ethics & compliance initiative™

BEST PRACTICES PAPER

USING YOUR ORGANIZATION'S **PERFORMANCE EVALUATION SYSTEM** TO DRIVE ETHICAL CONDUCT

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ECI
2650 Park Tower Dr., Suite 802
Vienna, VA 22180
Telephone: 703.647.2185 | FAX: 703.647.2180
www.ethics.org | *research@ethics.org*

ECI ethics & compliance initiative™

ABOUT ECI

The Ethics & Compliance Initiative (ECI) is a best practice community of organizations that are committed to creating and sustaining high quality ethics & compliance programs. With a history dating back to 1922, ECI brings together ethics and compliance professionals and academics from all over the world to share techniques, research and, most of all, exciting new ideas.

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CO-CHAIRS

Robert Mascola
Barrick Gold

Kim Kaminski
BAE Systems Inc.

MEMBERS

Mike Camilleri
United Technologies Corporation

D. Douglass Cotton
American Airlines

Rachel Gerstein
Avon Products, Inc.

Reagan Heine
American Airlines

Kristina Irvin
BP

Marisa Montoya
Endurance International Group

Hau Pho
Boeing

Tiffany Butler
World Concern

ABOUT ECI'S WORKING GROUPS

In an effort to encourage networking and collaboration among ethics & compliance (E&C) professionals, ECI regularly convenes small groups of our members to network, share ideas, and address issues that are of particular interest. Working groups of 20 to 25 individuals meet to identify, research, and develop new resources to help practitioners prepare for a new or emerging E&C issue. They also learn from best practice with regard to an existing E&C program area.

Several new working groups are now open. For more information about those groups, please see the back cover. For other information about ECI's working groups, please visit: www.ethics.org.

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EXECUTIVE SUMMARY

Most organizations are better at punishing misconduct than at rewarding ethical conduct.[1] Organizations with even basic ethics and compliance (E&C) programs typically have established processes that govern how allegations of misconduct are investigated and how to hold accountable those found to have engaged in misconduct. Fewer organizations, however, have a strategy to reward or positively incentivize compliant behavior. Nearly all E&C professionals we spoke with reported this was an area needing improvement in their organizations. This report will help organizations make those improvements, with a focus on structuring performance evaluation systems (PES) and related compensation systems as tools to incentivize ethical behavior.

No single approach to PES will fit all organizations, or even all departments within an organization. But the steps recommended here provide E&C professionals and their colleagues a **framework of factors** to consider to leverage their organization's PES and compensation systems to positively incentivize ethical behavior.

SCOPE OF WORKING GROUP'S TASK

The Working Group tried to describe ways that organizations can positively influence an ethical culture through their PES. We surveyed a range of organizations to learn what steps they are taking, and we have highlighted a few practices. We also examined how PES are evolving, and what this means for E&C programs.

PES are only one item in a toolbox to incentivize ethical behavior. An organization's code of conduct, its E&C trainings and communications, and its risk assessment and audit processes are equally important. These are, however, outside the scope of this document.

THE EVOLUTION OF PERFORMANCE EVALUATION SYSTEMS

Performance evaluation systems are transforming. Annual or semi-annual performance reviews based on cascading goals and forced (or quasi-forced) distribution of employee performance ratings still play an important role in many organizations, but a system of continuous feedback is becoming more popular. There is a shift from talking about people to a practice of talking with people, from performance appraisal to performance development, and from ranking employees to fostering teamwork.[2] These approaches are designed to increase employee engagement, collaboration, and innovation, and foster multidirectional communication up, down, and across the organization. A potential drawback of these strategies relative to annual reviews is that they may miss the benefit of the longer time horizon and broader perspective that annual reviews allow. More recently, some have argued for an entirely new approach to performance appraisal and compensation decisions, noting that performance targets and bonus pay are not only ineffective motivators, but can be destructive. In their book *Primed to Perform*, authors Neel Doshi and Lindsay McGregor argue that organizations reach top performance when employees enjoy what they do, when they value their work's impact, and when they can increase their potential through their work, and when negative motivators (emotional/economic pressure and inertia) are minimized.[3]

How to best leverage an organization's PES to improve an E&C culture will vary depending on the system the organizations uses. For organizations using cascading objectives to set annual performance targets that measure end-of-year performance, it is crucial that E&C professionals work to formally integrate E&C into these defined objectives. On the other hand, where organizations use a system of frequent conversations for evaluation and feedback, it may be more important to focus on training people managers how to meaningfully integrate E&C into those discussions. Finally, organizations structured around the new learnings on motivation will want to emphasize how ethical behavior makes employees feel good about their work, helps define their work's purpose, and ultimately helps them to reach their potential.

