

Ethical Risk Assessment: Crisis-prone or Crisis-prepared II

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The Challenge Revisited

Lots of pressure from both inside and outside the organization towards increasing ethical risk assessment in organizations:

- Internally, frauds are costly. Relationship management is costly.
- Externally, there is movement by governments here and abroad concerning tightened ethical risk assessment (e.g., U.S. sentencing guidelines).

New Emphasis on Ethical Culture in Organizations

- Recognition that tone at the top can help predict unethical behavior
- Implied and explicit push for companies to evaluate ethical risk

New Sources of Ethics Standards

- Sarbanes Oxley
 - Internal controls, code of ethics for execs
- NYSE standards
 - Expanded audit committee standards, annual CEO certification of corporate governance
- Sentencing guidelines
 - Culture that includes ethical conduct, periodic ethics risk analysis
- DOJ principles of prosecution
 - Adequacy of compliance program, history of similar wrongdoing

Where the Risk Comes From

Three sources of ethical risk:

1. The Industry
2. The Company
3. The Individual

Three Models for Ethical Risk Assessment

1. Global Reporting Initiative
 - Pulls together many social performance measures
2. Ethics Resource Center
 - An example of a culture survey
3. The Santa Clara Alternative
 - Gets at all three sources of risk

1. Global Reporting Initiative

- Multi industry level - sets common criteria for reporting about interactions with stakeholders and sustainability.
- The guidelines - the idea is to limit ethical risk by assuring compliance with multinational standards
- Backward looking - lots of social performance measures

GRI I-The Guidelines

- Guide the preparation of organization-level sustainability reports
- Assist organizations in presenting a balanced and reasonable picture of their economic, environmental, and social performance
- Promote comparability of sustainability reports
- Support benchmarking and assessment of sustainability performance with respect to codes, performance standards, and voluntary initiatives
- Serve as an instrument to facilitate stakeholder engagement

GRI II - The Guidelines

- The Guidelines do not:
 - provide instruction for designing an organization's internal data management and reporting systems
 - offer methodologies for preparing reports, or for performing monitoring and verification of such reports
- Not much help in assessing future risk

2. Ethics Resource Center

Ethics Effectiveness Quick-Test

- Short form is available for free at:
<http://www.ethics.org/quicktest/index.cfm>
- Focuses on 12 areas of assessing the organization's commitment to ethics
 - Examples are whether or not organization has guidelines for ethical decision making and an assessment of the organization's ethical climate
- Overly focused on the organization

Ethics Effectiveness Quicktest I- Values and Strategy

- Organization values
 - Clear and consistent values?
- Strategy, goals, and objectives
 - Is ethics part of the strategy?
- Ethics policies and procedures
 - Are ethics policies clear and communicated effectively to all employees?

Ethics Effectiveness Quicktest II-

Ethics in the Organization

- Organizational incentives
 - What behaviors are rewarded in the organization?
- Decision making
 - What's the consideration of ethical factors in decision making?
- Building support for ethical practices
 - Are ethical practices are of the organization's DNA?

Ethics Effectiveness Quicktest III- The Last Steps

- Ethical leadership practices
 - What is the tone at the top?
- Evaluation of ethical practices
 - Does the organization monitor the impact of its ethical practices?
- Ethics education and training
 - What types of ethical training are offered?

3. The Santa Clara Alternative

1. The Industry
2. The Company
3. The Individual

The Industry

1. How intense is the competition? *(More=Higher Risk)*
 - Where is the competition most severe? Sales, Design, etc.
2. How valuable is information about the competitor? *(More=Higher Risk)*
 - What type of information? To what unit of the company?
3. How differentiated is the product? *(Less=Higher Risk)*
4. How important are a few large customers? *(More=Higher Risk)*
5. How important are trade associations? How much contact is there between companies? *(More=Higher Risk)*
6. Is there overcapacity in the industry? *(More=Higher Risk)*
7. Does the industry have multiple relationships with its customers or business partners? *(If Yes=Higher Risk)*
8. How closely regulated is the industry? *(More=Higher Risk)*
9. How involved is organized crime in the industry? *(More=Higher Risk)*

