"C" Is for Crucible: Behavioral Ethics, Culture, and the Board's Role in C-suite Compliance

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Part I: The Best, the Brightest and a Wicked Problem

Introduction

The C-suite is a unique environment peopled with extraordinary individuals and endowed with the potential to achieve enormous good – or, as recent history has vividly shown, to inflict devastating harm. Operating largely beyond the reach of traditional compliance program controls, senior executives can leverage misconduct, and multiply its damage, through the same centralized command over people, assets, systems and tactics that has made the modern corporation the most efficient delivery system for goods and services ever invented.

It is easy for critics to paint all high-level corporate misconduct as the product of amoral individuals ruthlessly exploiting their power in the pursuit of self-interest, and to issue a simplistic call for ever-tighter regulations and internal controls to thwart these caricatured villains. There is no denying that C-suite psychopaths exist and do great damage, but they are not the source of most corporate compliance failures. An effective approach to C-suite misconduct must also account for a much more common phenomenon: morally normal executives who, despite their sincere belief in ethical principles, behave badly at least once.

C-suite misconduct is a so-called "wicked problem," a type of social problem with many interacting parts and no single correct solution, where interventions produce unexpected results, the problem is redefined as solutions are tested, and the solution itself is never finished. The pure command-and-control solution to misconduct – regulation, monitoring, punishment, and deterrence – has been tested and proven inadequate to the task, [1] prompting a more nuanced exploration of the causes and cures of ethical lapses. This article aims to redefine the problem by examining several of those causes in the specific context of the C-suite environment. In the next issue of Business Compliance we will discuss approaches to an improved solution, with particular attention to the role of the board as recruiter, overseer, coach and role-model for senior executives.

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[1] The continued prevalence of corporate scandals seems evidence enough that deterrence does not always deter. For several examples of how human psychology limits the effectiveness of command-and-control compliance systems, see Scott Killingsworth, *Modeling the Message: Communicating Compliance through Organizational Values and Culture*, GEORGETOWN JOURNAL OF LEGAL ETHICS, Vol. XV, No. 4 (Fall 2012), 961, available at http://ssrn.com/abstract=2161076.

Setting aside the issue of "good" versus "evil" executives, the C-suite ethics problem has two distinct layers. First, the C-suite is inherently home to intense pressures, powerful motivations and seductive temptations, presented in a context of high complexity and unrelenting urgency. On its face, such a charged environment would challenge the ability of even the most conscientious and rational executives to make consistently irreproachable decisions. But the predictable impact of strong pressures and temptations upon rational decision-makers is just the beginning. Recent behavioral research shows that the corrosive effects of these external forces are amplified by systematic, predictable human failings that can prompt us to slip our moral moorings and to overlook when others do so. Worse yet, our faulty ethical wiring operates automatically, and outside our awareness: when we start down the path of misconduct, the first person we deceive is usually ourselves.

The C-suite as Crucible

Several powerful forces converge in the C-suite to test the integrity of executives and the board that supervises them. First, to quote Willie Sutton,[2] "that's where the money is": the stakes are very high both for the organization and, crucially, for the individuals as well – as to pay, status, career prospects, and employment itself. The high stakes for the organization may tempt even faithful executives to cut corners for the benefit of the company and its stakeholders.[3] Separately, at the personal level, the prospect of gaining, or the risk of losing, large performance-based incentives can mean outsized temptations to do what it takes to obtain the desired results.

Another marker of the C-suite and its occupants is power: control over business strategy, tactics, and execution, and over employees and their careers. One facet of power is the ability to operate with great freedom and little supervision: subject to very few effective "hard" controls,[4] senior executives wield operational command over many compliance-sensitive activities, if not over the compliance function itself. Power also facilitates suppression of dissent, further eroding controls.[5] Similarly, power enables delegation, including the segmentation of tasks among subordinates, which can make it difficult for either the subordinates or auditors to see the entire process that adds up to a violation. [SK1] With power also comes enormous pressure to perform, particularly in public

[2] Actually, Sutton disavowed his famous quip, attributing it to an enterprising reporter in search of colorful copy. In our context, a genuine quotation from Sutton may be both relevant and cautionary: "Why did I rob banks? Because I enjoyed it. I loved it. I was more alive when I was inside a bank robbing it, than at any other time in my life." *See* http://www.snopes.com/quotes/sutton.asp.

[3] Where rules are disobeyed purely for the benefit of the company, we have a common ethical paradigm in which one valid ethical value – loyalty or devotion to a cause or shared goal – gains inappropriate ascendency over another ethical value, such as honesty or adherence to law. In the C-suite context, though, the usual alignment of incentives between the executives and the company means that few actions can be definitively portrayed as done for the benefit of the organization alone.

[4] Of course there are significant accounting and systems controls but many of these are vulnerable to collusion at the C-suite level.

[5] Few compliance officers are unaware of the cautionary tale of Paul Moore, fired by the CEO of HBOS shortly after having warned the board's audit committee about the bank's unbalanced sales culture.

companies where performance is measured hourly by stock price.[6] Senior executives are accountable to the board, to shareholders and creditors, to the news media and to the public, any one of which can topple them under the right circumstances.

Things happen fast in this crucible, with urgency driven not only by business necessity but also by the inexorable demands of the quarterly reporting cycle. Quick decisions about complex problems are required, often involving forced choices between competing values. (What if skirting a costly environmental requirement will save hundreds of jobs?)[7] Urgency can impair not only decision-making processes but also the operation of corresponding control functions such as counsel, the compliance group or the audit committee, which may find themselves with insufficient time to do a proper job.

The final unique feature of the C-suite is its occupants. People arrive there through a process of natural selection which only the most able, motivated, competitive and determined survive. We can expect high intelligence, strong ambition and goal orientation, domain mastery, and advanced skills in leadership and persuasion. We can also expect, most of the time, a hard-earned reputation for integrity. But the winnowing process also selects, in some cases, for a much stronger-than-usual attraction to perquisites found in unique abundance in the C-suite: money, power, autonomy, recognition, attention, and status, an attraction that may be strong enough to overpower allegiance to ethical or legal rules. And of course, the C-suite has no magical ability to detect and reject the most dangerous personality types – psychopaths, extreme narcissists, and others who lack conscience but often possess charisma, intelligence, motivation, and advanced manipulative skills.

There is no reason to believe that senior executives, individually or as a group, are innately less ethical than the general population. But experience and headlines tell us that reaching the top is also no guarantee of moral invulnerability. Where high stakes, strong temptations, vast power, extreme pressure, a fast pace, complex problems and ambitious people come together with few external restraints, could anything major go wrong? A high-impact risk[8] exists and must be addressed.

How the Crucible Amplifies Ethical Infirmities: Behavioral Ethics

The worst executives can intentionally cause great damage in pursuit of their self-centered agendas, but even the best are subject to predictable human infirmities that can

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[6] According to the Ethics Resource Center's 2012 National Business Ethics Survey of Fortune 500 companies, public-company employees are significantly more likely to feel pressure to compromise standards than those in privately-held companies – and public-company employees who follow the stock price daily are more than twice as likely to feel pressure as private company employees.

[7] We might pause to consider the relevance of Nobel Laureate Daniel Kahneman's observation that "people who are simultaneously challenged by a demanding cognitive task and a temptation are more likely to yield to the temptation." Daniel Kahneman, THINKING, FAST AND SLOW, New York: Farrar, Straus and Giroux 2011, p. 41.

[8] We should recall that most senior executives never get into serious trouble and probably never deserve to. In risk management terms, the statistical likelihood of serious executive misconduct in a given company is quite small, though it is hardly an unforeseeable "black swan;" the potential impact, however, is vast.

lead us astray. This should particularly worry us in the superheated environment of the C-suite. Over the past two decades, researchers in "behavioral ethics" have shown that an individual's morality is much more malleable under situational and social forces, and much less attributable to stable personality traits, than formerly believed. Most of the unethical behavior in organizations is actually committed by people who are psychologically normal, who value morality and consider themselves ethical, and yet often fail to resist temptation, or even to recognize that particular decisions have a moral dimension.[9] Our tendency to over-estimate the effect of a person's character on behavior and underestimate the effect of context is so pronounced that it is known in psychology as the "fundamental attribution error." This fallacy prompts us to mentally sort people into the bad ones who need to be watched and deterred, and the good ones who can be trusted. Since most people can be trusted most of the time, the error is usually harmless. But sometimes, instead of relying on character alone, we should be asking, "Do I trust this situation?"