In addition, for organizations that incorporate bonus pay into their PES, it is important to consider the role E&C factors will have in determining whether a bonus should be given and how big it should be. Do E&C factors apply only in a negative way when an employee violates the organization's code of conduct, or do they act as a gate through which leaders pass to access variable compensation? If so, can strong E&C leadership be a boosting factor that triggers a higher level of variable compensation? Should performance be measured individually or as a group? And for those in top leadership, under what circumstances may the organization "claw back" bonus pay? Some organizations limit this to cases of financial reporting fraud, but others have expanded it to misconduct more generally.[4]

FACEBOOK: HANGING ON TO TWICE YEARLY PERFORMANCE REVIEWS

Facebook is noteworthy among high tech companies for hanging on to its formal performance review process and has done so in a way that integrates ethics and compliance. Glassdoor named Facebook as the #1 company to work for in 2018.* One reason for this, according to an internal survey, is that Facebook retains high employee satisfaction for its PES. In November 2016, Harvard Business Review featured Facebook as one high-profile company that continues to use performance evaluations, even though many other Fortune 500 companies have abandoned them. Facebook continues to utilize performance evaluations for three reasons – fairness, transparency, and development.**

- Fairness – To create a fair PES, Facebook does not treat leaders as a special class. Leaders participate in the same performance evaluations as every other employee. The expected ethical conduct, Mission, and Values of Facebook are baked into the leader's job competencies, operationalizing aspirational expectations by role and level. Performance evaluations for leaders, like those of all Facebook employees, escalate through peers, managers, and a team of analysts that review performance evaluations for bias. Facebook then translates ratings directly into compensation. As Facebook applies this process to a predetermined equation by role, leaders know that their assessment will be equitable and fair.
- Transparency – Without formal performance evaluations, bonuses and promotions often happen in a black box. The Facebook PES helps leaders to know how the organization sees their contributions, and it gives leaders a way to gauge their overall performance.
- Development – Real-time feedback, while it can help leaders to repeat successes and learn from failures, can make it hard for leaders to figure out which information matters most and what to ignore. The Facebook PES allows leaders to understand the meta-goals and the incentives involved as they develop their overall performance. So performance evaluations become an opportunity to give personal, consistent, and clear examples for leadership development.

These three factors help leaders know what is expected of them and incentivizes them to work toward their professional development, including in areas relating to E&C.

*Gillet, Rachel, "7 reasons Facebook is the best place to work in America and no other company can compare," (*http://www.businessinsider.com/facebook-best-place-to-work-in-america-2017-12*) Business Insider (December 7, 2017).

**Goler, Lori, et al. (*https://hbr.org/2016/11/lets-not-kill-performance-evaluations-yet*) Let's Not Kill the Performance Evaluations Yet. Harvard Business Review. November 2016.

LEGAL AND EXTERNAL STANDARDS

Evolving legal and professional standards are raising the bar for compliance programs generally, and this is true in incentivizing ethical conduct. Chapter 8 of the U.S. Federal Sentencing Guidelines sets forth the seven elements of an effective compliance program. An effective compliance program requires organizations to both "exercise due diligence to prevent and detect criminal conduct" and "otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."[5] To meet these twin objectives, organizations must meet standards in seven areas, one of which requires getting both discipline and positive incentives right.

> §8B2.1(b)(6) The organization's compliance and ethics program shall be promoted and enforced consistently throughout the organization through (A) **appropriate incentives to perform in accordance with the compliance and ethics program**; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct.[6]

In March 2017, the Fraud Section of the U.S. Department of Justice issued a guidance document entitled "Evaluation of Corporate Compliance Programs," which picked up on this point. In evaluating corporate compliance programs in criminal investigations, the Fraud Section may ask about incentives.

> **Incentive System** – How has the company incentivized compliance and ethical behavior? How has the company considered the potential negative compliance implications of its incentives and rewards? Have there been specific examples of actions taken (e.g., promotions or awards denied) because of compliance and ethics considerations?[7]

The United States is not alone in focusing attention on incentive systems to evaluate compliance programs. In 2010, the OECD published its "Good Practice Guidance on Internal Controls, Ethics, and Compliance," which included 12 recommendations for organizations, including one encouraging positive incentives for compliance: "appropriate measures to encourage and provide positive support for the observance of ethics and compliance programmes or measures against foreign bribery, at all levels of the company."[8]

In addition, the ISO standard on Anti-Bribery Management Systems (ISO 37001), which was published in 2017, makes the point that "Personnel evaluations, promotions, bonuses and other rewards could be used as incentives for personnel to perform in accordance with the organization's anti-bribery policy and anti-bribery management system."[9]

Finally, leading professional organizations have highlighted the importance of incentivizing ethical conduct. For example, in its 2016 “Blue Ribbon Panel Report,” the Ethics and Compliance Initiative set out five principles that define High-Quality Ethics & Compliance (HQP) programs. Principle 3 states: “Leaders at all levels across the organization build and sustain a culture of integrity.”[10] Each principle has supporting objectives, and Principle 3 includes a supporting objective that those in leadership positions must be expected and incentivized to act with integrity and be held accountable if they do not. To achieve this, it is important that “E&C performance affects compensation, advancement and retention of all employees.”[11] But while individually acting with integrity is an important foundation, more is required. Leaders must also own and be accountable for *building* a strong ethical culture. To achieve this, the Blue Ribbon Panel report notes that a leading practice is annual performance reviews for leaders that evaluate their efforts to build and maintain a culture of integrity.[12]

> “Evolving legal and professional standards are raising the bar for compliance programs; there is a growing expectation that they must do more than prevent and detect misconduct—they also must positively incentivize ethical conduct.”

