

# PERSPECTIVES

College of Business at the University of Illinois at Urbana-Champaign

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## Is the Party Over?

**What's Ahead for Private Equity?**



# One Thing Leads to Another

## How Corruption Topples Business

**A**fter the biggest corruption investigation in history, engineering conglomerate Siemens AG agreed in December 2009 to pay more than \$1.3 billion to settle charges in the United States and Germany. In addition, it created the Siemens Integrity Initiative, which will distribute \$100 million over 15 years to nonprofit organizations to support global efforts to fight fraud and corruption. In a form of institutionalized corruption, the company had allegedly been securing contracts around the world by systematically funneling about 1.3 billion euros in bribes through slush funds.

While global cases such as this capture the media's attention, corruption can happen anywhere. It usually has subtle, almost unrecognizable beginnings. "Corruption can start in the back of a cab at the end of a negotiation, during a dinner discussion, when applying for a license, or in the process of signing a contract," says Gretchen Winter, executive director of the Center for Professional Responsibility in Business and Society at ILLINOIS. "It happens so quickly that sometimes you don't even realize it, and you rarely have time to think too deeply before you respond."

“People don’t wake up in the morning and make a decision to cross the line,” says C. K. Gunsalus, professor of business administration and coordinator of undergraduate education. “Rather, corruption is usually the result of cumulative processes. For instance, your golf partner may ask you to change the score, and if you’re willing, the next request may be to change some numbers at work. It happens slowly and incrementally as you establish a pattern of conduct.”

### The Limits of Legislation

While a company may benefit temporarily from corrupt practices, in the long run it always suffers the consequences—lost jobs, ruined lives, poor reputation, diminished shareholder value. “Beyond the company, corruption inhibits development, contributes to organized crime, and undermines democratic stability,” says Winter. “It’s really not the oil that greases the wheels. As business has become global, so has corruption and anti-corruption enforcement. Governments around the world have implemented statutes and programs to prevent unethical practices, and the trend has been for jurisdictions to collaborate rather than conducting separate investigations and prosecutions.”

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— ABHIJEET VADERA

The accounting scandals of the early 2000s prompted the passage of the Sarbanes-Oxley Act of 2002 (SOX), which requires companies to enhance and/or implement ethics and compliance programs. Despite SOX and other legislative initiatives, including The United States Foreign Corrupt Practices Act of 1977, the Organization of Economic Cooperation and Development’s (OECD) Convention on Combating Bribery of 1997, and the United Nations Convention Against Corruption of 2004, scandals make the news almost every week.

Abhijeet Vadera, a doctoral candidate in business administration working with Associate Professor Ruth Aguilera at ILLINOIS, suggests one possible explanation for the ineffectiveness of

SOX. “Companies simply copy an ethics and compliance program from an industry peer, and their training programs amount to little more than a 20-minute online test,” he says.

In general, one-size-fits-all laws are ineffective, says Aguilera, a fellow at the Center for Professional Responsibility in Business and Society. “‘Hard laws,’ such as SOX, seek to strengthen corporate governance through legal rules that cover all companies operating in a particular jurisdiction,” she explains. “Compliance usually amounts to window dressing. Companies publish the necessary policies, but don’t invest the resources to make them effective. In the area of finance, for example, the law is so rigid that companies circumvent it by entering a gray area. While they remain legal, they are really violating the principle of the law.”

By contrast, “soft laws” are voluntary codes of good governance or codes of ethics, which Aguilera believes are more effective. “Self-determination theory holds that people don’t want to be told what to do, but will go the extra mile for something they believe in,” she says.

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"Some European countries, for instance, have best practice recommendations regarding the behavior and structure of the board of directors. Companies have to comply with these codes of good governance or disclose the reasons for noncompliance. The flexibility to adapt or mix various practices may help them tailor corporate governance to diverse organizational environments. Giving good quality explanations for noncompliance is associated with higher corporate performance than box-ticking compliance."

Codes of good governance have spread around the world, encouraged by transnational organizations such as the European Commission, the World Bank, and the OECD. The Equator Principles is one such example. This voluntary set of standards for determining, assessing, and managing social and environmental risk in project financing, is modeled on the environmental standards of the World Bank and the social policies of the International Finance Corporation.

### Culture Matters

Organizational culture plays a huge role in either condoning or fighting unethical practices. The design of formal compliance and training programs is just the beginning. "A less formal, but very important aspect is how you treat your employees," says Vadera. "If you are honest with them, compensate and

promote them fairly and systematically, and communicate openly about organizational decisions, then the citizens of your organization will mimic those behaviors in dealing with their colleagues, subordinates, customers, and other stakeholders."