As we have seen, the C-suite is rife with potent situational and social forces; we now turn to a few examples of how those forces can interact with unconscious psychological biases and "blind spots"[10] to subvert ethical decision-making in morally normal executives.

Conflicts of Interest. One of the core teachings of behavioral ethics research is that it is not just difficult, but impossible, to be truly objective about a decision when we have a significant interest in the outcome.[11] Judgments about what is good for the company (or shareholders, or employees) that are made in entire good faith may be infected by an unconscious self-serving bias, and justified by post-hoc rationalization,[12] if the executive's personal interests weigh heavier on one side of the scales than on the other.[13] The same holds true for judgments about whether certain conduct violates an inconvenient regulation, or about what is fair to a customer or supplier. In a C-suite where large incentive compensation for most or all of the executives may hinge sensitively on quarterly earnings reports, there is clear potential for these conflicts of

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[9] Max H. Bazerman and Francesca Gino, *Behavioral Ethics: Toward a Deeper Understanding of Moral Judgment and Dishonesty*, ANNUAL REVIEW OF LAW AND SOCIAL SCIENCE, Vol. 8, pp. 85-104, 2012.

[10] This apt term is borrowed from Max H. Bazerman and Ann E. Tenbrunsel, ***Blind Spots: Why We Fail to Do What's Right and What to Do about It***, Princeton University Press, 2011.

[11] For an early study, see Linda Babcock, Xianghong Wang, & George Loewenstein, *Choosing The Wrong Pond: Social Comparisons That Reflect A Self-Serving Bias*, QUARTERLY JOURNAL OF ECONOMICS 111(1996) pp. 1-19. For a seemingly inexhaustible supply of contemporary examples, and related behavioral science research, ***see*** Jeffrey Kaplan's Conflict of Interest Blog, http://conflictofinterestblog.com.

[12] Where the financial interests of the company and of the executive are aligned, and cheating will produce a good result or avoid a bad one, the rationalization is particularly seductive through a kind of conflation of Charles E. Wilson's statement that what is "good for our country [is] good for General Motors, *and vice versa*" with Charles DeGaulle's "L'etat, c'est moi," resulting in "what is good for me must be good for the company."

[13] As Upton Sinclair put it, "It is difficult to get a man to understand something, when his salary depends on his not understanding it." I, CANDIDATE FOR GOVERNOR, AND HOW I GOT LICKED, (1939), repr., University of California Press, 1994, p. 109.

interest to influence decisions involving ethics, legal compliance and risk.[14] This potential has been confirmed in several studies that show a significant correlation between unusually large incentive compensation for CEOs and the risk of credit default, large credit-rating downgrades, accounting restatements, and fraud.[15]

Small Beginnings, Rationalization and Incrementalism. A key to understanding how ordinary people can end up doing very bad things is that it seldom happens in a single step. Most people will cheat a little from time to time to obtain benefits or avoid losses, given conducive circumstances. But the extent and seriousness of the cheating is constrained by our need to maintain a positive self-concept as an ethical person.[16] This is where the right rationalization comes to the rescue (of our self-image, not our morals). If we can dodge or obfuscate the ethical implications of our actions, we can take what we want and still hold ourselves in high regard. We may reason that a small infraction does no one harm, that it solved an urgent problem, that the general rule was not meant to apply to our specific situation, that it's expected and everyone does it, that we had no choice, or that another, more important rule or value takes priority (such as loyalty over compliance). A suitable rationalization resolves the cognitive dissonance between our positive self-concept and the reality that we have violated a rule for selfish reasons. And sometimes that is the end of it.

But rationalizations are durable, and reusable. In the process of resolving that one internal conflict, we have created, accepted and internalized an ideology for justifying future infractions, especially if they are small and arise in a similar context.[17] Indeed, if each successive infraction is only a little worse than the previous one, the rationalization is likely to seem not just acceptable but compelling. Where misconduct is justified by rationalization and reinforced by success, small steps can take us a long way.[18] By the

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[14] The issue of proper alignment between executive compensation and organizational goals is subject to considerable debate and is beyond the scope of this paper; for our purposes the key point is that conflicts do exist and are relatively ineradicable in the presence of large incentive compensation. *See* Lynn A. Stout, *Killing Conscience: The Unintended Consequences of 'Pay for Performance,'* working paper, 2012.

[15] *See* Kenneth Bertsch and Chris Mann, *CEO Compensation and Credit Risk*, Moody's Special Comment, July 2005 (as to credit defaults and ratings downgrades); Merle Erikson, Michelle Hanlon, and Edward Maydew, *Is there a Link between Executive Compensation and Accounting Fraud?,* working paper, University of Michigan, 2004 (as to restatements and accounting fraud). To be fair, CEOs, for all their power, do not act in a vacuum. We should not presume that the directors who oversee these CEOs and approve their strategic moves are immune to similar temptations, in an age where options and restricted stock have become an increasing percentage of board compensation. The outsized CEO incentives in these studies were, after all, granted by corporate boards, and it would be interesting to know what kind of compensation plans those directors had voted for themselves.

[16] *See* Nina Mazar, On Amir, & Dan Ariely, *The Dishonesty of Honest People: A Theory of Self-Concept Maintenance*, 45 J. MARKETING RES. 633-644 (2008).

[17] Here, cognitive dissonance reinforces the rationalization: abandoning it now would force us to acknowledge that we were wrong to use it to justify our previous misconduct.

[18] We are easily seduced by small increments. As Milgram's famous electroshock experiments demonstrated, it is possible to get people to administer a 450-volt shock to another person, if you start at 15 volts and increase each subsequent shock by only another 15. *See* Stanley Milgram, *Behavioral Study of Obedience*, 67 J. ABNORMAL AND SOCIAL PSYCHOL. 371-378 (Oct. 1963). Tenbrunsel and Messick dissect the slippery slope into two mechanisms. The first is "ethical numbing" where repeated exposure to the

time a person realizes that they are in indefensible territory, it is too late to turn back.

Motivated Blindness and Framing. Rationalization of misconduct is especially tempting where the ethical or legal issues are unclear, uncertain, deferred, or simply not in the frame of reference – and the frame of reference has a way of shrinking. We are subject to "motivated blindness," a tendency to acquire tunnel vision if it will help us ignore inconvenient facts. This may occur if a decision that has ethical implications is inadvertently framed as a matter of pure business,[19] a hazard that behavioral ethics pioneer Max Bazerman illustrates with the Ford Pinto episode, where Ford used a "formal cost-benefit analysis – putting dollar amounts on …lives – and determined that it would be cheaper to pay off lawsuits than to make the repair." [20] We can also be blinded if we have a substantial stake in not noticing something: Bazerman recalls how long it took Major League Baseball, the players' union, and his team's management to pay attention to the changes in Barry Bonds as his hitting improved.[21] And being simply too focused on one particular goal, such as closing a sale or beating out a competitor, can crowd out all competing input – a phenomenon that is often triggered by overly-narrow performance metrics[22] and that has been unforgettably demonstrated with a simple basketball exercise that one must see to believe.[23]

Time Pressure. A form of motivated blindness can also take over when we are in a hurry. In a well-known study, seminary students at Princeton were sent across campus to give a short talk on the story of the Good Samaritan. Along the way they had to pass by a groaning man collapsed in a doorway. Under unhurried conditions 63% of the students stopped to give aid, but if the experimenter sent the students off with no time to spare, only 45% helped the man, and if the experimenter instructed them to get to their destination as fast as possible, only about 10% helped.[24] If this happens to seminarians on their way to preach about helpfulness, what does it suggest about the likelihood that

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same situation or decision lends it a routine character, resulting in unreflective behavior. The second is called the "induction effect," by analogy to logical induction, where if a past decision in situation N is presumed correct, then the same decision also seems correct for the values N+1, N+2, etc. While going from N directly to N+20 might trigger a new moral judgment, incremental changes do not. *See* Ann E. Tenbrunsel and David M. Messick, *Ethical Fading: The Role of Self-Deception in Unethical Behavior*, SOCIAL JUSTICE RESEARCH, Vol. 17, No. 2 (June 2004).

[19] One attribute of "business" framing is that decision-making is typically governed by cost-benefit analysis – another way of saying that tradeoffs are to be expected, and usually negotiable. This approach yields considerable ethical flexibility. In ethical framing, or analysis of illegality, problems may be difficult but the answers are not negotiable.