RECOMMENDATIONS

Organizations looking to more effectively use their PES and related compensation structures to incentivize ethical conduct must make complex strategic and tactical decisions. The five recommendations below will help frame that decision-making.

1

Performance evaluation systems and related compensation and promotion decisions should consider how employee performance measures against the organization's ethics and compliance standards, both in terms of what they achieve and how they achieve it.

Employees are evaluated on many objective and subjective factors, and the design of PES varies considerably across organizations and over time. From an E&C perspective, performance reviews should consider how observable behaviors measure against the organization's stated values, its code of conduct, and its compliance policies. This follows from HQP Principle 1, which states that "[e]thics and compliance is central to business strategy." When organizations do not follow this principle, they increase the likelihood that there will be inconsistencies between an organization's stated values and its actions or decisions. Employees are quick to pick up on these inconsistencies, and may conclude that stated organizational values are (1) not shared by leadership, (2) not important to advancing in the organization, and (3) take a back seat to bottom line results. To avoid this impression, organizations must at a minimum consistently hold employees at all levels accountable when they fail to meet those values and standards. But if this "stick" approach is the only mechanism an organization uses to integrate E&C in its PES, then it will miss the opportunity to use its PES as a "carrot" to promote desired behaviors more generally. As explained below, this involves evaluating both what an employee achieves and how the employee achieves it.

> " E&C professionals must be prepared to articulate to Human Resources and the C-Suite how formally incorporating E&C into performance evaluations aligns with the organization's approach to performance management and advances the organization's mission and strategic objectives "

Successfully integrating E&C metrics into PES requires both a deep understanding of the organization's performance management philosophy and buy-in at the highest levels of the organization to ensure alignment with the organization's E&C standards. Typically, Human Resources has overall responsibility for an organization's PES, and the C-Suite sets an organization's strategic direction and objectives. E&C professionals must be prepared to articulate to Human Resources and the C-Suite how formally incorporating E&C into performance evaluations aligns with the organization's approach to performance management and advances the organization's mission and strategic objectives. (See box below for tips on doing this.) Where the ultimate decision is not to formally integrate ethics and compliance into PES, or to do so only in limited ways, E&C professionals must look for informal ways to integrate E&C into decisions to evaluate, promote and reward employees.

TIPS ON MAKING THE CASE FOR INTEGRATING E&C INTO PERFORMANCE EVALUATION SYSTEMS

1. **UNDERSTAND** your organization's performance management philosophy. You are more likely to succeed with a proposal that works within the existing framework for evaluating performance instead of trying to replace or circumvent an existing system, particularly if Human Resources and senior leaders support that system.

2. **DEVELOP** a concrete proposal. Prepare by answering these questions:
   - What are the key behaviors you are trying to promote, and how do they relate to your organization's risks?
   - Who is your target audience? C-Suite, senior leaders, all managers, all employees?
   - What are the relevant hard and soft metrics?
   - What data is available to measure them?
   - How reliable is the data (recognizing that you'll never have perfect data), and how will you deal with its limitations?
   - How will the data be collected? Who will assess the data?
   - How much effort will the data collection and assessment take?
   - What specific adjustments must be made to the organization's tool for performance evaluation?
   - How will E&C be incorporated into the employee (or unit or department) objective setting process?
   - Will performance in E&C affect incentive compenation awards? How?
   - Will the proposed system be (and be perceived as) fair and objective?
   - Will adoption of the proposal have any unintended negative consequences, and if so, how can you mitigate the impact?

3. **BALANCE** simplicity and complexity. Complex measurements may be more precise in incentivizing behaviors, but simple ones require fewer resources and may be easier to sell and implement—strike a balance.

4. **SELL** your proposal to senior leaders and Human Resources by making the case that:
   - Ethical culture has a strong link to employee engagement and retention, innovation, and commercial success.*
   - A well-designed PES promotes ethical behavior and helps leaders promote an E&C culture.
   - The DOJ and other enforcement agencies expect companies to adopt systems that positively promote E&C.

*Kiel, Fred. Return on Character: The Real Reason Leaders and their Companies Win (Harvard Business Review Press 2015). See also EthicalSystem.org's Behavior Science One Sheets, (*http://ethicalsystems.org/sites/default/files/files/Ethics Pays_FINAL.pdf*) Fall 2017.

2

E&C professionals should advise the business in defining and communicating the organization's or business unit's objectives or targets to ensure that they are not misaligned with the organization's values and commitment to E&C.

Many of the largest corporate scandals link back to aggressive targets that encouraged employee behaviors contrary to stated values. Employees respond to targets and can be tempted to cut corners or play loose with established policies and practices to meet the numbers. When organizations look back to diagnose how the scandal happened, they often find that the goals, and how they were communicated, were important drivers.

