive fraud.

Suppose that in 1990, the Justice Department had tasked a team of lawyers and economists with crafting a regulatory approach that would improve the ethical behavior of corporations, especially financial companies. The result would probably look something like the Federal Sentencing Guidelines for Organizations (FSGO), which were published by the U.S. Sentencing Commission in 1991.[1]

The carrot-and-stick approach that the commission adopted incentivized companies to put personnel and procedures in place to guide employee conduct, encourage reporting of misconduct, and monitor and punish wrongdoing. Firms that developed ethics and compliance (E&C) programs that could "prevent and detect violations of law"[1] effectively would benefit by receiving lighter penalties and shorter probation periods if their employees were later discovered to have committed criminal offenses. The FSGO outlined the commission's expectations for reasonable components of E&C programs, including periodic risk assessments, due diligence (with respect to hiring individuals and undertaking periodic evaluations of its E&C program), and an obligation to report the results of assessments.

Since 1991, most large companies have established E&C programs. Many in the regulatory community, however, remain skeptical that the programs are working as the authors of the FSGO intended. They fear that too many are "check-the-box" programs that make it seem like a company is making an effort (by establishing policies and procedures that look good on paper) when, in fact, many employees perceive that the programs are mere window dressing.

In 2004, recognizing that many E&C programs appeared to adhere to the letter of the guidelines but were not seriously integrated into daily organizational life, the U.S. Sentencing Commission revised the FSGO so that companies were obliged to "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."[2] This new element, however, left companies and regulators to wonder, How does one create an ethical culture and assess whether a company's culture encourages ethical conduct?

In this article, we offer answers to those questions. In the first section, we provide context, surveying current regulatory initiatives that encourage companies to embrace ethical culture through E&C programs and other measures. Next, we outline the complex systems that constitute an ethical culture, integrating insights from anthropology and the organizational-behavior literature specific to ethical culture. In the final sections, we review the literature on ethical culture assessment and offer recommendations for how to regulate ethical culture in organizations.

Core Findings

What is the issue?
Assessing and regulating ethical culture in organizations is important for preventing fraud and costly cases of misconduct. In order to know where to begin, however, leaders and policymakers need to know how E&C orientation, leadership, climate, fairness, and trust feed into actionable assessments of ethical culture.

How can you act?
Selected recommendations include:
1) Creating an independent third-party organization to serve as a neutral research entity that conducts assessments of ethical culture, communicating between the industry and regulators
2) Monitoring how an organization's ethical culture changes over time in a process of continual learning and experimentation

Who should take the lead?
Regulators and industry leaders, organizational psychologists, behavioral science researchers

Recent Regulatory Interest in Culture

The FSGO remains the main source of guidance for organizations creating internal E&C programs. In recent years, the regulatory and enforcement community, particularly in the financial industry, has come to agree with its stance that creating an ethical culture is key to an organization's successful compliance with regulations. Notably, in October 2014, William Dudley, the president of the Federal Reserve Bank of New York, convened the heads of U.S. financial institutions for the first of a series of Reforming Culture and Behavior in the Financial Services Industry conferences. This meeting occurred at a time of intense scrutiny of the financial industry: in the wake of the global financial crisis of 2008, the Bernard Madoff Ponzi scheme (2008/2009), the J.P. Morgan Chase "London whale" trading scandal (2012), and revelations of collusion by financial institutions in setting the London Interbank Offered

Rate (better known as LIBOR; 2012), among others.

Dudley made a strong case for the importance of measuring and improving ethical culture. He began by rejecting claims that these scandals could generally be pinned on one or a few rogue traders or bad apples. He then gave a succinct definition of organizational culture and argued that the behavior of senior management is critical to establishing ethical norms:

> Culture exists within every firm whether it is recognized or ignored, whether it is nurtured or neglected, and whether it is embraced or disavowed. *Culture reflects the prevailing attitudes and behaviors within a firm. It is how people react not only to black and white, but to all of the shades of grey* [emphasis added]. . . .
>
> As a first step, senior leaders need to hold up a mirror to their own behavior and critically examine behavioral norms at their firm. . . .
>
> Firms must take a comprehensive approach to improving their culture that encompasses recruitment, onboarding, career development, performance reviews, pay and promotion.[3]

Dudley then urged the assembled chiefs of financial institutions to develop a common approach to measuring an organization's culture, beginning with an anonymous employee survey:

> An important measurement of progress is employees' assessment of their firm's culture. To this end, we encourage the industry . . . to develop a comprehensive culture survey. This anonymous survey would be fielded across firms each year by an independent third-party and the results shared with supervisors. Having a common survey instrument would promote benchmarking of, and accountability for, progress on culture and behavior.[3]

(Researchers have developed some survey tools, which we describe later. So far, though, most industries lack standardized measures for their fields.)