[20] Max H. Bazerman and Ann E. Tenbrunsel, *Ethical Breakdowns*, HARVARD BUSINESS REVIEW, April 2011, p. 58.

[21] Id.

[22] This risk was elegantly portrayed in the following dialogue from the Scott Adams "Dilbert" comic strip of November 28, 2012. Boss: "Your compensation will be based on achieving these goals." Dilbert: "Awesome. It's like written permission to ignore everything else you ask me to do."

[23] *See* the video at http://www.youtube.com/watch?v=vJG698U2Mvo. *See also* Christopher Chabris and Daniel Simons, THE INVISIBLE GORILLA, HarperCollins Publishers, 2011.

[24] John M. Darley and C. Daniel Batson, *From Jerusalem to Jericho: A Study of Situational Variables in Helping Behavior*, JOURNAL OF PERSONALITY AND SOCIAL PSYCHOLOGY, 27: pp. 100-108.

business executives, rushing to meet a launch date, will pause[25] to consider whether the product may present safety, ethical or legal issues? Deepwater Horizon comes to mind.

With complex issues at stake, time pressure can force decision makers to resort to heuristics – simplified problem-solving procedures or sense-making narratives invoked in the hope of a shortcut to the right answer when systematic analysis is impractical. As with motivated blindness, heuristics can simplify ethical or legal variables right out of the equation, with predictable results. Cost-benefit analysis, for example, is a valuable business heuristic, but one that fails utterly when "costs" are too narrowly defined, or when applied to an issue that ought to be non-negotiable at any price.

Irrational Loss Aversion. Prospect theory[26] teaches that we experience, and anticipate, much greater pain from a loss than the joy we receive from an equivalent gain. As a result, we are far more likely to act unethically, and to take risks in general, to avoid losses than to obtain equivalent gains. Surprisingly, this holds true even where an identical situation is simply *described*, or *framed*, in terms that emphasize the possibility of either loss or gain.[27] Here the notion of failing to "hit the numbers," or of "losing" a bonus one has come to expect, or of failing to close a sale that one has considered likely, has obvious relevance: risk-taking increases and ethical standards may sag. For the ambitious occupants of the C-suite, we might consider fear of failure generally as a species of loss aversion – reputation, status, position, power, and promising prospects are all possessions capable of being lost if performance lags, and the imagined impact of their loss could well dwarf the impact of whatever failure triggered it.

Of course, taking more risk to avoid a loss doesn't always turn out as hoped; and when this leads to greater losses, still greater risk-taking may follow – a cycle known as "escalating commitment" that seldom ends well. This is the story of Barings Bank, of the London Whale, and of countless embezzlers who originally planned to repay their employers before the missing funds could be discovered. An especially poignant example of how loss aversion can operate in practice is the cover-up: a person who has been merely negligent, or has committed a minor infraction, may be instinctively goaded by loss aversion into active and intentional misconduct in order to cover up the initial event – thus compounding what may have been a manageable situation and sending the associated risks careening out of control. This can happen even if the initial misconduct is not our own, as when someone who passively witnesses a co-worker's misconduct

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[25] The effect of time pressure on ethical decision making has been studied from the opposite direction as well, in studies showing that greater honesty results when a person pauses to think before making an ethical decision. See B. C. Gunia, L. Wang, J. Wang, L. Huang, & J. K. Murnighan, *Contemplation and Conversation: Subtle Influences on Moral Decision Making*, ACADEMY OF MANAGEMENT JOURNAL, 55, 13-33 (2012), and Shaul Shalvi, Ori Eldar and Yoella Bereby-Meyer, *Honesty Requires Time (and Lack of Justifications)*, PSYCHOLOGICAL SCIENCE, vol. 23, no. 10: 1264-1270 (2012).
[26] Daniel Kahneman and Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, Econometrica, Vol. 42, No. 2 (March 1979), p. 263. *See also* Kahneman, THINKING, FAST AND SLOW, supra note 7, Chapter 26.
[27] Mary C. Kern and Dolly Chugh, *Bounded Ethicality: The Perils of Loss Framing*, PSYCHOLOGICAL SCIENCE, Vol. 20, No. 3: 378-384 (2009).

remains silent, and later realizes that they have something to lose if accused of complicity. Active complicity may be the ironic result.

Overconfidence. Another recurring theme in behavioral ethics and cognitive psychology is overconfidence.[28] Most of us have it to some degree, from the incompetent[29] to the accomplished, and given their personal histories of success C-suite officers probably have more than most. Like loss aversion, overconfidence leads us to take on more risk than we intend to. One especially vicious cycle is that overconfidence can be fueled by early success in high-risk initiatives, leading decision makers to recalibrate their risk assessment using hindsight, discount the risk already taken, and "double down" on risky business going forward. Essentially, the thinking is that if nothing bad *has* happened, this is evidence nothing bad *will* happen. The space shuttle Challenger disaster and the collapse of U.K. banking giant HBOS are tragic products of this beguiling form of self-deception.[30] Worse, since we tend to attribute our successes to our personal characteristics,[31] we may not only downgrade our risk assessment, we may simultaneously raise our opinion of our own ability to judge risk and to predict the future.[32]

In the C-suite, these principles can distort judgments of whether an activity is in fact illegal and, more cynically, to judgments of the likelihood that anyone will notice the violation, or of the severity of the consequences. If overconfidence leads to excessive risk-taking even in a small matter of compliance, then regardless of the outcome,

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[28] *See generally* Kahneman, THINKING FAST AND SLOW, *supra* note 7, Chapters 19-24.

[29] *See* Justin Kruger and David Dunning, *Unskilled and Unaware of It: How Difficulties in Recognizing One's Own Incompetence Lead to Inflated Self-Assessments*, JOURNAL OF PERSONALITY AND SOCIAL PSYCHOLOGY, Vol. 77, No. 6, 1121-1134 (1999).

[30] Space shuttles had repeatedly suffered, without consequence, partial O-ring burn-throughs of the kind that later caused the Challenger explosion. This experience led NASA management to conclude that the burn-throughs, though unexpected and poorly understood, must not pose a significant risk – when any dispassionate analysis would have predicted that if the burn-throughs continued, sooner or later one would cause an explosion. *See* Nobel Laureate Richard Feynman's APPENDIX TO THE REPORT OF THE PRESIDENTIAL COMMISSION ON THE SPACE SHUTTLE *CHALLENGER* ACCIDENT (1986), admonishing that contrary to NASA's way of thinking, "When playing Russian roulette the fact that the first shot got off safely is little comfort for the next." With respect to HBOS, *see* PARLIAMENTARY COMMISSION ON BANKING STANDARDS, *'AN ACCIDENT WAITING TO HAPPEN': THE FAILURE OF HBOS*, April 4, 2013: "The growth of HBOS's Corporate Division was not the result of superior performance but of its high-risk strategy." As HBOS moved increasingly into credit derivatives and foreign markets, "HBOS was excessively confident that its understanding of UK residential mortgages and related securitizations gave it the ability to understand and evaluate the risks in a wide range of asset-backed instruments." (at 46-47)

[31] That we tend to attribute our successes to our talent or merit while blaming failures on external situational causes is one of the implications of attribution theory, first developed by Fritz Heider in the 1950s and later elaborated on by Weiner and others. *See, e.g.*, Fritz Heider, *The Psychology of Interpersonal Relations*, Wiley (1958); Edward E. Jones, David E. Kannouse, Harold H. Kelley, Richard E. Nisbett, Stuart Valins, and Bernard Weiner, Eds. *Attribution: Perceiving the Causes of Behavior,* Morristown, NJ: General Learning Press (1972).

[32] For example, according to the Parliamentary Commission, the HBOS "culture was brash, underpinned by a belief that the growing market share was due to a special set of skills which HBOS possessed and which its competitors lacked." *Id.*

compliance risk increases: if the risk turns out badly, there is the consequent temptation to cover up the result; if the compliance risk turns out well (nothing happens), then the risk assessment may be re-calibrated, taking that risk can become routine or institutionalized,[33] and incrementalism may lead to more serious violations.