One well-known example is the scandal at Wells Fargo, where employees were aggressively pushed to open multiple accounts for each customer (the CEO famously said, "Eight is great"). This led (and some argue predictably led) to widespread fraud in opening false accounts, and the company failed to quickly address the issue once raised. When the widespread fraud came to light, Wells Fargo suffered a punishing blow to its reputation, and faced hefty fines and lawsuits that will last for years.[13] Volkswagen's diesel dupe scandal from 2016 can similarly be linked to its aggressive targets of being the world's largest seller of automobiles—a goal it achieved at a heavy price.[14] And more recently, Kobe Steel admitted widespread fraud in reporting the quality of its copper and steel used in cars, trains, and airplanes, which Kobe's own internal assessment linked to, among other things, overly strict quality standards that employees' felt were unreachable.[15] Some have blamed the 2008 financial crisis on compensation structures linked to aggressive targets. (See box below.)

A VIEW OF THE 2008 GLOBAL FINANCIAL CRISIS

"When the dust settles on the current financial crisis, one likely lesson will be that it was as much a story of misaligned incentives as of ineffective controls. Even companies with advanced internal control systems have been discovering that they may have a back-door vulnerability in their compensation and rewards systems. If not properly calibrated, such systems can create a force of their own that can cloud individual and corporate perceptions of risk and of what is in the company's interest."

Varges, Gabe Shawn, "Incentives and Disciplinary Procedures to Promote and Protect the Compliance Program," in Compliance Practice Guide: the Next Generation (C. Basri, ed. 2017).

To avoid these problems, organizations must ensure that business targets are carefully defined and communicated in a way that is aligned with the organization's ethical standards. Often, this will occur naturally, particularly for organizations whose values are integrated into their business strategy. For others, however, achieving business targets may work against company values, even if not intended.

Ideally, E&C professionals have a role in advising on these targets to avoid unintended consequences. If E&C professionals are not directly part of the process that defines the "what," they should at least be in a position to voice any concerns about targets, and indirectly influence the process of both refining targets and how they are communicated. Enforcement agencies, particularly in the financial services sector, have signaled that they expect careful oversight of performance incentive programs.[16] For example, in 2016 the U.S. Consumer Financial Protection Bureau (CFPB) published a Compliance Bulletin that highlighted the risks of performance incentives and set forth its expectations for financial services companies that implement them.

> Despite their potential benefits, incentive programs can pose risks to consumers, especially when they create an unrealistic culture of high-pressure targets. When such programs are not carefully and properly implemented and monitored, they may create incentives for employees or service providers to pursue overly aggressive marketing, sales, servicing, or collections tactics... The CFPB expects supervised entities that choose to utilize incentives to institute effective controls for the risks these programs may pose to consumers, including oversight of both employees and service providers involved in these programs.[17]

E&C professionals advising on structuring performance incentives will find helpful guidance in the 2009 Harvard Business Review Working Paper, "Goals Gone Wild," in which Lisa Ordóñez and her colleagues set forth a framework (see below) for designing goals in a way that reduces the risks of fraud and other misconduct.[18] By using this framework with colleagues in other functions charged with defining and communicating objectives, E&C professionals can lessen the risks that aggressive or unrealistic targets will promote behaviors that can cause serious legal and reputational risk for an organization. For example, one lesson from recent scandals that is reflected in Ordóñez's framework is that unachievable targets generate pressure, fraud, and other misconduct. But the solution is not as simple as avoiding apparently unrealistic targets, because stretch objectives, communicated correctly, can succeed in getting teams to achieve what even they did not believe they could.[19]

GOALS GONE WILD

TABLE 1: A WARNING LABEL FOR SETTING GOALS*

To avoid the "Goals Gone Wild" problem, the definition and communication of goals should be designed with the following in mind:

1. **Are the goals too specific?**
   Narrow goals can blind people to important aspects of a problem. Be sure that goals are comprehensive and include the critical components for firm success (e.g., quantity and quality).

2. **Are the goals too challenging?**
   What will happen if goals are not met? How will individual employees and outcomes be evaluated? Will failure harm motivation and self-efficacy?

   Provide skills and training to enable employees to reach goals. Avoid harsh punishment for failure to reach a goal.

3. **Who sets the goals?**
   People will become more committed to goals they help to set. At the same time, people may be tempted to set easy to reach goals.

4. **Is the time horizon appropriate?**
   Be sure that short-term efforts to reach a goal do not harm investment in long-term outcomes.

5. **How might goals influence risk taking?**
   Articulate acceptable levels of risk.

6. **How might goals motivate unethical behavior?**
   Goals narrow focus, such that employees may be less likely to recognize ethical issues. Goals also induce employees to rationalize their unethical behavior and can corrupt organizational cultures. Multiple safeguards may be necessary to ensure ethical behavior while attaining goals (e.g., leaders as exemplars of ethical behavior, making the costs of cheating far greater than the benefit, strong oversight).