Other banking regulators, including the Financial Industry Regulatory Authority (the self-regulatory organization for broker-dealers also known as FINRA) and the Office of the Comptroller of the Currency (OCC), have likewise turned their attention to culture as a lever to improve ethical behavior in organizations. In January 2016, FINRA's annual Regulatory and Examinations Priorities Letter[4] to the firms it oversees asked them to report on how they monitor the implementation of and compliance with the firm's cultural values.

The OCC has taken a slightly different approach and put responsibility directly on the banks' executives and boards of directors to integrate the oversight of corporate culture into their duties. The July 2016 *Comptroller's Handbook: Corporate and Risk Governance,*[5] which serves as the guidance document for OCC bank examiners (and thus communicates regulatory expectations to the firms), states that it is the duty of the board and senior management to "promote a sound corporate culture." The handbook lists a series of expected undertakings by the C-suite (that is, the company board and senior management) to this end, including ensuring that the appropriate behaviors are "linked to performance reviews and compensation practices" and that managers "integrate the culture into the bank's strategic planning process and risk management practices."

Clearly, regulators are increasingly focusing on using corporate culture as a tool to prevent misconduct. And they continue to have their work cut out for them, as the ethics scandals of the past couple of years make clear. Recall when, for example, Wells Fargo employees opened accounts for customers without their knowledge or consent,[6] and Volkswagen engineers installed software designed to fool regulators into thinking that the company's vehicles met emission standards.[7] To be successful, regulators need a deep understanding of exactly what an ethical culture looks like, as well as how that culture can be assessed, reported on, and managed within large, complex organizations.

Regulators would also be wise to familiarize themselves with psychology. Just as economists have expanded their thinking about the drivers of financial interactions to include behavioral economics, regulators interested in enhancing ethical behavior in corporations should read more psychological research, particularly work exploring the drivers of ethical and unethical behavior in organizations. The behavioral ethics literature generally defines *ethical behavior* as activity that is consistent with society's accepted moral norms,[8] and studies found in the literature typically focus on behavior that breaches those norms (for example, cheating, lying, and stealing).

The realms of ethical and legally compliant behaviors overlap to a large extent, because the law represents general agreement in society about what constitutes right and appropriate behavior. However, many of the ethical and unethical behaviors found in organizations simply are not addressed by law and regulation (such as certain conflicts of interest) or have not yet been addressed (such as whether new information technology is being used ethically). Therefore, decisions about what is ethical or unethical reside in a gray area that is open to discussion and social consensus within organizations and society as a whole.

Because organizational culture is being targeted as a tool for managing ethical conduct in organizations, those who are charged with managing and regulating it need to have a firm grasp of what an ethical culture looks like. We now step back to examine its features in detail.

What Is Ethical Culture?

The word *culture* comes from the Latin word *cultura,* which means cultivation or tillage. The agricultural origin of the word conveys the sense of shaping or nurturing something over time. Like plants, people are rooted in a particular place, and they are shaped by the norms of that place. For example, when employees show up for work in a new organization, they quickly get a sense of "how things are done around here" and what kinds of behaviors are accepted and expected.

Culture has been the central concept in anthropology for over a century, and anthropologists have taken the lead in defining the term. Writing in 1995, Richard Shweder, one of the founders of modern cultural psychology, gave this definition:

> Culture is a reality lit up by a morally enforceable conceptual scheme composed of values (desirable goals) and causal beliefs (including ideas about means-ends connections) that is exemplified or instantiated in practice.[9]

Shweder's definition notes that culture is more than conceptual schemes and beliefs: it envelops people and creates a reality that is expressed and passed on to others by the practices and rituals of the group. Most important, Shweder's definition explicitly recognizes the role of morality in enforcing the group's ways of thinking and acting. A company's moral norms can lead employees to engage in upright behavior, but only if socially beneficial behavior is what is modeled. If the culture includes unethical practices, such as cheating customers, then going along with those practices can seem like a moral necessity to insiders. An employee who violates the implicit rules of the culture by exposing its practices to outsiders—or who just tries to change it from within—may face criticism, shaming, and ostracism. For such reasons, social psychologists generally focus on the "bad barrel" rather than on individual "bad apples" when they study wrongdoing in organizations.[10]

Shweder's approach aligns with the definition of ethical culture in organizations that one of us (Treviño) has used for years: if culture can be thought of as "how we do things around here," then ethical culture is the employees' understanding of "how we do things around here in relation to ethics."[11] More specifically, an organization's ethical culture is a complex system with multiple moving components that constantly send messages to employees that either support or do not support ethical conduct. The

> "If the culture includes unethical practices, such as cheating customers, then going along with those practices can seem like a moral necessity to insiders"

behaviors of leaders and the activities carried out through a company's systems for managing and improving employee performance are just two powerful examples of an organization's activities sending signals, both formal and informal, to employees about an organization's ethical culture.