Power. Power by itself has been shown to breed overconfidence[34] and to increase risk taking.[35] In the corporate arena there is specific evidence that companies with high-powered CEOs take more risk than those with less-powerful CEOs.[36] Approaching the issue from another angle, researchers have shown that companies with very powerful CEOs show significantly above-average variation in performance – higher highs and lower lows – again, consistent with increased levels of risk (and reward).[37]

There is ample reason to believe that the elevated risk tolerance associated with power applies to ethical or legal risks just as it does to business risks. In an experimental setting, participants endowed with power not only committed more moral or legal infractions, they judged their own infractions less harshly than they judged the same conduct by others: they felt they were entitled to their transgressions while others were not.[38]

Does power corrupt? It seems more justified to say that power amplifies our native tendencies: the core principle seems to be that power lowers inhibitions – and most inhibitions exist for a good reason. Undesirable behavior becomes more likely as inhibition is reduced, and even behaviors desirable in moderation, like risk taking, can become undesirable when limits are lifted.[39]

Group Dynamics. The C-suite is a group, a small and sometimes insular one where members see a lot more of one another than of other employees. Like any group it will develop its own distinct identity, behavioral norms and culture, for better or worse. The stronger the group ties, the more group members will merge their own identities with that

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[33] *See generally* Blake E. Ashforth and Vikas Anand, *The Normalization of Corruption in Organizations*, RESEARCH IN ORGANIZATIONAL BEHAVIOR, Volume 25, 1-52: "Once a corrupt decision or act produces a positive outcome and is included in organizational memory, it is likely to be used again in the future" (at 8).
[34] Niro Sivanathan and Adam D. Galinsky, *Power and Overconfidence* (2007), IACM 2007 Meetings Paper.
[35] See Jeffrey Pfeffer, POWER: WHY SOME PEOPLE HAVE IT – AND OTHERS DON'T, HarperCollins Publishers 2010, p. 200: "Studies on the effects of power on the power holder consistently find that power produces overconfidence and risk taking…"
[36] Krista B. Lewellyn and Maureen I. Muller-Kahle, *CEO Power and Risk Taking: Evidence from the Subprime Lending Industry*, CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW, Vol. 20, No. 3, 289-307 (2012).
[37] Renee B. Adams, Heitor Almeida, and Daniel Ferreira, *Powerful CEOs and Their Impact on Corporate Performance*, THE REVIEW OF FINANCIAL STUDIES, Vol. 18, No. 4 (2005), pp. 1403-1432.
[38] Joris Lammers, Diederek A. Stapel and Adam D. Galinsky, *Power Increases Hypocrisy: Moralizing in Reasoning, Immorality in Behavior*, PSYCHOLOGICAL SCIENCE Vol. 21, No. 5, pp. 737-734. One is reminded that "rank hath its privileges," and that "privilege" translates to "private law."
[39] D. Keltner, D. H.Gruenfeld, and C. Anderson, *Power, Approach and Inhibition*, PSYCHOLOGICAL REVIEW, *110*, pp. 265-284 (2003).

of the group, using group norms as a dominant reference point for acceptable or expected behavior. The risk of groupthink – collegiality and teamwork devolving to uncritical thinking or an absence of dissent – cannot be discounted, particularly on the turf of a dominant CEO.[40] These themes of in-group identification, conformity and deference to authority have unsettling ramifications for compliance. Experiments have shown that misconduct by an authority figure such as a CEO strongly primes independent episodes of misbehavior by others,[41] and the "copycat" misconduct can be of any type: the lesson taught by example is not theft, or bribery, or misrepresentation: it's disregard of rules. This principle can apply within the executive corps between more and less powerful executives, and then "trickle down" throughout the organization via a process Enron seems to have perfected, and even named.[42]

A similar effect operates laterally between those of equal power within a group, even one that is not particularly close-knit. Freud was on the mark when he observed that "something is unmistakably at work in the nature of a compulsion to do the same as others, to remain in harmony with the many,"[43] even when the many are in the wrong. In one study, Francesca Gino and Adam Galinsky discovered that feelings of closeness drawn from group membership, or even from trivial commonalities such as shared birthdays, leads people to emulate misbehavior committed by those they identify with.[44] In another study of in-group effects, Gino and others showed that college students will more readily cheat if they see another student in the same class cheating – but the effect disappears if the cheater appears to be from another school.[45]

As these findings would suggest, group membership also impairs our critical judgment when it comes to evaluating or monitoring the behavior of our closest colleagues. As a result, those in the best position to detect and identify C-suite misconduct may find it paradoxically hard to do so. Another finding of the Gino/Galinsky study mentioned

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[40] It is hard to say no to any boss, domineering or not, and the "authority bias" compellingly demonstrated by Milgram's electric shock experiments reminds us that deference to authority can quite easily override ethical qualms. *See* Milgram, *Behavioral Study of Obedience*, *supra* note 18.

[41] Kees Keiser, *The Spreading of Disorder*, doctoral dissertation, University of Groningen, 2010, summarized and cited in Muel Kaptein, *Why Good People Sometimes Do Bad Things: 52 Reflections on Ethics at Work*, July 25, 2012, available at http://ssrn.com/abstract=2117396. See also Kees Keizer, Siegwart Lindenberg, and Linda Steg, *The Spreading of Disorder*, SCIENCE, Vol. 322 (2008), pp. 1681-1685.

[42] See Lynne L. Dallas, *A Preliminary Inquiry into the Responsibility of Corporations and their Directors and Officers for Corporate Climate: The Psychology of Enron's Demise*, Public Law and Legal Theory Research Paper 44, St. John's University Law Review Symposium (2002), quoting a member of Enron's Risk Assessment and Management Group about the "Enronizing" of new employees: "[i]f your boss was fudging, and you have never worked anywhere else, you just assume that everybody fudges earnings…It was easy to get into 'well, everybody else is doing it, so maybe it isn't so bad'"(at 66).

[43] Sigmund Freud, GROUP PSYCHOLOGY AND THE ANALYSIS OF THE EGO, (Strachey Tr.) London: The Hogarth Press, 1949, p. 28 (originally published 1921).

[44] Francesca Gino and Adam Galinsky, *When Psychological Closeness Creates Distance from One's Moral Compass*, paper presented at the 23rd Annual International Association of Conflict Management Conference, Boston, Massachusetts, June 24-27, 2010.

[45] Francesca Gino, Shahar Ayal and Dan Ariely, *Contagion and Differentiation in Unethical Behavior: how One Bad Apple Spoils the Barrel*, PSYCHOLOGICAL SCIENCE, Vol. 20, No. 3, (2009) pp. 393-398.

above is that we tend to rationalize and justify misconduct committed by other members of our group – we give them the benefit of the doubt and interpret their actions in a favorable light, a stark departure from our usual tendency to judge others' conduct more harshly than our own.[46] Similar degradation of the peer-monitoring function occurs as a result of other cognitive biases mentioned earlier, notably incrementalism and motivated blindness. We can experience "change blindness" in the face of gradual ethical erosion of others' behavior, just as we gradually accept our own increasingly questionable acts.[47] Likewise, we are not very good at assessing the ethicality of someone else's behavior, if recognizing misconduct would hurt us – a principle that is "obvious to psychologists" but "is regularly ignored by those who set up organizations and regulatory structures."[48] This motivated blindness to others' failings is seen not only in the Bonds doping case and in numerous auditing scandals, but in countless everyday contexts where careers are tied together, where one person's bonus may depend on another's achievement, or where confronting a colleague would be at best uncomfortable and at worst career-limiting. Needless to say, we cannot put a stop to what we fail to notice.

If these experimental studies of group effects seem academic, consider *CEO Connectedness and Corporate Frauds*, a retrospective study of securities fraud in nearly 3,000 public companies over a 10 year period.[49] The study measured fraud incidence as a function of how many of the other top four C-suite executives were appointed during the current CEO's tenure, a rough index of "connectedness" within the suite based on the assumption that CEOs likely played a role in the selection of others appointed during their term. More connected executive teams may be more susceptible to unhealthy in-group influences, and if misconduct occurs, connectedness would also be conducive to collusion and covering for one another. The study's bottom line was that in firms where all four of the other executives were appointed during the current CEO's term, the fraud incidence was 34% higher than in firms where none were appointed during that term, with fairly linear results in between these two extremes. Detection was also significantly slower as connectedness increased. C-suite closeness probably does not cause fraud, but, aided by the kinds of psychological forces discussed above, it certainly seems to enable and prolong it.

Do We Have a Problem?

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[46] Francesca Gino, Don A. Moore and Max H. Bazerman, *See No Evil: When We Overlook Other People's Unethical Behavior*, in R. M. Kramer, Ann E. Tenbrunsel & Max H. Bazerman (Eds.), SOCIAL DECISION MAKING: SOCIAL DILEMMAS, SOCIAL VALUES, AND ETHICAL JUDGMENTS, pp. 241-263 New York: Psychology Press 2009

[47] Francesca Gino and Max H. Bazerman, *When Misconduct Goes Unnoticed: The Acceptability of Gradual Erosion in Others' Unethical Behavior,* J. OF EXPERIMENTAL SOCIAL PSYCHOLOGY 45, pp. 708-719 (2009).