7. **Can goals be idiosyncratically tailored for individual abilities and circumstances while preserving fairness?**
   Strive to set goals that use common standards and account for individual variation.

8. **How will goals influence organizational culture?**
   If cooperation is essential, consider setting team-based rather than individual goals.

9. **Are individuals intrinsically motivated?**
   Assess intrinsic motivation and recognize that goals can curtail intrinsic motivation.

10. **Consider the ultimate goals of the organization and what type of goal (performance or learning) is most appropriate?**
    In complex, changing environments learning goals may be more effective.

* Ordóñez, Lisa et al., Goals Gone Wild: The Systematic Side Effects of Over-Prescribing Goal Setting, (*https://www.hbs.edu/faculty/Publication%20Files/09-083.pdf*) HBR Working Paper 09-083 (2009).

3

E&C professionals should partner with Human Resources to ensure that measuring the "how" includes a fair assessment of desired E&C behaviors.

Performance evaluations should consider not only what employees achieve, but how they achieve their goals. These are often "soft" measurements, and critics understandably object that measuring the how is arbitrary and subject to individual bias. But having a clear framework for making subjective assessments helps address these concerns—essentially specifying how the "how" will be evaluated and what weight it will be given (vs. the "what"). Measuring the "how" need not be limited to soft metrics. But as discussed earlier (see section 2), even the more objective, achievement-oriented "how" metrics must be carefully selected. As one sociologist wrote: "Not everything that counts can be counted, and not everything that can be counted counts." This makes the use of metrics,[20] and in particular the less objective "how" metrics, more of an art than a science. The E&C professional must approach the task with humility, pragmatism, and a strategic vision of what the metrics achieve.

More organizations are formally reserving a space for the "how" in their PES and a priority for E&C professionals is to ensure that E&C values are embedded into this space. For many organizations, the framework is defined by the organization's stated values. So it is essential that the organization's values are aligned with "ethics and compliance."[20] But alignment is not enough. Values like respect and integrity are aligned with an E&C culture, but asking supervisors to evaluate the "integrity" of their subordinates may be unrealistic, and lead to top scores for everyone—making the measurement useless (at best) and potentially harmful (at worst) by undervaluing the importance of integrity. If these metrics are used, employees need meaningful guidance on what each "score" in the category means, and it may help to clarify that the expected score is in the mid-range and that higher scores should reflect exceptional circumstances. See Emergent Biotechnology case study below for one example.

Other values—such as "collaboration" or "innovation"—may have only vague connections to "ethics and compliance" or may even work at odds with E&C. E&C professionals should collaborate with HR to draw connections between those values and behaviors important from an E&C perspective, and ensure those connections are clear and visible to those evaluating performance. For example, one measure of innovation is the creation of an environment that encourages the free flow of ideas, which is a form of speaking up. This aspect of innovation should be specified so evaluators remember it when conducting assessments. For most organizations, the evaluator is the supervisor. Some organizations, however, are taking a "360" approach to performance assessment, and give subordinates and peers a role in the evaluation process. This can be particularly powerful for measuring how a leader exhibits the organization's values.

Some organizations have gone a step further by requiring employees to include at least one E&C performance objective at the outset of a review period. This has the advantage of communicating that E&C is sufficiently important to merit a dedicated performance objective, which can more concretely bring E&C into the performance evaluation discussion. For organizations that take this approach, E&C professionals should collaborate with HR to provide guidance on what qualifies as an E&C objective. And it should be made clear that meeting a single E&C performance objective does not mean employees have completed their ethical obligations for the year.

Case Study: EMERGENT BIOTECHNOLOGY

In 2016, Emergent Biotechnology (EB) revised its performance evaluation system to give equal weights to the what and the how. For the "how" part of the evaluation, employees are now rated on a five-point scale based on EB's five core values: respect, commitment, communication, empowerment, and innovation. Because people managers needed guidance about how to recognize and fairly evaluate the behaviors associated with each core value, EB's HR function, with assistance from E&C, developed guidance documents on each value and conducted training workshops for people managers. These focused not only on how to assess the behaviors associated with each value, but also on how to develop those behaviors individually and among team members.

As part of the annual review, each employee completes a self-assessment rating for each value. The supervisor then provides his or her own rating, which is used to establish the overall performance assessment. Most rankings are 3 or 4, and only a small fraction are below or above that.

The equal weighting of the what and the how sends a powerful message to employees that EB is committed to its core values, and has prompted greater awareness of the core values and how they can be brought to life through specific behaviors.

4

Leaders should be accountable for taking specific actions to advance the organization's E&C culture.

Efforts to incentivize ethical conduct often start with senior leaders since they play a key role in shaping company culture. In recognition of this, global enforcement agencies, such as those in the United States,[21] United Kingdom,[22] and Brazil,[23] have set forth what they expect from senior leaders, which makes it crucial that organizations create and maintain incentives for ethical leadership. For senior leaders, acting with integrity sets the foundation for tone at the top and a culture of integrity. However, organizations should expect more from leaders, particularly those in senior positions, and hold them accountable for building and sustaining a culture of integrity.