Regulators and corporate leaders also need to understand that ethical culture is not an objective truth. Rather, it comprises the messages that employees perceive they are getting and that they are acting on every day, not necessarily the messages that management intends to convey. An organization's efforts to study and improve its culture must therefore include direct questions asking its employees for their perceptions of the multiple aspects of ethical culture.

In a perfectly ethical culture (a rare bird), all of the culture components consistently send a clear message that ethical conduct is expected. Employees are recruited on the basis of and then socialized into a set of aspirational values, rules, and codes that are designed to guide behavior in the gray areas. These are upheld every day by communications from leaders and by role models and are supported by a reward and discipline system that sends consistent messages about expectations and accountability. In a perfectly unethical culture (also rare, thankfully), all of the culture components send a clear message that unethical conduct is expected and rewarded. Employees find that they need to get with the program or leave. Most organizations, however, fall in between these two extremes. Employees receive mixed messages from different components of the culture, leaving them to make sense of what behaviors are expected of them and what they should and should not do. These cultures are in need of assessment and intervention just as much as perfectly unethical cultures are.

Figure 1 depicts the constituents of an organization's ethical culture. Employee behavior is influenced by the messages received from formal and informal cultural systems. The formal systems include the official communications and actions of the executive leadership, employee selection systems, policies and codes, orientation and training systems, performance management systems, organizational authority (hierarchy) structures, and decisionmaking processes. The informal systems consist of role models (managers at all levels), norms of daily behavior, rituals that help members understand the organization's identity and what it values, myths and stories people tell about the organization, and the language people use in daily behavior.

Note that the tone set at the top of an organization trickles down to influence all other

Figure 1. Components of an ethical organizational culture

Formal Systems	**Informal Systems**
Executive Leadership	Role Models and Heroes
Employee Selection Systems	Norms
Policies and Codes	Rituals
Orientation and Training Systems	Myths and Stories
Performance Management Systems	Language
Organizational Authority Structures	
Decisionmaking Processes	

1991

Year in which the U.S. Sentencing Commission published the Federal Sentencing Guidelines for Organizations (FSGO)

E&C

Corporate Ethics and Compliance program responses to the FSGO

2004

FSGO revised to include ethical culture

elements, including leadership at lower levels. Senior leaders are critical to establishing an ethical culture—they provide resources for effective programs, send values-based messages, and serve as role models for ethical behavior and the use of ethical language. They have the potential to influence every other system within the organization.

Critically, leaders also need to attend to the alignment of the organization's cultural systems. When all of the constituent systems support ethical behavior, the company will have an ethical culture, although it needs constant attention to keep it that way. When the culture is in a state of misalignment—when cultural systems send mixed messages—the company is less likely to have an ethical culture. For example, employees pay close attention to what the performance management system rewards; many employees will assume that messages about bottom-line performance are the real messages they should be attending to, and they will behave accordingly.

The most direct way to evaluate ethical culture is to measure employee perceptions of both the formal and the informal systems and the alignment or the misalignment of those messages. Next, we discuss methods for assessing culture in organizations, and we present evidence that using and tracking those measures can lead to more effective E&C programs.

How to Assess Ethical Culture: The Big Picture

One important guideline for assessing ethical culture is that success depends on corporate policymakers, including the chief executive officer (CEO) and the board of a company, being driving forces in the process. In many organizations, a chief ethics officer advocates for ethical culture assessments, but for an assessment effort to be effective, senior leadership's full support must be clear. The effort must also have the backing of other internal stakeholders, such as the human resources department.

Although CEOs have a crucial role to play, most do not have the time to also be the chief ethics officer. Yet, like a garden, an ethical culture must be constantly tended. An organizational leader with credibility and authority needs to be thinking about and nurturing the organization's ethical culture every day and ensuring that weeds and pests do not begin to take over—something that can happen very quickly, unraveling all that has been so carefully built over time. This role should fall to a highly respected ethics officer who has the full support of the CEO and the board (as well as an independent relationship with the board). Then the CEO must model the right behaviors, provide resources for building and sustaining ethical culture, and consistently back the endeavor by aligning internal systems.

