Can You Predict an Ethical Lapse in Your Organization?

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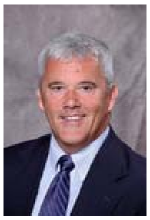

How can we educate, monitor and begin to positively affect ethical behavior in business organizations? Publicly reporting failures, regulating actions, and punishing violators may have an impact, but these actions follow ethical lapses. We need prevention, not treatment after failure.

The social sciences have accomplished this. Researchers in this field have identified risk factors that can predict behavioral problems and factors that protect against them. The risk and protective factors are well-known, monitored, reported and tracked. By monitoring the correlated measures, researchers can determine, for example, when juvenile delinquency will rise.

We should be able to do the same for organizational ethics. A brief look into social science research offers a compelling example of how we can promote ethical behavior in business.

A Powerful Metaphor

Social scientists at the Social Development Research Group at the University of Washington have developed the Social Development Strategy for positive youth development. SDRG's research shows a strong correlation between certain community, family, school, peer and individual conditions that increase or decrease the probability of juvenile delinquency.

SDRG contends that certain protective factors insulate and buffer teens from delinquency and promote positive development, health and success. The key protective factors include intelligence; resilience; social competence; bonding to family, school and peers; and clear healthy standards to follow (Hawkins & Weis, 1985).

In contrast, if a teen's community has certain elevated risk factors, an increased risk of juvenile delinquency has been shown. For example, a high availability of drugs; laws or norms that allow or encourage drug use; economic deprivation; family history of problem behaviors or conflict; and unfavorable parental attitudes have been shown to result in numerous adolescent problem behaviors, such as substance abuse, delinquency, teen pregnancy, school dropout and violence. Gangs exploit these risk factors by bonding teens to their unhealthy beliefs and standards, thus forming a cycle of delinquency that is difficult to escape.

The Social Development Strategy shows that risk and protective factors correlate – but do not guarantee – negative or positive outcomes in social development among teens.

Application to Business

The Social Development Strategy is a model businesses can relate to. In business organizations, employees enter the organization with their individual characteristics. Over time, company boards, managers, human resources professionals and existing employees all work to bond the new employee to the organization. They are taught skills to do their work, offered opportunities to contribute in a meaningful way, and are recognized for their contributions. As they bond to the organization, they are typically infused with its beliefs and standards for behavior.

Consider the example of Enron. At Enron, top management created a goal for employees that was clear and healthy. Management indoctrinated employees with its beliefs and standards within the organization, community and business world. Staff joined the firm with individual characteristics and were given opportunities to succeed. They were given positive recognition by their families, community and peer groups. As a result, employees were highly bonded to the organization.

The trouble came when the goals became criminal. Just as gangs use the strong ties teens form to their beliefs and standards to promote their illegal activities, what was once a highly positive, motivated, bonded business organization used its cohesiveness to facilitate months and years of unethical and criminal business practices.

Risk and Protective Factors: A Guide

What are the risk and protective factors for unethical behavior in business? If we use the examples of unethical professionals of the past as a guide, we can gather a set of conditions and behaviors that could be longitudinally tested to see if they correlate to unethical behavior in business.

For example, the Committee of Sponsoring Organizations of the Treadway Commission (COSO), in its Internal Control over Financial Reporting Guidance for Smaller Public Companies report, offers examples of protective factors that mitigate fraud risk in organizations. These factors include certain characteristics of an organization's internal controls, management culture, compensation and incentive structure, and the structure of the organization's board of directors or governing committees.

A Committee on Ethics

The Institute of Management Accountants' Committee on Ethics encourages deeper research in this area. Being able to predict movement toward an ethical lapse would be highly desirable for all businesses, as the cost of a lapse can be devastating to an organization, community, family and individual.

While individual fraud can happen with the best of controls, managers and boards should be able to identify the risk of organizational ethical lapses prior to their occurrence by following well-established models, developing risk profiles, and reporting and responding to movement in the factors over time.

The Case of General Electric

How could research into the risk and protective factors of organizational ethical lapses have helped General Electric when, in the summer of 2009, it was accused of fraud by the SEC? The SEC complaint, filed in federal court in Connecticut, alleged that GE – commonly recognized as a highly ethical company – met or surpassed analysts' earnings estimates every quarter from 1995 through 2004. A company's shares will often fall if it misses earnings estimates.

According to the SEC, on four separate occasions from 2002-2003, GE executives signed off on accounting decisions that were not in compliance with the rules for how public companies must report their finances. The agency claimed that the executives committed outright fraud twice, and twice were negligent. In one instance, the accounting changes allowed GE to avoid falling short of analysts' expectations.

GE seems to be doing all the right things with regard to establishing healthy beliefs and clear standards of behavior. It hires employees with high intelligence, resilience and social competence. GE's employee training programs are recognized throughout the world for their excellence, and their employees are given opportunities to participate in meaningful ways. GE's recognition and rewards systems are diverse and significant.

However, GE's lapse could be viewed as predictable. If you look at its publicly reported measures, the company is trending negatively on metrics which we would likely correlate to ethics. Its sales and profits are "unbelievably" consistent. If it had longitudinally tested risk and protective factors that were tracked with the same level of importance as the financial measures, GE would have been looking for areas of fraud and non-compliance with policies. Also, shareholders and investors would have been monitoring these factors and placing value on these measures, as they will impact the value of the company when a lapse occurs.

How does all this reconcile with an organization that displays strong leadership, good business planning, goal attainment and achieves success? Wouldn't a strongly led, high-performing and desirable workplace have all the risk factors for ethical lapses?

Most assuredly. Such organizations need to communicate healthy, ethical beliefs and clear standards of behavior, and then monitor them throughout the organization and investment community.

Communication of these risk factors is essential. It will take time to educate employees to consider these factors in their day-to-day work. However, consider how we have become more aware of risk and protective factors for heart disease since the America Heart Association was formed in 1924.

Readers of this article, for example, could probably offer at least some of the risk factors for heart disease – smoking, high cholesterol, high blood pressure and obesity. Likewise, readers would likely come up with the protective factors – eat a healthy diet, exercise and manage stress. We measure and monitor heart disease risk with cholesterol testing, blood pressure and other means. Heart disease in the U.S. has declined as a result of the promotion of these risk and protective factors.

The key to predicting and preventing ethical lapses in companies is to give businesses a set of risk and protective factors that are proven and effective. These factors can focus attention on movement toward or away from being an ethically healthy and financially sound organization, all of which must be transparent to the employees, the community, the management, its board of directors and investors.

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http://www.webcpa.com/news/Predict-Ethical-Lapse-Your-Organization-53264-1.html