> “For senior leaders, acting with integrity sets the foundation for tone at the top and a culture of integrity. However, organizations should expect more from leaders, particularly those in senior positions, and hold them accountable for building and sustaining a culture of integrity.”

The two most common areas for measuring E&C leadership are in training and communication, but there are other areas in which leadership performance can be evaluated. In **training**, leaders can be recognized for encouraging participation in compliance trainings using metrics for e-training and live training completion rates. This assumes that the learning management system can accurately report data at the level of the team reporting to the leader; this is typically easier for e-training, where courses are automatically assigned to a pre-defined audience. Completion rates for live training are harder to capture because they require a defined target audience and target frequency of training. One solution is to limit evaluation of the participation rates to those live trainings that are an important priority for the year, say a training on the code of conduct or supervisor-led discussion on ethical scenarios.

Other training metrics to consider include:

- the number of training sessions that the leader either led or introduced (before handing over the session to the E&C trainer),
- the post-training knowledge retention rates based on follow-up online questions, and
- live compliance training completion rates, measured in total training hours per 100 or per 1000 employees (which allows for comparisons across the organization).

Leaders can also be assessed on their consistent and visible **communications** supporting company values and the organization's code of conduct. Ideally, both the quantity and quality of communications should be assessed. But there are challenges to each. Leadership communications supporting E&C are often most effective when they are naturally integrated into business communications, and may be unplanned and unscripted, making it harder to capture and measure. Planned formal communications to support E&C are easier to measure, but may be less impactful particularly if the communication is separate from normal "business" communications. And even if the quantity is measurable, there is the challenge of measuring quality. But companies are recognizing that these challenges are worth facing. One company asks leaders to discuss during their performance evaluations what they have done in the last year to instill the mission, vision, and values in their team, which allows them to discuss these less formal communications. (See World Concern case study below.) Another company has addressed these challenges by requiring leaders to make a certain number of compliance communications each quarter, and provided them clear message points to include. For oral communications, leaders had to provide a written summary of the message, context, and audience (which in practice was done by the local compliance function). A separate global compliance team at the organization tracked not only the number of communications, but it also selectively evaluated them for their content.

Sometimes a leadership communication can be broadly effective even if delivered to one employee or a small group of employees. For example, when an employee acts with courage to report misconduct, a leader who takes the time to thank that individual demonstrates powerful support for a culture of integrity, which can contribute to the leader's credibility and reputation.

Besides training and communication metrics, **cultural metrics** can also be used to assess leadership "performance." Employee survey scores can be a strong indicator of a leader's performance, and when those surveys incorporate E&C questions they can strongly incentivize ethical leadership. For example, surveys that ask about comfort in speaking up, about leaders' modeling of organizational values, and about reporting of observed misconduct can all measure a leader's impact in shaping the organizational culture. For companies that do surveys infrequently, cultural metrics may be unreliable since culture is shaped gradually over time and a leader's good works may be overshadowed by events that took place before the leader arrived, or may not bear fruit until after the leader departs.

Another source of data is an organization's **compliance help-line and case management data.** This can provide useful data points for a leader's performance. The number of compliance violations in an area, whether in absolute terms or on a per 100 employee basis, provides a measure of organizational health. Fewer violations are a positive sign if it reflects a genuine downturn in misconduct and not just a decrease in speaking up (which requires that the helpline data be combined with survey or other data about comfort in speaking up). Similarly, in a strong culture, there is no need to report anonymously, so a decrease in the rates of anonymous reporting may be a positive cultural indicator.

Case Study: WORLD CONCERN

World Concern, a Christian non-governmental organization, aspires to incentivize leaders toward ethical behavior via "Ethics Competencies" woven into every level of the leader's life of employment. World Concern is updating leadership performance evaluations globally to include these Ethics Competencies. During a performance evaluation, leaders are asked to:

- Talk about what they have done in the last year to instill the mission, vision, and values in their team.
- Talk about a situation in the last year where they considered World Concern's values to make their final decision.

Additionally, performance evaluators assess their own experience working with the leader. Characteristics and competencies such as the items below are assessed:

- The leader exemplifies the ethics and conduct expected of World Concern personnel.
- The leader inspires me to exemplify the ethics and conduct of World Concern.
- The leader asks questions when unsure of the ramifications of his or her conduct or in relation to a work decision.
- The leader keeps commitments.
- The leader's performance follows compliance mandates.
- The leader is knowledgeable of policies and procedures that affect his or her work.
- The leader is pleasant to work with.

There are also **controls and risk assessment metrics** that can capture a leader's performance in creating a strong controls environment. These include, for example, whether (1) the area under a leader's responsibility has timely closed all audit findings, (2) agreed mitigation measures identified in the risk assessment process were timely implemented, and (3) a leader gives opportunities for E&C to present at staff or management meetings.