Executives in upper management must also recognize that their own perceptions of the organization's ethical culture are almost certainly rosier than are the perceptions of rank-and-file employees. Research indicates that top managers are often the last to know about an unethical or misaligned culture.[12] Their elevated status may render them oblivious, or their people may be unwilling to tell them what is really going on. Bad news does not travel up very effectively in most organizations. Recent research also suggests that higher ranking employees are less likely to engage in principled dissent—to report and act on unethical behaviors they observe—perhaps because they identify so much with the organization.[13] So it is essential that managers recognize their own limitations and biases and rely on good data that are based on employee perceptions at all levels of the organizational hierarchy. It is a safe bet that lower level employees are the ones who know what is really happening in an organization.

The tools chosen to assess an organization's culture are also critical. Unethical behavior is difficult to observe because it is purposely kept hidden. Therefore, anonymous surveys and focus groups (often in combination) have been the assessment methods of choice. Done right, those approaches are useful. What does not work is relying on compliance officers who simply note the existence of program elements (such as an employee orientation program “if regulators access the underlying data generated by assessments, then respondents will be motivated to influence, alter, or withhold the results of assessments”

that describes the company’s values and an accompanying training program on the code of conduct) or including a couple of broad ethics-related questions on the annual employee survey. Unfortunately, the latter is what many organizations are currently doing, if they are doing anything at all to assess whether their culture is ethical.

As Dudley urged in 2014, companies should use a validated, reliable, and standardized way of assessing “how we do things around here” with regard to ethics.[3] Yet having the right tools alone is not enough. Who conducts the assessment and who can access the data can influence whether the final data are informative and used appropriately. The regulatory challenge, however, is that if regulators access the underlying data generated by assessments, then respondents will be motivated to influence, alter, or withhold the results of assessments. Bodies that regulate an industry should therefore create incentives for the industry to create an independent third-party organization to serve as a neutral research entity that conducts assessments and facilitates communication of their results between the industry and regulators. The regulatory stick in this instance can be penalties against companies that do not participate in such industry initiatives.

We know of two effective models of industry-based self-governance organizations: (a) the Defense Industry Initiative on Business Conduct and Ethics, comprising 77 signatory companies that are U.S. Defense Department contractors,[14] and (b) the U.K. Banking Standards Board, created after the global financial crisis to promote high standards of behavior and competence across the banking industry in the United Kingdom and currently comprising 31 member companies.[15] Neither of these was created because of a law or regulation, although the U.K. Banking Standards Board was a response to recommendations made by the Parliamentary Commission on Banking Standards.

The standardization of assessment tools is important because it can enable companies in an industry to compare their results against those of other firms of the same size and circumstances. Such comparisons are helpful because firms in the same industry are likely to face similar ethical issues and circumstances (such as the regulatory environment). Standardization also encourages voluntary sharing of information across organizations, quickening the pace of learning about what works to improve culture. Moreover, standardization allows companies to measure their ethical culture against their own ethical aspirations, values, and goals, and it can provide longitudinal data to indicate whether new ethics-promoting policies and interventions are working as planned.

Some of the top academic researchers in behavioral ethics have already developed many of the tools necessary to assess the various features of an ethical culture; those features and tools are reviewed in the next section. We recommend the measures described there, which are drawn from published analyses, because they have been validated using sophisticated psychometric procedures that ensure the approaches can accurately and reliably measure what they are intended to measure.

Ideally, companies would assess employee perceptions of all components of the multi-system framework that constitutes ethical culture, as described in Figure 1. Validated survey measures do not yet exist in the literature for every component, however. To address this gap, Ethical Systems, where one of us (Filabi) works and two of us (Treviño and Haidt) participate as Steering Committee members, has convened the Ethical Systems Culture Measurement Working Group. The group, consisting of prominent behavioral ethics researchers, is conducting research to develop the needed assessment tools. (See note A.) The data collected in the project will be used to study the relationships among elements of ethical culture and to determine their relative effects on important outcomes, such as observed unethical conduct and the likelihood that employees will report problems to management. Future phases of the project will include additional modules on other aspects of the multisystem framework of ethical culture.

Past research has uncovered ways to increase the truthfulness of survey results. Employees are likely to complete surveys and do so honestly if they know their responses are anonymous, if they trust that their responses will not be traced back to them, and if they believe that the results will be used for a good purpose. Hence, it is extremely important to have a trusted third party collect and manage the data, delivering results to management that do not identify individuals. Obviously, if employees view management as corrupt, they may distrust anyone brought in by management. And employees who are benefiting from a corrupt environment will probably be dishonest to maintain the status quo. But, in our experience, most employees would prefer to work for an ethical organization, will participate, and will provide truthful feedback.