He recommends customizing ethics programs not only to the company, but to specific groups, and phasing in their implementation. "Start by focusing on the departments that need it the most," he says. "For example, you could begin with the purchasing department, training employees about relationships with

vendors. Later, deal with departments which focus on internal logistics and may have less exposure."

A greater voice for shareholders in corporate governance also may help keep companies on the straight and narrow, Aguilera suggests. "Shareholder access to ballot," for instance, permits shareholders to set the agenda for shareholder meetings and nominate directors that represent their interests, and the "say on pay" proposal currently in the Senate would allow shareholders to vote on the pay of directors and top management. "This is quite common in Europe, and in the U.K. it's law," says Aguilera. "Greater shareholder control and higher levels of disclosure may help stem the tide of corruption."

"It's difficult to measure the effectiveness of anti-corruption policies and programs because you can't easily measure a negative," says Winter. "Only a small number of companies require people to report requests that were refused. Creating a standard against which employees can measure their conduct can nip some problems in the bud." Vadera suggests that the success of an anti-corruption program could be measured longitudinally over time by tracking the frequency of incidents before and after implementing the program.

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# Bad Economy, Good Ethics

## What Workers Say

2007 2009

I've Observed Misconduct 56% 49%

I've Reported Observed Misconduct 58% 63%

I Believe There is Pressure to Report Misconduct 10% 8%

I Believe I've Experienced Retaliation for Reporting Misconduct 12% 15%

I Believe My Company Has a Strong Ethical Culture 53% 62%

Source: Ethics Resource Center

The Ethics Resource Center conducted a National Business Ethics Survey in 2009, talking with more than 3,000 randomly chosen employees across the country to assess their attitudes toward ethical conduct in the workplace. This year's results showed improvement over the findings reported in the last survey conducted in 2007: misconduct is down, reporting of misconduct is up, ethical culture is stronger, and pressure to violate ethics is lower. The only negative trend was in the perception that a report resulted in some form of retaliation, ranging from feeling excluded to verbal abuse.

Surprisingly, these positive findings were achieved during a period of significant economic upheaval and followed a trend also seen in another turbulent time, 2002-2003. Both were periods of high-profile business scandals and failures followed by strong government intervention and the threat of not only stepped-up enforcement but prosecution. The ERC offers a possible explanation: "During hard times, when a company's well-being or even existence may be on the line and regulators are watching, management talks more about the importance of high standards to see the organization through

the crisis. It may also be that some are less inclined to commit misconduct when management is on high alert." This could lead to what the report termed an "ethics bubble" that could burst when the economy turns around unless leadership takes decisive and deliberate action to raise the bar for ethical conduct.

To learn more about the survey results and what business leaders, policy makers, and ethics professionals can do to create a strong ethical climate, visit [www.ethics.org/nbes](http://www.ethics.org/nbes).

– Cathy Lockman

## Whistle-blowing Do's and Don'ts

According to the Association of Certified Fraud Examiners, tips, mainly from employees, are the most common way in which fraud is detected. Yet, according to The Hudson Employment Index, only half of the 31 percent of U.S. employees witnessing ethical misconduct actually report it.

What makes people report unethical practices, and how can whistle-blowing be encouraged?

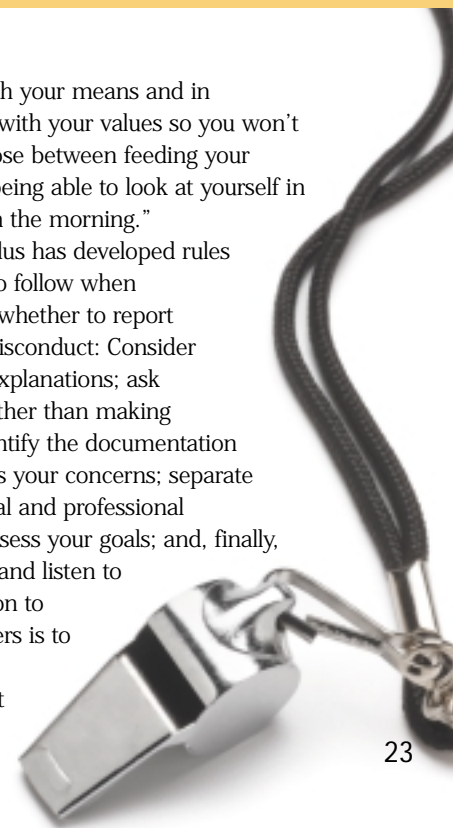
Vadera has studied what motivates people to report unethical practices as well as the factors that influence them not to report it. "The results were counter-intuitive," he says. "The decision to report or not report was not based on a cost-benefit analysis. It was mostly an

emotional process. People who were morally outraged when they observed wrongdoing wanted to report it, even when it meant possible job loss."