Finally, there are other more **ad hoc observation**s about a leader that can help evaluate ethical leadership. For example, evaluations can consider how leaders handle tough calls from investigation findings and how they respond in the presence of inappropriate conduct of others. Although the ad hoc nature of such observations make them difficult to use in a systematic way, they can supplement more data-driven metrics.

Once the core E&C metrics are identified, they should be translated into performance objectives and formally integrated into the performance evaluation process. The target E&C metrics can change to address particular needs or gaps, and can also vary from one department or function to another to address group-specific issues.

Besides selecting the core metrics for assessing leadership performance, organizations must decide whether and how to link performance assessment to compensation. More senior leaders are likely to have incentive compensation as part of their compensation, and organizations have taken different approaches to using this bonus to incentivize ethical leadership.

Some E&C professionals we spoke with say their organizations have avoided linking incentive awards to ethical behavior as a matter of principle, arguing that rewarding ethical conduct

- turns ethical decision-making into a commercial transaction,
- decreases the intrinsic motivation for ethical behavior, and
- converts desired behaviors into “tick the box” exercises.

These opponents also argue that intrinsic motivation is more powerful than any incentives from a PES, so anything that dampens intrinsic motivation comes at a heavy price. They also argue that the imprecise, subjective nature of the measurements raises questions of fairness, and that it is better to separate performance measurements and incentive pay decisions.

Other organizations, however, have formally reserved a portion of their bonus for particular E&C objectives. Advocates argue that intrinsic motivation to be an ethical leader does not necessarily translate into desired ethical leadership behaviors, so an effective set of metrics tied to bonus pay can incentivize desired behaviors.

This may make the most sense for organizations

- operating in highly regulated fields,
- addressing a specific gap in a significant compliance risk area,
- experiencing legal and reputational harm linked to behaviors driven by misaligned incentive compensation systems.

In these circumstances, there is likely to be greater willingness at senior levels to incorporate E&C factors into incentive compensation and to allow input from the E&C function into what is commonly a closed, restricted process.[24]

Because of the challenges of finding reliable metrics for measuring E&C leadership performance, some organizations have chosen more informal channels without explicitly tying these metrics to performance assessments or incentive compensation decisions. See Large Multinational case study. These generally rely on a structured self-assessment used for discussion in a performance review, supplemented by data-driven feedback from the E&C function for validation. If leaders know they must discuss their ethical leadership in a performance review discussion (even one where E&C has no pre-defined weight), it may motivate ethical leadership behaviors, particularly if leaders believe that their own career advancement may be impacted by their ethical leadership behaviors.

Every organization must wrestle with this dilemma and balance intrinsic and extrinsic incentives to make it both easy and desirable for leaders to do the right thing and actively promote an E&C culture.

Case Study: LARGE MULTINATIONAL

At one large, multinational company, E&C provided senior leaders with three questions to include in performance review discussions with their leadership teams. The questions were shared in advance with these (subordinate) leaders so they could take actions during the year that would prepare them for the discussions. E&C also provided senior leaders with some data before their one-on-one discussions as a point of reference in the discussion.

1. During the last year, have you successfully communicated your support for our code of conduct and the values of compliance and integrity throughout your area of responsibility?
2. What efforts have you made to ensure that your area of responsibility has a robust compliance plan (including the identification and mitigation of compliance risks) that is regularly monitored and updated?
3. Are there any recent decisions or achievements that stand out as demonstrating your commitment to compliance and integrity?

5

Formal reward programs and informal recognization channels may advance an E&C culture.

Many organizations have separate awards to recognize employees or teams of employees for outstanding performance, and organizations can use these to reward exemplary E&C behavior. This is often a challenge as many would-be recipients may not want the public attention that comes with an award. In addition, rewarding employees for exemplary E&C behavior may have the unintended consequence of showing that desired ethical behavior is uncommon and exceptional, which "de-normalizes" E&C behaviors.

Informal, non-public recognition systems may avoid these problems. For example, organizations try to encourage employees to speak up. Taking the time to thank those who do can be very rewarding for the employee, especially if the thank you comes from a senior person. We cannot expect senior leaders to thank all those who raise concerns, but where an employee has demonstrated particular courage in raising an issue or where an employee's report helps save the company from larger legal or reputational issues, a leader's personalized and authentic expression of appreciation can have a significant impact.

CONCLUSION

E&C professionals strive to embed a culture of ethics and compliance into their organizations. The code of conduct, speak up programs, training and communication, and risk assessments all are tools that rightly deserve attention. Historically, E&C professionals have been less involved in incentivizing ethical conduct through performance evaluation and compensation systems. This is changing, led in particular by developments in the financial services industry and by increasingly sophisticated regulators.

As more organizations seek to adopt methods to incentivize ethics and compliance, we hope that the framework set forth here, and the cited examples from other organizations, will serve as a useful guide to E&C professionals.

ENDNOTES

1. We use the term “misconduct” to refer to work-related conduct by employees that violates an organization’s own code of conduct or compliance policies; the term “ethical behavior” is effectively the opposite and refers to behaviors aligned with those documents.