Survey administrators can further increase the trustworthiness of the results by including a measure of social desirability bias (the tendency to give answers that employees perceive researchers or managers want to hear) and by controlling for that bias statistically in the data analysis. Social desirability bias can also be minimized by asking about observed unethical conduct (for example, by asking, "How frequently have you observed a certain kind of unethical behavior in the organization during the past year?") rather than by having employees report on their own unethical conduct. Employees are more honest when reporting on observations.

As long as individuals are not identifiable, it is also helpful to collect and analyze data in a way that enables the organization to learn whether the members in a unit agree that the unit has ethical culture problems. Ideally, units with such problems can be spotted and their problems addressed. For example, by examining unit-level data, a firm could learn that a particular division has a more unethical culture than other divisions do, suggesting a need for intervention. At that point, focus groups might be convened to delve more deeply into issues that surface in the survey. Trusted outsiders can also be brought in to run these focus groups and thereby assure employee anonymity. Results of surveys and focus groups (the good, the bad, and the ugly) should be shared with employees, along with plans for intervention, so that they know the results are being taken seriously.

How to Assess Ethical Culture: The Nuts & Bolts

Employee perceptions of the following five aspects of ethical culture have a profound effect on their behavior. Assessing these perceptions can reveal where interventions and changes are most needed.

1. Orientation of E&C Programs

In 1999, Treviño and colleagues carried out a large-scale study to investigate which aspects of E&C programs support or interfere with an organization's goals for ethical behavior.[16] They administered a survey to more than 10,000 randomly selected employees at all hierarchical levels in six large U.S. companies across a variety of industries. Their results have important implications for how policymakers should define the effectiveness of E&C programs, as well as for how companies should manage such programs.

In the study, they assessed program effectiveness by focusing on seven outcomes that are relevant to the success of any E&C program (see Table 1 for the complete list of desired outcomes). The investigators concluded that, among other elements, an effective E&C program is one that reduces observations of misbehavior, increases awareness of ethical issues, and increases the likelihood that employees will speak up about problems to managers as well as report misbehavior via other channels established by the company.

Table 1. What is an effective ethics & compliance program?

Effective ethics and compliance programs achieve the outcomes listed below. Program effectiveness can be evaluated in part through surveys of employees. Assessments often ask respondents to rate statements on a sliding scale. The sample items here come from a survey developed by Linda K. Treviño and her colleagues.[A] Outcomes 2 through 7 are evaluated using a 5-point scale that ranges from *strongly disagree* (1) to *strongly agree* (5).

Program outcomes	Sample survey items
1. Reduced observations of unethical and illegal behaviors.	On a scale of 1 (*never*) to 5 (*very frequently*), indicate how often have you observed each of the behaviors listed below during the past year: (A list of 32 behaviors can be adjusted to best fit the needs of the organization. Examples of behaviors to evaluate include lying to customers, padding an expense account, falsifying financial reports, giving kickbacks, stealing from the company, and misusing insider information.)
2. Increased employee awareness of ethical and legal issues that arise at work.	Employees in this company are quick to notice when a situation raises ethics or compliance issues.
3. Creation of conditions that increase employee willingness to seek ethical and legal advice within the company.	When ethical issues arise, employees look for advice within the company.
4. Increased employee willingness to report bad news to management.	Employees here are comfortable delivering bad news to their managers.
5. Increased employee willingness to report ethical violations to management, such as via ethics hotlines (often anonymous) and other reporting channels.	If someone here knew that a coworker was doing something unethical, he or she would report it to management.
6. Increased employee perception that the program is contributing to better (and more ethical) decisionmaking in the organization.	People in this firm make more effective ethical decisions because of the ethics and/or compliance activities that are in place.
7. Increased employee commitment to the organization.	I feel attached to the company because of its values.

A. Treviño, L. K., Weaver, G. R., Gibson, D. G., & Toffler, B. L. (1999). Managing ethics and legal compliance: What works and what hurts. *California Management Review, 41*(2), 131–151.