The Company – Structure/Strategy

1. How hierarchical is the company? *(More=Higher Risk)*
2. How independent are the company divisions? *(More=Higher Risk)*
3. How different are company policies in divisions? *(More=Higher Risk)*
4. How closely do divisional financial and accounting staff work with headquarter's staff? *(Less=Higher Risk)*
5. To what extent does the company have "multiple" relationships with other companies? *(More=Higher Risk)*
6. How much business does the company do in "problematic" countries? *(More=Higher Risk)*
7. How much business does the company do with "problematic" industries? *(More=Higher Risk)*
8. How much business does the company do with "problematic" suppliers and business partners? *(More=Higher Risk)*
9. How flexible is the company in adjusting goals and objectives when industry conditions change? *(If Not=Higher Risk)*

The Company – Ethics System

1. Does the company have a code of conduct? *(Yes=Less Risk)*
2. Does the company have a values statement? *(Yes=Less Risk)*
3. Are the CEO and other leaders known for their ethics? *(Yes=Less Risk)*
4. Does the company communicate frequently regarding the ethics code and values statement? *(Yes=Less Risk)*
5. Does the company conduct meaningful ethics training? *(Yes=Less Risk)*
6. Does the company incorporate ethical and value-oriented behavior formally into the performance evaluation system? *(Yes=Less Risk)*
7. Does the company reward ethical behavior in practice? *(Yes=Less Risk)*
8. Does the company have an effective system for reporting ethical violations and concerns? *(Yes=Less Risk)*
9. Does the company have an effective mechanism for employees to raise questions on difficult ethical choices? *(Yes=Less Risk)*
10. Does the company renew its ethical code and values on a periodic basis?
11. Does the company ever punish senior executives for unethical conduct? *(Yes=Less Risk)*

The Company - Culture

1. How approachable and open to communication are the leaders of the company? *(Less=Higher Risk)*
2. How transparent is the company leadership about decisions made? *(Less=Higher Risk)*
3. How strong is the leadership's reputation for honesty and integrity? *(Less=Higher Risk)*
4. Are there units of the company known to be ethical outliers? *(If Yes=Higher Risk)*
5. Do employees believe the company genuinely wants ethical behavior? *(If No=Higher Risk)*
6. Do employees trust the systems put in place to enable ethical behavior? *(If No=Higher Risk)*

The Individual

1. Does the company's ethics program credibly emphasize that ethics is every employee's business? *(Yes=Less Risk)*
2. Does the company's ethics program seek to develop employee skills in identifying and reasoning about ethical issues? *(Yes=Less Risk)*
3. Does the company seek to rein in arrogance and hubris, and encourage humility and openness in its leaders? *(Yes=Less Risk)*
4. Does the company do a thorough background check on every new hire, including verifying degrees and employment history? *(Yes=Less Risk)*
5. Does the company screen out employees with problematic ethical incidents in their background? *(Yes=Less Risk)*
6. How decisive is the company dealing with ethical violations which arise? *(More=Less Risk)*
7. How effective is the employee assistance program in helping employees with personal or financial problems? *(More=Less Risk)*

Measuring Total Risk

FACTOR	RATING (1 TO 10)	IMPORTANCE (1 TO 10)	WEIGHTED RISK (RATING X IMPORTANCE)
1.			
2.			
<u>TOTAL RISK</u>			

Basic Risk Analysis Using This Tool

- What aspects of our industry, company, and employees give rise to ethical risk?
- Which risks are giving rise to current incidents of unethical behavior in the company?
- What risks are controllable and uncontrollable?
- What risks are we creating by our structure, strategy, policies and culture?
- What strategies are we using to manage each risk identified?
- What risks are we NOT currently managing?

Dynamic Risk Analysis Using This Tool

- What aspects of our industry, company, and employee risk have changed in the past year?
- How have changes in our structure, strategy, policies and culture changed our risk profile?
- What new measures have we put in place to manage areas of increased risk?
- What new patterns of improper behavior have we experienced? What risks explain these?
- How have our responses to incidents of improper behavior raised or lowered risk?

THE CRISIS-PREPARED ORGANIZATION...

- Understands its own ethical risk profile
- Minimizes risk by lowering risks that can be controlled
- Minimizes risk by creating effective countermeasures to risks that cannot be avoided
- Reevaluates its risk profile frequently
- Considers the impact on ethical risk of new strategies, structures, policies, etc.
- Tracks incidents of improper behavior to identify new areas of risk