[48] See Gino, Moore & Bazerman, *supra* note 46 (quoted matter at 245).

[49] Vikramaditya S. Khanna, E. Han Kim and Yao Lu, *CEO Connectedness and Corporate Frauds*, University of Michigan Law School Public Law and Legal Theory Research Paper Series, No. 283, June 2012.

This is a fitting time to remind ourselves that the combustible mixture of C-suite pressures and temptations with intractable human frailties doesn't actually explode very often. That tells us a lot about the integrity of the "average" senior executive.

But failures do happen and the damage to the organization can be vast, for two distinct reasons. First, serious C-suite misconduct can directly cause major financial and reputational damage, as the rare but spectacular corporate collapses of the past decade show. Second, and much more common and insidious, the C-suite is the font of corporate culture and whether through the direct and intentional exercise of power or through instructive example,[50] the C-suite tends to leverage its own culture, ethics, and behavioral expectations throughout the organization. C-suite ethical failures need not be severe to affect organizational culture, just visible. Recall that when leaders disregard rules and bend ethical principles, the lessons subordinates internalize are generalized: disrespect for rules and flexible ethics. A poor example at the top may produce ripple effects on organizational compliance that are as varied as the individuals throughout the organization, the functions they perform, and the temptations and pressures they face.

Any board member or compliance professional who has read this far has undoubtedly considered our issues and examples in comparison to their own organization, asking "do we have a problem?" Certainly there are many possible markers of a C-suite devolving towards a lax, dismissive, or toxic ethical culture. We might look for "leading indicators" such as narcissistic or power-hungry leaders; hypercompetitiveness and extreme focus on financial goals to the exclusion of other values; a cynical attitude towards regulation and regulators; or financial desperation at the organizational or personal level.

We can also look for direct symptoms – most people do not hide their true values very well, in part because, as we have seen, they are usually comfortable with their values and blind to their own ethical shortcomings. People who do not respect rules ordinarily show that disrespect in multiple ways – granting or expecting special treatment, open defiance of rules, a proclivity towards testing legal boundaries or making compliance decisions based on likelihood of detection, an imperial or disrespectful relationship with subordinates, and of course a history of violations, small or large.

A board, or chief compliance officer, whose C-suite is symptomatic has work to do. But the larger point is that all boards, and all chief compliance officers, have work to do in the C-suite, all the time. The defining feature of our wicked problem is its intractability. The pressures and temptations prevalent in C-suites are not going away. Our cognitive biases, self-deception mechanisms, group dynamics and rationalizations are here to stay. The C-suite will always be home to ambitious, driven, goal-oriented people. Like the weight of water against a dike, these realities exert constant pressure on ethical decision-making at the top of an organization, and the best time to practice prevention is always now.

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[50] *See* text accompanying notes 38-44 above for examples of how toxic leadership by example can influence follower behavior.

Part II: The Role of the Board in C-Suite Compliance

Addressing the risk of senior executive misconduct is among the fundamental duties of a board of directors, inseparable from its broader duty to supervise and monitor executive performance generally. We now consider how best the board can approach this "wicked" problem through a combination of selection and supervisory practices, purposeful engagement with the C-suite on ethics and compliance issues, vigilant corporate decision-making, and appropriate relationships with other control functions. Finally, we will examine three ways in which boards can apply to this problem the power of organizational culture to dramatically affect both ethical conduct and detection of misconduct.[51] All of these approaches must be informed by an appreciation not only of the psychologically knotty character of the C-suite misconduct problem but also of the peculiar difficulties inherent in the monitoring relationship.

The challenges directors face in working effectively with senior management are legendary. The task requires constant balancing among conflicting goals such as monitoring versus mutual trust, objectivity versus collegiality, collaboration versus independence, and support and motivation versus discipline and deterrence. Trade-offs are inevitable. The board must team with management in setting strategy, guiding its execution, and making or approving key business decisions. A basic trust in and respect for management is a prerequisite for effective teamwork, and is a given in any healthy boardroom.[52] Yet the board must simultaneously act as monitor, leavening its collaborative business role with a healthy and constructive skepticism exercised on behalf of the shareholders and the public.

As we saw in Part I, it is hard to exercise truly independent judgment about fellow members of a group with whom one regularly works hand-in-hand on important shared goals. The resulting personal relationships, and the tendency to identify with the larger group – board plus management, as a team – can impair objectivity and promote a tendency to overlook, rationalize or justify questionable behavior by our colleagues.[53] Directors' susceptibility to "motivated blindness" induced by these social forces is recognized not just by psychologists but, at least in Delaware, by judicial precedent. In one opinion assessing the independence of directors from management, the court called attention to social and organizational ties between them and stated,

> [Law should not] ignore the social nature of humans. To be direct, corporate directors are generally the sort of people deeply enmeshed in social institutions. Such institutions have norms, expectations that,

[51] For a review of the effects of cultural factors on workplace compliance and on speaking up about misconduct, see Scott Killingsworth, *Modeling the Message: Communicating Compliance through Organizational Values and Culture*, GEORGETOWN JOURNAL OF LEGAL ETHICS, Vol. XV, No. 4 (Fall 2012), 961, available at http://ssrn.com/abstract=2161076.

[52] Needless to say, if an executive has actually earned the board's distrust, the answer is not to "manage around" the problem by surrounding him with tight controls: he should be immediately encouraged to find a more suitable position elsewhere.

[53] See Gino and Galinsky, supra note 44.

> explicitly and implicitly, influence and channel the behavior of those who participate in their operation… In being appropriately sensitive to this factor, our law also cannot assume – absent some proof of the point – that corporate directors are, as a general matter, persons of unusual social bravery, who operate heedless to the inhibitions that social norms generate for ordinary folk.[54]

Nor are directors immune to other human failings that may affect monitoring, such as "change blindness" in the face of gradually deteriorating behavior, or the "fundamental attribution error" mentioned earlier, where having once judged the character of an individual, we assume that we can rely upon them to behave always in conformity with that character. We also know that when a person commits transgressions indirectly, through other people, "indirect blindness" can cause us to overlook or minimize the instigator's culpability[55] – a phenomenon with obvious relevance to senior executives who delegate most operational activities, and who may do so with plausibly deniable intimations as to means and ends. Finally, where the board has directly participated in the hiring of an executive, cognitive dissonance may inhibit directors from recognizing that their initial judgment was in error, or from noticing signs to that effect.

In the end, then, the board's monitoring task includes monitoring itself against succumbing to groupthink, contagious rationalizations and motivated blindness of its own as it works hand in hand with trusted management.

What Not to Do

The answer to C-suite compliance risk is not to double down on controls, confrontation, and suspicion. Monitoring is not the same as distrust. The essence of C-suite monitoring by the board is that it must coexist with trust in management and persist despite that trust. As suggested in Part I, the board should take a cue from behavioral ethics and de-personalize the monitoring role, focusing less on issues of moral character and more on situational risk factors and the cognitive biases that aggravate those risks: not "do I trust this colleague," but "do I trust this situation?" It is easier to be objective about the latter, easier to identify situational risks than to reliably judge character, and far less taxing on C-suite relationships if the focus is on situations where "*we* must be careful."

As a practical matter, the board cannot, and should not, attempt to manage the corporation nor can it, or should it, directly supervise senior executives in the execution of their duties.[56] And projecting expectations of misconduct upon executives – very few of whom deserve it – will produce, at best, dysfunction and at worst, a self-fulfilling prophecy.

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[54] In re Oracle Corp. Derivative Litigation, 824 A.2d 917 (Del. Ch. 2003).

[55] *See* Neeru Paharia, Karim S. Kassam, Joshua D. Greene, and Max H. Bazerman, *Dirty Work, Clean Hands: The Moral Psychology of Indirect Agency*, ORGANIZATIONAL BEHAVIOR AND HUMAN DECISION PROCESSES 109(2), pp. 134-141 (2009).

[56] The customary shorthand for the appropriate engagement level of directors is "nose in, fingers out."