Treviño et al. also found that employee perceptions of program orientation are extremely important to the outcomes of any E&C program.[16] The researchers identified four orientation categories: (a) values based, rooted in self-governance and intrinsic motivation; (b) compliance based, focused primarily on preventing, detecting, and punishing legal and policy violations; (c) external stakeholder based, focused on maintaining relationships with customers, the community, suppliers, and others; and (d) protection based, focused on shielding top management from blame in the face of legal or ethical problems. To assess employee perceptions of program orientation, Treviño et al. asked survey respondents to choose from a list of goals to indicate what they believed the company's E&C policies and activities were designed to accomplish (for instance, support employee goals and aspirations, encourage shared values, or detect unethical employees). The researchers then determined whether and how strongly those responses each correlated with the criteria for effectiveness—the desired program outcomes, as described in Table 1.

The programs that employees perceived to have a values-based orientation scored highest on each of the seven effectiveness criteria in Table 1. Compliance-based and external-stakeholder-based orientations were not as powerful but were still helpful. The researchers also found a clear marker of a bad program: employee perception that the E&C program was oriented toward protecting top management from blame. When the protection-based orientation was perceived, more unethical or illegal behaviors were observed, employees were less aware “self-interested ethical climates increase unethical behaviors”

of ethical issues, and employees were less likely to seek advice about ethical concerns.[16]

In practice, the program orientation of most companies is probably best described as a hybrid. The data suggest that a primarily but not entirely values-based orientation can nonetheless be highly effective at improving ethical behavior if it is backed up with accountability systems and discipline for rule violators (elements that tend to be emphasized in compliance-based orientations).

2. Ethical Leadership

Treviño et al. also found that leadership is one of the strongest drivers of ethical culture.[16] In a later study, published in 2005, Michael Brown, Treviño, and David Harrison developed a model of ethical leadership that builds on Albert Bandura’s social learning theory, which focuses on how people learn by observing others.[17] To influence followers’ ethical behavior, they found, leaders must be credible and legitimate role models and be able to influence others, and they must model correct behavior by behaving ethically, communicating about ethics, setting high ethical standards, and holding employees accountable to those standards.

How can policymakers assess whether an organization has ethical leaders? Brown et al. developed an empirically validated 10-item Ethical Leadership Scale[17] that has since been used in many studies to show that ethical leadership correlates with increases in employee satisfaction, commitment to the organization, citizenship behavior, and willingness to report problems to management, as well as in a reduction in unethical behavior. Most of this research has been conducted among middle levels of management, supporting the idea that direct supervisors are at the front lines of building and sustaining an ethical culture.

3. Ethical Climate

In 2012, Anke Arnaud and Marshall Schminke published a paper on the role of egoism in shaping organizational ethics—that is, in establishing an ethical climate that is either self-interested or other-interested.[18] They developed and validated a 20-item instrument to measure ethical climate, as well as empathy and efficacy. To assess climate, they had employees rate their agreement with such statements as “People in my organization/department are very concerned about what is best for them personally,” “People around here are mostly out for themselves,” and “People in my department are actively concerned about their peers’ interests.”

Their research built on earlier work by Bart Victor and John B. Cullen[19] and by Kelly D. Martin and Cullen[20] on ethical workplace climates, which demonstrated that self-interested ethical climates increase unethical behaviors (such as theft, lying on or falsifying reports, accepting bribes, and employee deviance) and that the inverse is also true—that nonegoistic (benevolent) climates positively influence ethical outcomes.

In their 2012 study, Arnaud and Schminke found, however, that an ethical climate alone may be insufficient to lead to ethical behavior.[18] In other words, when employees generally agree on the right thing to do, the organization may not see a reduction in unethical behavior unless employees also collectively feel empathy toward the target of their behavior (such as the client, other employees, or other stakeholders) and believe they have the capacity to influence outcomes through their own actions (efficacy). The evidence showed that assessing employee perceptions of their colleagues’ empathy and efficacy provides a more complete picture of how strongly the informal norms of an organization can reduce misbehavior. (See note B.)

4. Fairness

Treviño et al. determined in 1999 that fair treatment of employees is another important aspect of culture—as would be expected, given that organizational justice affects so many elements of day-to-day work, including compensation, promotion, and perceptions of whether all voices are heard equally. They reported that employees' perceptions of general fairness within an organization (as indicated by responses to statements such as "This organization treats its employees fairly"); fairness of rewards and punishments; and whether supervisors treat employees with courtesy, dignity, and respect all strongly correlated with each of the outcomes described in Table 1.[16] The two strongest correlations were between perceptions of fairness and (a) an employee's commitment to the organization and (b) an employee's willingness to deliver bad news to management.