Gunsalus teaches emerging professionals how to avoid situations in which they have to become whistle-blowers. Her advice is to establish a pattern of ethical conduct from day one. "As you interview for a job, express the values that matter to you and your interest in the company's ethical climate," she says. She also teaches students how to build an "ethical cushion" that will support them in the unlikely event of extreme consequences (e.g., losing a job) for blowing the whistle. "Arrange your finances so that you will never go hungry or miss a mortgage payment because you decided to 'do the right thing,'" she says.

"Live beneath your means and in congruence with your values so you won't have to choose between feeding your family and being able to look at yourself in the mirror in the morning."

Gunsalus has developed rules of conduct to follow when considering whether to report perceived misconduct: Consider alternative explanations; ask questions rather than making charges; identify the documentation that supports your concerns; separate your personal and professional concerns; assess your goals; and, finally, seek advice and listen to it. Her caution to whistleblowers is to manage emotions. "It



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—STEVE VAN ARSDELL



## The Culture of Ethical Behavior

“Too often organizations have assumed that ‘unethical behavior won’t happen here,’” says Steve Van Arsdell, who received both his bachelor’s and master’s degrees in accountancy from ILLINOIS and now serves as deputy chief executive officer of Deloitte & Touche LLP, the audit and enterprise risk services arm of Deloitte LLP. “But it can happen anywhere.”

Van Arsdell, past chairman of the Governance Committee of the Board of Directors of Deloitte, explains how critical a high standard of ethical behavior is to the success of every organization.

“Nothing is more effective in promoting ethical behavior than the tone set by leadership,” he says. “The board and senior management are responsible for establishing guiding principles and ethical standards and for making sure all

employees know that unethical behavior is not tolerated.”

Translating its principles and standards into the operating environment, Deloitte has created an open, collaborative atmosphere and built control systems to promote ethical behavior. Following the same advice it provides to its clients, Deloitte offers different avenues for people to report behavior they believe to be inconsistent with its values. Employees can go through regular reporting channels in their functional areas or call hotlines to make reports anonymously. They know that the organization is committed to responding and investigating issues promptly.

Deloitte personnel participate in extensive annual continuing education, which includes substantive ethics and compliance training. “We constantly

emphasize the need to view everything we do from the perspective of the highest quality,” says Van Arsdell. “Both explicit and implicit within that focus on quality is the ethical context in which we operate. Training is provided in a myriad of formats including classroom settings, self-study, and facilitated and self-directed online learning. We’re not just fulfilling a regulation or compliance obligation, but we are instilling a culture of continuous improvement based on the highest ethical standards. To that end, Deloitte has recently broken ground near Dallas on a new 700,000+ square foot, state-of-the-art learning facility which will open in 2011 and be the hallmark of Deloitte’s learning and development culture.”

“Just 25 years ago, people commonly spent their entire careers at a single company,” says Van Arsdell. “Today many will have multiple employers during their careers. As a result, it is more important than ever that organizations clearly and consistently promote ethical behavior—from the tone at the top to policies, guidelines, and training that create a culture and an atmosphere in which employees know that doing the right thing in the right way is the only thing to do—every time.”

—Alice Shepherd

can be very stressful to speak with an investigator,” she says. “Any emotions you display may be taken as a sign of lack of credibility or malicious intentions.”

Gunsalus has witnessed many investigations that derailed because people became sidetracked by personalities, emotions, and positions rather than basing their conclusions on evidence and fact. “Many cognitive biases affect human interaction, and we have to learn to safeguard against them,” she says.

Leadership plays a key role in cultivating an ethical environment and avoiding the need for whistle-blowing. “Leadership has to walk its talk,” says Gunsalus. “Leaders have to think about, talk about, and act in an ethical, honorable

way that consistently embodies the organization’s values and codes and provides a core reference for decision-making. The steps are: Send the right messages; provide guidance for the well-intentioned; create an environment where it is safe to ask questions; develop appropriate responses; respond to problems; and enforce consequences.”

The Center for Professional Responsibility in Business and Society teaches students what to consider when making ethical decisions. “We provide them with a framework and give them experience and practice articulating their positions,” says Winter. “We hope to instill the confidence to exercise sound judgment when they confront potentially corrupt activity in the workplace.”

## Can We Talk?

Winter’s fondest hope is that frank discussions of professional responsibilities and ethical dilemmas will someday be part of everyday corporate conversation, just like sales targets and financials. “Creating such an environment depends on a well-implemented ethics and compliance program and a corporate culture that values candor and engagement,” she says. “The Siemens case ought to be required reading for every management team around the world. What happens when you compare it to your company’s practices? Unless you have open, reflective conversations, you won’t know until it’s too late.”

—Alice Shepherd