In the face of a distrustful board, executives can be expected to react defensively and to involve the board only in decisions where its participation is clearly required; and teamwork and effectiveness will suffer. Executives may also react by exerting tighter control over the already-limited information the board receives, even beyond management's intrinsic motivation to portray their own performance favorably,[57] thus actually impairing the board's monitoring capability.[58]

In its role as the final guardian of ethical culture,[59] the board can be far more effective by taking positive actions than by adversarially positioning itself as the C-suite's "compliance cop." The greatest impact will be achieved if the board focuses on selecting executive leaders with unblemished records of integrity, working supportively with the CCO and other internal-control officers, maintaining continuity of "tone at the top" as executives come and go, and promoting ethical leadership within the C-suite and a robust ethical culture throughout the organization.

Leadership Selection

Good leadership selection, especially *not* hiring the *wrong* people, is critical for compliance. This is one time when focusing on the individual's basic character – despite its likely inconstancy – is most beneficial.[60] It is not always easy to distinguish between the confidence, ambition, dedication and persuasive power that makes for a successful executive and the aggression, ambition, intensity and manipulative power that characterizes a narcissist or psychopath. Still, it helps to be clear about what you're trying to avoid.

The Group of Thirty offers this advice about CEOs who think of themselves as "stars": "A very good CEO is preferable to a "star" CEO."[61] Very good CEOs "care much more about doing the right thing than about being right," while "star" CEOs "may conflate the

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[57] See Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms and the Unintended Consequences of Independence and Accountability*, Georgetown Law and Economics Research Paper No. 241402, September 2000, available at http://ssrn.com/abstract=241402.
[58] This key vulnerability in the board's monitoring function – the fact that much of the board's information on the C-suite's performance is provided and to some extent controlled by the C-suite, and most of the Board's information on the integrity, character, and ethics of the C-suite is similarly based on direct interaction with the C-suite – points us towards some alternate approaches. See below under "Culture And Expectations Of The C-suite" and "Culture and the 'Information and Reporting System'."
[59] See Michael D. Greenberg, DIRECTORS AS GUARDIANS OF COMPLIANCE AND ETHICS WITHIN THE CORPORATE CITADEL: WHAT THE POLICY COMMUNITY SHOULD KNOW, RAND Center for Corporate Ethics and Governance Conference Proceedings 2010.
[60] In executive hiring, "pink flags" – small warning signals – are worth paying attention to. One study, for example, demonstrated a correlation between prior-year CEO legal infractions, such as speeding tickets, driving under the influence, and disturbing the peace, and heightened risk of accounting fraud and financial statement errors. Robert H. Davidson, Aiyesha Dey, and Abbie J. Smith, Executives' 'Off-the-Job' Behavior, Corporate Culture, and Financial Reporting Risk (November 1, 2011). Chicago Booth Research Paper No. 12-24; Fama-Miller Working Paper. Available at SSRN: http://ssrn.com/abstract=2096226.
[61] Group of Thirty, TOWARD EFFECTIVE GOVERNANCE OF FINANCIAL INSTITUTIONS, 2012, p.20. It is telling that this 81-page report by some of the world's most prominent and hard-nosed financial executives and scholars uses the word "culture" 126 times, and "values" 86 times.

[company's] success with their own personal goals,"[62] "advance their own ideas in preference to listening to the good ideas of others, and they may start to believe their own press."[63] Essentially, they are warning against the temptation to hire charismatic CEOs who are high in narcissism, and who in their unending pursuit of admiration, affirmation and applause, have been shown to regularly take greater risks, make more acquisitions, pay higher premiums for them, and produce more extreme results (good or bad) on several measures of corporate performance than those lower in narcissism.[64]

To similar effect, in his book Good to Great,[65] Jim Collins pointed out that the successful companies he studied had in common that they were led predominately by 41 "humble CEOs," or servant-leaders, who were continually described with words like "quiet, humble, modest, reserved, shy, gracious, mild-mannered, self-effacing, understated, did not believe his own clippings, and so on."[66] Similarly, compliance strategist Donna Boehme has observed that "the most enduring, most powerful ethical cultures have at their core some simple, well-worn CEO stories" of humility.[67]

The Group of Thirty also recommends direct board involvement in the selection of C-suite officers other than the CEO, and that "[a]t a minimum, the board must confirm the appointments of corporate officers for whom independence from line of business management is critical. These typically include the internal auditor, the chief financial officer, the chief risk officer, the chief compliance officer, and the chief legal officer."[68] Besides offering prophylaxis against undue "connectedness" in the C-suite,[69] this step would underscore the expectation of independence of these officers.

Below the CEO level, leadership selection does not end when an officer is hired. For those still eligible for higher office, the board's oversight of promotions should include a fresh look at currently available information on the candidate, especially in connection with CEO succession planning.[70]

Working with the Chief Compliance Officer

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[62] See note 12, *supra*.
[63] Id. at 38.
[64] See Arjit Chatterjee and Donald C. Hambrick, *It's All About Me: Narcissistic CEOs And Their Effects on Company Strategy and Performance*, ADMINISTRATIVE SCIENCE QUARTERLY 52:351-386 (2007). This paper helpfully provides a number of indicia of narcissism that a board could use in vetting management candidates.
[65] James Collins, GOOD TO GREAT, HarperBusiness, 2001.
[66] It is noteworthy that the increased misconduct and hypocrisy found in the Lammers study, *supra* note 38, occurs only if the subject *also* feels entitled to his power: humility trumps hypocrisy.
[67] See Donna Boehme, *5 Ethical Culture Lessons for CEOs from Pope Francis*, CORPORATE COUNSEL, April 4, 2013.
[68] TOWARD EFFECTIVE GOVERNANCE OF FINANCIAL INSTITUTIONS, *supra* note 61, at 39.
[69] *See* text accompanying note 49, *supra*.
[70] The Federal Sentencing Guidelines for Organizations require companies to use reasonable efforts to ensure that persons with a history of "illegal activities or other conduct inconsistent with an effective compliance and ethics program" will not be given positions of substantial authority. This applies equally to promotions from within as to lateral hires. United States Sentencing Commission, GUIDELINES MANUAL §8B2.1.(b)(3).

The board should develop a close and supportive relationship with the Chief Compliance Officer, ensure her independence,[71] and communicate directly with her on a regular basis. An integral (and unavoidable) part of the CCO's job is understanding the board's and the C-suite's attitude towards modeling and supporting ethics and compliance within the organization. In a healthy company the CCO should always be in a position to "speak truth to power" in the C-suite itself, but to whatever extent this is not the case, it is all the more essential that she be able to speak frankly, and privately, with the board.

In the United States, the vital connection between direct CCO-board communication and the issue of C-suite compliance is recognized in, and reinforced by, the Federal Sentencing Guidelines for Organizations: unless the CCO regularly reports directly to the board, the company cannot receive leniency under the Guidelines in connection with senior executive misconduct, no matter how excellent the company's compliance program may be in other respects.[72] Notably, the Guidelines also emphasize that the CCO must have "adequate resources" and "appropriate authority."

Similar considerations apply with respect to other officers whose jobs involve a monitoring element and require independence, as mentioned earlier. In fact, the Group of Thirty's discussion of the Chief Risk Officer (CRO) role applies equally well to the role of the CCO, as well as those of Internal Audit, the General Counsel and the CFO. After observing that, in many of the financial institutions that failed during the recent financial crisis, the CRO "struggled to properly influence their firm's risk-taking activities" and "lacked sufficient independence from and credibility with the firm's top management and business units,"[73] the report concluded that CROs need the following conditions to be successful:

> They need courage and conviction, and they should be willing to walk away from their job if their judgment on major issues is ignored. They should have the right stature in the organization. They should be a member of the senior management team and should report to the CEO. They should have high visibility in the boardroom and should have unfettered access to the chairman of the risk committee and the full board where necessary.[74]

Given a real "seat at the table" in senior management and regular interaction with the board, all of these officers can assist the board's C-suite monitoring function by providing current information on the climate in the C-suite, on particular issues of compliance and reputational risk, and on "pink flags" or emerging concerns. The board

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[71] *See* Donna Boehme, *Making the CCO an Independent Voice in the C-Suite*, CORPORATE COUNSEL, March 19, 2013.

[72] United States Sentencing Commission, GUIDELINES MANUAL 8C2.5(f)(3)(C) (2010). This has led no less an authority than the National Association of Corporate Directors to recommend, in understated fashion, that boards "should at least consider having their chief ethics/compliance officer report to the audit committee and/or board of directors," National Association of Corporate Directors, C-SUITE EXPECTATIONS: UNDERSTANDING C-SUITE ROLES BEYOND THE CORE, 2013, at 16.