These findings are consistent with those of recent research by Maureen Ambrose and Schminke.[21] Ambrose and Schminke developed the Perceived Overall Justice (POJ) scale, a six-item survey that asks employees to rate their agreement with three statements related to their perceptions of fair treatment (such as "Overall, I'm treated fairly by my organization") and three statements related to the organization more generally (such as "Overall, this organization treats its employees fairly"). The researchers found statistically significant correlations between POJ scores and outcomes such as employee job satisfaction, commitment to the organization, and intention to leave. They also found strong correlations with outcomes that were not self-reported—such as supervisors' assessments of how well employees performed on a task, whether they were good organizational citizens, and whether they engaged in behaviors that were harmful to the organization (organizational deviance).

5. Trust

The decision to trust another person or a company and its products is often based on a calculation of the trustworthiness of the other party. Measures of trust have been developed on the basis of the theory that a decision to trust can be assessed by considering an individual's willingness to be vulnerable and thus take the risk of putting faith in the other party. In 2006, David Schoorman and Gary Ballinger developed a seven-item scale to assess an employee's willingness to trust a supervisor.[22,23] The scale integrates constructs relating to the supervisor's ability, benevolence, and integrity. Sample statements rated by employees include "If my supervisor asked why a problem occurred, I would speak freely even if I were partly to blame"; "It is important for me to have a good way to keep an eye on my supervisor"; and "Increasing my vulnerability to criticism by my supervisor would be a mistake."

Evidence shows that trust pays. That is, high-trust environments result in more efficiency, more employee engagement, and better financial performance for organizations.[24,25]

How to Regulate Ethical Culture

We started this article by noting that regulators want guidance on how to assess whether companies have an ethical culture. Further, they want to be able to judge whether efforts to enhance ethical culture are translating into E&C programs that, in fact, increase ethical behavior.

Regulators can begin to address the first need by requiring companies to assess the state of their ethical culture regularly through surveys of employees, preferably ones that are standardized for the relevant industry. Although regulators cannot and should not attempt to mandate what the culture should be at a firm, they can require that each firm study its own culture to assess how the culture could be contributing to misconduct by employees and management. For example, if employees indicate that they are unlikely to report the misconduct they observe, because they do not believe management will take any action on their reports or they fear retaliation, regulators should expect that the organization will take that information seriously, search for root causes of the problems, and act to change systems that encourage such behavior and accompanying perceptions. Policymakers (including those who determine internal corporate policies) should also carefully consider who should have access to the results of culture assessments. On the one hand, access by regulators could incentivize firms to try to game the system or could make employees less forthcoming about their opinions; on the other hand, without regulatory pressure, many firms may be unwilling or unlikely to delve deeply into their ethical cultures.

Once baseline measures are in hand, firms should be encouraged to design interventions, monitor how their ethical culture changes over time, and determine whether targeted interventions are working. Companies can develop a process of continual learning and experimentation. For example, the baseline culture data can be used to understand the impact of various internal or external initiatives at the firm—such as whether revising compensation plans improves or damages ethical culture, whether a revamped training program alters employee perceptions of the culture, or whether the addition of an ombudsman program changes perceptions of the safety of speaking up.

To determine whether all these activities result in E&C programs that increase ethical behavior, policymakers can begin by encouraging companies and regulators to use the outcomes that indicate effectiveness provided in Table 1 and supplement those with additional outcomes that are particularly relevant for them. Ideally, a firm would also use internal data to measure ethical behavior, such as the firm's pending (defense) litigation matters, the frequency and underlying causes of regulatory enforcement actions by regulators, human resources data on the amount and kinds of reported misconduct, and the number of ethics-hotline calls made by employees and customers (although tying hotline calls to E&C effectiveness can be challenging).

Many in the E&C field have considered it extremely difficult to determine program effectiveness, because an effective program should prevent problems, and one cannot measure problems that have been avoided. They are right to an extent, but we have shown in this article that ethical culture can be assessed, interventions can be designed, and progress in outcomes can be monitored. The combination of self-reported survey data and other internal data can reveal how the firm's E&C program and culture are influencing outcomes. A more effective program would be associated with positive outcomes (such as an increased willingness of employees to deliver bad news to management) and negatively correlated with negative outcomes (such as pending defense litigation or regulatory enforcement actions).

Conclusion

Would assessments of ethical culture over time have prevented recent corporate scandals, such as those at Wells Fargo or Volkswagen? Yes, but only if employees reported honestly and senior management and the boards of directors gave those assessments credence and took serious action. Leaders who tend the ethical culture garden notice when weeds are sprouting and spreading. If the leaders at Wells Fargo and Volkswagen had done that, senior management would have been more attuned to the profound effects of their statements, actions, and policies on their employees. They would have been more aware of how their unattainable performance goals were being pursued unethically at lower levels. As ethical leaders, they would have been more approachable and open to input about the inability to achieve, without fraud, the very demanding goals that were set at the top. Middle managers and employees would have felt more empowered to speak up (anonymously, if necessary), and, in an ethical culture, their concerns would have been taken seriously.