[73] TOWARD EFFECTIVE GOVERNANCE OF FINANCIAL INSTITUTIONS, *supra* note 61, at 48.

[74] Id.

should also pay attention to the relationships between these "control" officers and the rest of the C-suite; distance, antagonism, or portrayal of these officers as the "department of sales prevention" are danger signs. The rest of the C-suite should appreciate that the faster the car, the more it needs a good set of brakes.

Modeling the Message

The final responsibility for corporate culture remains with the board – duties may be delegable but responsibility is not. Our final sections examine three different ways the board can harness organizational culture as a means of effectively monitoring and managing C-suite ethics: by modeling and articulating the culture the board wishes to establish (and thereby sending a powerful implicit message to management); by explicitly engaging the C-suite with cultural and ethical-leadership responsibilities; and by taking advantage of a positive culture's potential as a compliance "information and reporting system" for the board.

There is no longer doubt that organizational culture drives improved compliance results through a variety of mechanisms,[75] including broadly the establishment and pervasive reinforcement of behavioral norms, demonstrating the legitimacy of the company's ethical leadership and rules,[76] harnessing group loyalty and engagement[77] and invoking and leveraging employees' existing ethical values.[78] Culture counteracts the undertow of temptation and rationalization by helping people recognize the ethical dimensions of workplace issues, encouraging upright behavior and providing tools for dealing with ethical conflicts and compliance failures. The results are dramatic: the Ethics Resource Center found that the incidence of misconduct at companies in the lower quartile of an ethical culture measure was triple the incidence at companies in the top quartile,[79] and using its own index of ethical culture, the Corporate Executive Board found the same 3-to-1 ratio between the bottom and top quartiles for violations in high-risk compliance areas such as conflicts of interest and accounting irregularities.[80]

If the C-suite is the font of organizational culture, the board is its wellspring. Consider the interaction between these two assertions:

> *If each level in a corporate hierarchy emulates the one above it, then a*

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[75] S*ee, generally*, Killingsworth, *Modeling the Message, supra* note 1.
[76] *See, e.g.*, Tom R. Tyler, John Dienhart and Terry Thomas, *The Ethical Commitment to Compliance: Building Value-Based Cultures*, 50 Calif. Mgmt. Rev. 31, 35 (2008) and Linda K. Treviño, Gary R. Weaver, David G. Gibson, and Barbara Ley Toffler, *Managing Ethics and Legal Compliance: What Works and What Hurts*, 41 CAL. MGMT. REV. 131-151 (1999)
[77] *See* Steven L. Blader & Tom R. Tyler, *Testing and Extending the Group Engagement Model: Linkages between Social Identity, Procedural Justice, Economic Outcomes, and Extrarole Behavior*, 94 J. APPLIED PSYCHOL. 445, 457 (2009).
[78] See Dan Ariely, PREDICTABLY IRRATIONAL 195-216 (2008)
[79] Ethics Resource Center, 2011 National Business Ethics Survey, p.20.
[80] Compliance and Ethics Leadership Counsel of the Corporate Executive Board, ETHICAL LEADERSHIP: THE IMPORTANT LINKS BETWEEN CULTURE, RISK MANAGEMENT, AND BUSINESS PERFORMANCE, 2010, p. 67.

corporation can never be better than its board – Alice Peterson[81]

You're only as good as the leaders you have underneath you. You might think that because you're projecting our values, then the rest of the company is experiencing the values. What you realize is that the direct supervisors become the most important influence on people in the company. – Victoria Ransom[82]

To instill an ethical culture, the board and the C-suite each depend on one another: the board must inspire the C-suite and the C-suite must propagate that inspiration down through the organization's management layers and to all employees. And if the company can be no better than the C-suite's perception of its board, the board must embrace without reservation its obligation to model ethical behavior.

As with any leadership position, that of directors is fraught with the potential to influence the attitudes and behavior of those farther down the hierarchy – influence that may be either inspirational or malignant depending on how it is exercised. Improper or questionable behavior by directors, even in small matters, both undermines the legitimacy of directors' ethical leadership and directives, and promotes misconduct by those aware of director misbehavior.[83]

Directors often overlook the intensity with which their actions are scrutinized by senior management. The conflict of interest inherent in a board's setting its own compensation, perquisites, meeting sites, and expense reimbursement policies is lost on no one, and the decisions made in that domain, and the process by which they are made, are received as powerful messages about the board's values and integrity.[84] Moreover, some officers may justifiably observe that directors are just as vulnerable to the pernicious influences of power, money, urgency, in-group preference, and motivated blindness as are ordinary mortals, and through this skeptical lens they may tend to ascribe the worst plausible motivations to directors' behavior.

With regard to its own members' behavior, as well as that in the C-suite, the board must consistently "repair the broken windows" of even small legal and ethical breaches that come to their attention.[85] The literature is replete with evidence that tolerating visible infractions breeds further infractions *of all kinds*, and leads step-by-step to continued

[81] Remarks at the Practising Law Institute Corporate Compliance and Ethics program, Chicago, Illinois, May 6, 2012.
[82] Quoted in Adam Bryant, *If the Supervisors Respect Values, So Will Everyone Else*, THE NEW YORK TIMES, January 26, 2013.
[83] *See* note 41, *supra*.
[84] The principle discussed in connection with note 35, that persons in power may be more forgiving of their own transgressions while simultaneously harsher in judging the actions of others, may have special cautionary relevance to board with respect to its C-suite relationships. Any taint of apparent hypocrisy on the part of the board will be fatal to the board's moral authority.
[85] *See* George L. Kelling and James Q. Wilson, *Broken Windows: The Police and Neighborhood Safety*, THE ATLANTIC MONTHLY, March 1982, pp. 29-38.

decline in overall compliance.[86] Where misbehavior is concerned, there is much truth in the adage, “what you permit, you encourage.” Conversely, if you deal with small problems conspicuously now, you may not have to deal with big problems later. Of course, the response must be proportional to the infraction, but the point is that there must be a response, lest a climate of delinquency and disorder gain a foothold in the organization, at the top of a slippery slope.

In addition to ensuring that misconduct is dealt with, from a communications and modeling perspective the board should be reluctant to “let a good mistake go to waste.” The value of correcting a single violation can be multiplied if the company can get the word out about the nature of the violation and the steps taken to address it.[87] This reinforces not only the organization's behavioral norms but also its genuine commitment to organizational justice.

Nothing is more important to ethical culture than employees’ belief that if misconduct is discovered, appropriate action will follow – especially where high performers or those in senior positions are involved. How important is it? In a large-scale study, the Corporate Executive Board identified seven key drivers of employee perceptions that their organization has a culture of integrity. At the top of the list, and *three times as important as the other six factors combined*, was organizational justice: the perception that the company responds quickly and consistently to proven unethical behavior and that unethical behavior is not tolerated in their department.[88]

Finally, the board can also exercise leadership with respect to other cognitive traps that can lead to compliance breakdowns, such as motivated blindness, business-only framing, and tunnel vision in strategic decision-making. The board is uniquely positioned to be the voice for a broader analysis of strategic problems, one that systematically takes into account how other constituencies, such as regulators, customers, or the press, might frame a problem under consideration, and that explicitly sifts business decisions through the organization’s core values. And through its role in setting executive compensation, goals, incentives and the associated timelines, the board can mitigate corrosive psychological forces at work in the crucible.

Culture and Expectations of the C-Suite

The board should also challenge senior leaders to take ownership of the organization's ethical culture and to be accountable for results. Setting these expectations has a dual function: to benefit the overall organization by engaging the C-suite in supporting ethical culture through modeling, communications, discipline, etc., while simultaneously raising the salience of ethical behavior in the minds of the executives themselves. A clear, explicit expectation from the board that the senior executive's duties include serving, and

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[86] *See* note 26 and accompanying text.
[87] For an excellent example of how this can be done effectively in a large company without identifying the participants, *see* the blog by Kathleen Edmond, Best Buy’s chief ethics officer, at www.kathleenedmond.com.
[88] Corporate Executive Board, Ethical Leadership, *supra* note 80.

being accountable, as a positive role model for the rank and file can do much to focus the mind on topics that might otherwise be consigned to the back burner.

At a minimum, compliance failures should be included in executive performance reviews. Senior executives can also be invited to account for their objective actions in promoting compliance and ethical culture, such as completing required training and encouraging their staffs to do so; contributing to compliance-related newsletters and other communications; attending compliance-related functions; including “compliance moments” in presentations; making resources available for employee training; assisting with internal investigations; assisting with the design of compliance controls in their area of responsibility, etc.[89] What gets measured gets done.