Government policymakers and regulators should attend to the above recommendations for how to conduct assessments of culture and should integrate those assessments into their regulatory processes. Corporate policymakers, such as the CEO and board members, should also integrate ethical culture assessment into their efforts to proactively manage ethics and to use ethical culture as a lever to increase ethical conduct throughout their organizations. (For further discussion, see Policies That Encourage the Create of Ethical Organizational Culture.)

Researchers have learned a lot about conceptualizing and measuring ethical culture in organizations, but much more work remains to be done. For example, in this article, we have emphasized survey approaches. A full understanding of ethical culture, however, would also require qualitative approaches, such as

Policies That Encourage the Creation of Ethical Organizational Culture

To increase ethical behavior in organizations, policymakers and regulators should encourage organizations to undertake the following measures:

- **Assess ethical culture regularly.** A culture assessment, which evaluates perceptions of norms and behaviors, should be carried out in addition to an assessment of employee perceptions of the formal ethics and compliance (E&C) program. Use standardized and validated surveys that measure employee perceptions of the ethical orientation of E&C programs, ethical leadership, the fairness of the organization, and the trustworthiness of the company and its leaders, among other factors. Industries should consider having a trusted third party conduct sector-specific surveys, a method that can increase the honesty of the respondents.

  The Defense Industry Initiative (DII) on Business Ethics and Conduct, which represents several dozen companies that contract for the government, has worked for years with the Ethics & Compliance Initiative (ECI) to regularly survey the companies' employees about their perceptions of E&C programs and ethical culture.

- **Identify, through data and investigations, how the organizational culture contributes to misconduct.** This identification can be achieved by requiring companies to use employee surveys as critical inputs into a root cause analysis of problems that arise in the organization. For example, if employees indicate that they are uncomfortable reporting problems to management, the company should determine why the culture engenders such fear and how internal systems can be reformed to promote a speak-up culture.

  Anonymous surveys remain one of the best ways to gauge the extent to which an organization has a serious problem with fear of retaliation for reporting, for example. The DII provides its member organizations with information about their own companies as well as benchmarking data from organizations within their industries.

- **Design interventions to improve conduct and culture.** Once baseline measures are in hand, firms should be encouraged to design interventions (for example, new ways to integrate ethics goals into performance evaluations or a new policy on sales goals and compensation) and monitor how the company's culture changes over time. This is a way to determine whether targeted interventions are working and to develop a process of continual learning and experimentation. The baseline culture data can thus be used to understand the long-term impact of various internal or external initiatives at the firm.

  There is little reason to conduct extensive surveys unless the organization is open to using the revealed information to attempt to make change. In some cases, concerns about employees' reluctance to speak up, for example, have motivated organizations to create new programs based on Mary Gentile's *Giving Voice to Values* approach.[A] Subsequent surveys can help companies to assess whether they are moving the needle on this issue.

A. Gentile, M. C. (2010). *Giving voice to values: How to speak your mind when you know what's right.* New Haven, CT: Yale University Press.

interviews and focus groups, which can provide a richer sense of what it means to employees to live and work within a particular culture. If regulators, policymakers, and companies are willing to collaborate with academics to develop and validate a suite of methods for assessing ethical culture, we can together achieve the goals of the original FSGO and the vision laid out more recently by William Dudley: a business culture in which "how we do things around here" means measuring ethical culture and then trying to improve it.

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endnotes

A. The Ethical Systems Culture Measurement Working Group members are Linda Treviño (Chair), Michael Brown, Jonathan Haidt, David Mayer, Marshall Schminke, Sean Stevens, Ann Tenbrunsel, Jeffrey Thomas, and Siyu Yu. Find more information about Ethical Systems at http://ethicalsystems.org.

B. To assess the ethical climate, including ethical efficacy and collective empathy, Arnaud and Schminke had respondents indicate their degree of agreement with each item of a 20-item instrument. The instrument included 10 items on the overall ethical climate (both self-interested and other interested), such as "People around here protect their own interest above other considerations." It included three items assessing ethical efficacy, such as "When necessary, people in my department take charge and do what is morally right," and seven items assessing collective empathy (also known as *collective moral emotion*), using statements such as "For the most part, when people around here see that someone is treated unfairly, they feel pity for that person."

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