On a broader scale, C-suite executives can, individually or as a group, be rewarded for measurable improvements in the company's compliance in a variety of ways. Metrics of commonly recurring issues such as employment discrimination suits, safety citations, etc. can go into an evaluation.

Other facets of executive ethical leadership can best be measured through the eyes of others, for example through 360° evaluations by peers, direct and indirect reports, and the board, or via employee surveys – both emerging best practices employed by leading companies.[90] Validated survey tools can reliably measure employees' perception of key ethical-culture variables, such as organizational justice, comfort speaking up about violations, comfort seeking advice about compliance issues, tone at the top, clarity of behavioral expectations, trust in colleagues, and the like. These cultural assessments can identify organizational weak spots and compliance danger zones, across the company as a whole or within particular locations or functions, and can serve as roadmaps for remedial action. The board can send no stronger message about the priority it assigns to ethical culture than by tying part of executive compensation to improvements on these key measures.

Culture and the “Information and Reporting System”

The board's fundamental obligation with respect to compliance is to establish, and monitor, an “information and reporting system” designed to provide sufficient timely, accurate information to support informed judgments about the corporation's compliance.[91] With respect to C-suite compliance, the information and reporting system includes the CCO, Internal Audit, the General Counsel and other control officers, external auditors, and the board's direct experience with senior executives. All of these

[89] In C-SUITE EXPECTATIONS, *supra* note 72, the NACD suggests asking the CEO directly about “how the CEO is engaged in ongoing evaluation of the ethics program” and requesting examples of “how the CEO is building ethics requirements into his/her staff’s objectives” and of “how the CEO is modeling ethical behaviors” (at p. 17).

[90] *See* Joseph E. Murphy, SOCIETY OF CORPORATE COMPLIANCE AND ETHICS, USING INCENTIVES IN YOUR COMPLIANCE AND ETHICS PROGRAM (2011)

[91] For U.S. companies, at least, this standard has been explicitly established as law: *See In re Caremark International, Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996).

represent different windows into the executive suite, and each window is limited in its own way. But few things happen in a corporation completely unwitnessed.

Gwyn Morgan, the Chairman of SNC-Lavalin when its corruption scandal broke, has said that the scandal's "first lesson" is that "since non-executive directors receive essentially all information from people in the company, boards should do everything possible to strengthen and diversify those information channels."[92] These channels cannot all be as direct as the board's relationships with senior control officers: the final piece of a fully-developed information and reporting system is, quite simply, everyone else in the company.

The effectiveness of this component depends on how comfortable employees feel in speaking to their supervisor, to a compliance officer, to in-house counsel or to an internal auditor about compliance concerns and questions; how much they trust the integrity of the hotline service and of the investigative process that follows a report; whether they believe that the company will take appropriate action when misconduct is discovered, especially if the culprit is a high achiever, occupies a senior position, or has friends in management; and whether they believe that good-faith whistleblowers will be protected from retaliation.[93]

In a high-functioning culture, these factors operate to make rank-and-file employees the eyes and ears, the early warning system, and sometimes the conscience, of the company. A culture of "speaking up" can uncover existing or incipient violations via up-the-chain reporting and anonymous hotlines,[94] and can identify organizational red flags and renegade microcultures via surveys or focus groups. It can also be good for earnings.[95] As mentioned earlier, these crucial perceptions of the company's integrity and the

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[92] Gwyn Morgan, *Lessons I Learned from SNC-Lavalin's Woes*, The Globe and Mail, July 26, 3013. Morgan recounted two other lessons relevant here: one emphasized the importance of having all leaders, from the CEO on down, model compliance diligently and consistently, and the other urged building a corporate culture "on strong ethical values that penetrate every level in the company," so as to promote not only ethical behavior but also speaking up when misconduct is observed.

[93] *See generally*, Michael D. Greenberg, FOR WHOM THE WHISTLE BLOWS: ADVANCING CORPORATE COMPLIANCE AND INTEGRITY EFFORTS IN THE ERA OF DODD-FRANK, RAND CENTER FOR CORPORATE ETHICS AND GOVERNANCE, CONFERENCE PROCEEDINGS REPORT (2011); Ethics Resource Center, INSIDE THE MIND OF A WHISTLEBLOWER, SUPPLEMENTAL REPORT OF THE 2011 NATIONAL BUSINESS ETHICS SURVEY (2012).

[94] See *id*, reporting that in companies with a weak ethical culture and a weak compliance program, approximately half the employees who witness misconduct do nothing to report it, while in companies with both strong culture and a strong program, only 3% fail to report misconduct they have observed. In another Ethics Resource Center study that measured reporting-up purely as a function of culture (as opposed to culture plus compliance program), employees in a stronger culture were one-third more likely to report observed misconduct than those in a weaker culture. Ethics Resource Center, THE IMPORTANCE OF ETHICAL CULTURE: INCREASING TRUST AND DRIVING DOWN RISKS, SUPPLEMENTAL RESEARCH BRIEF OF THE 2009 NATIONAL BUSINESS ETHICS SURVEY. More generally, see also discussion in Michael D. Greenberg, CORPORATE CULTURE AND ETHICAL LEADERSHIP UNDER THE FEDERAL SENTENCING GUIDELINES: WHAT SHOULD BOARDS, MANAGEMENT AND POLICYMAKERS DO NOW? RAND CENTER FOR CORPORATE ETHICS AND GOVERNANCE, CONFERENCE PROCEEDINGS REPORT (2012).

[95] See ETHICAL LEADERSHIP, supra note 80, which found a significant positive and linear relationship between employee comfort in speaking up and 10-year total shareholder return.

resulting willingness of employees to speak up can be measured and, through ethical leadership at the senior executive and supervisor level, fair treatment of employees, communications, and training, can be improved.

By investing in a robust ethics and compliance program and committing to the long-term development of a consistent and uncompromising ethical culture, a board can ensure that its most effective "information and reporting system" – its people – will be there when most needed.

About the Author

Scott Killingsworth is a corporate lawyer who has worked with public and private companies in fields as diverse as computer hardware and software, medical devices, manufacturing, e-commerce, logistics and distribution, and health care, often serving as outside general counsel.

A partner at Bryan Cave LLP, he has a particular interest in corporate governance, compliance and ethics and has assisted with the establishment, design, policy formulation and periodic evaluation of ethics and compliance programs for clients ranging from medium-sized private businesses to Fortune 500 companies.

Mr. Killingsworth serves on the Board of Governors of the Center for Ethics and Corporate Responsibility at Georgia State University, on the Editorial Board of the Journal of Business Compliance, and is an active member of the Society of Corporate Compliance and Ethics. He has been invited to speak on compliance topics at Georgetown Law School's Corporate Counsel Institute; the SCCE Annual Compliance and Ethics Institute; PLI's Corporate Compliance and Ethics Institute and its Advanced Compliance and Ethics Workshop, the Journal of Legal Ethics Symposium; the Ethics and Compliance Officer Association Annual Ethics and Compliance Conference, the NACD/Terry Board Governance Summit, Ethisphere and SCCE webinars; several law and business schools and private workshops; and many other accredited educational programs on compliance program design, structure, effectiveness, and assessment.

He is one of 12 attorneys in private practice named to Ethisphere Institute's list of "Attorneys Who Matter" in ethics and compliance in both 2013 and 2014, is listed in Who's Who in America and Who's Who in American Law, is a "Superlawyer," and was one of only 17 U.S. lawyers designated as "Client Service All-Stars" by the BTI Consulting Group in both 2007 and 2008.

Mr. Killingsworth's article, "Modeling the Message: Communicating Compliance through Organizational Values and Culture," received a 2013 Burton Award for Distinguished Legal Writing and is among the top 1% most requested titles from the Social Science Research Network archive. He has served on the editorial or advisory boards of five legal or compliance journals. His scholarly work has been cited in law reviews from Harvard, Stanford, Vanderbilt, Berkeley, Georgia, and Washington University and in an opinion of the Supreme Court of Canada, and has been incorporated into several textbooks. He received his bachelor's degree in Culture and Behavior at Yale University, where he was a Yale National Scholar and National Merit Scholar, graduated Phi Beta Kappa and with Honors with Exceptional Distinction, and later served on the alumni Board of Governors. He received his J.D. from Yale Law School, and has served as Vice President and a member of the Executive Committee of the Yale Law School Association.

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