2. Burkett, Holly, HR Certification Institute, *The Evolution of Performance Management* (March 14, 2017).

3. Doshi, Neel and McGregor, Lindsay, Primed to Perform: How to Build the Highest Performing Cultures Through the Science of Total Motivation (2015). A summary is available in the authors’ article “*How Company Culture Shapes Employee Motivation*,” Harvard Business Review (November 25, 2015). See also Pink, Daniel. Drive: The Surprising Truth About What Motivates Us (2011) (breaking down motivation into three main elements: autonomy, mastery, and purpose). A summary video of the author’s book is available *here*.

4. Verizon and GSK are examples of companies that have broader clawback provision. See Verizon Corporate Governance *Selected Policies* (indicating that a Human Resources Committee “shall determine whether the covered individual has engaged in ‘willful misconduct’ and whether the conduct resulted in ‘significant reputational or financial harm to Verizon.’” See also GSK, *2017 Remuneration Policy Summary* at 139-140 (extending clawback provisions to significant violations of GSK’s Code of Conduct). The #MeToo movement has brought the scope of clawback provisions into the spotlight, with more companies seeking the right to use the provision in sexual harassment cases. Powell, Christine, “*4 Ways #MeToo Is Affecting Executive Compensation*,” Law350 (April 9, 2018) (subscription required).

5. United States Sentencing Commission, *Guidelines Manual*, §8B2.1 (Nov. 2016).

6. Id. at 534 (emphasis added).

7. U.S. Department of Justice, Fraud Section, *Evaluation of Corporate Compliance Programs* (2017).

8. Organization for Economic Cooperation and Development, *Good Practice Guidance on Internal Controls, Ethics, and Compliance* (2010).

9. International Organization for Standardization, *ISO 37001 – Anti-bribery management systems, 2016, Annex A.8.2 (available for purchase at https://www.iso.org/standard/65034.html).*

10. Ethics and Compliance Initiative (ECI), “Principles and Practices of High-Quality E&C Programs: Report of ECI's Blue Ribbon Panel” (2016) is available for download on *ECI’s website*. In addition, the first principle –“Ethics and Compliance is central to business strategy” – means that “leaders across the organization are expected to drive ethics/compliance forward as a routine but essential part of daily operations.” Id. at 17. The other three principles are:
    2. Ethics and compliance risks are identified, owned, managed and mitigated.
    4. The organization encourages, protects, and values the reporting of concerns and suspected wrongdoing.
    5. The organization takes action and holds itself accountable when wrongdoing occurs.”

11. Id. at 26.

12. Id. at 27.

13. “*The Wells Fargo Fake Account Scandal: A Timeline*,” Forbes (2016); Bistrong, Richard and Hodak, Mark, “Wells Fargo: How reasonable pay plans morphed into perverse incentives,” FCPA Blog (January 26, 2017).

14. Parloff, Roger. “*How VW Paid $25 Billion for ''Dieselgate'' — and Got Off Easy*,” Fortune Magazine (February 6, 2018).

15. Kobe Steel, *Report on investigation into the causes of the Kobe Steel Group’s improper conducts and on measures to prevent recurrence* (November 10, 2017).

16. See Held, Michael, General Counsel and Executive Vice President of the Legal Group at the Federal Reserve Bank of New York, "The Evolving First Line of Defense," *Keynote Address at First Line of Defense Summit* (April 17, 2018) ("We need to think creatively about how to structure compensation in ways that promote conduct aligned with the values and long-term financial interests of the firm."); Financial Stability Board, "*Measures to reduce misconduct risk: Progress Report,*" at 3 (November 6, 2015) (noting that "[t]he focus of boards is not only on appropriate compensation policies for those staff with low adherence to values, but also on how to adjust compensation to encourage positive behaviour."); International Association of *Insurance Supervisors, Insurance Core Principle 7 Corporate Governance* (stating "[t]he Board should also ensure that the relevant Key Persons in Control Functions are involved in the remuneration policy-setting and monitoring process to ensure that remuneration practices do not create incentives for excessive or inappropriate risk taking, are carried out consistently with established policies and promote alignment of risks and rewards across the organisation."); *2010/01 FINMA Circular Remuneration schemes*, "Minimum standards for remuneration schemes of financial institutions" (October 21, 2009) (stating that an "impartial body, (e.g. internal audit) review whether the design and implementation of the remuneration scheme is in compliance with the board of director's remuneration policy and the requirements of this circular.) See also Varges, Gabe Shawn, "*Financial Stability Board links executive compensation and conduct*," Ethical Boardroom (June 23, 2015) (noting that the push to link compensation and conduct is spreading from the financial services to other industries).

17. CFPB, Compliance Bulletin 2016-03, "*Detecting and Preventing Consumer Harm from Production Incentives*," November 28, 2016.

18. Ordóñez, Lisa et al., *Goals Gone Wild: The Systematic Side Effects of Over-Prescribing Goal Setting*, HBR Working Paper 09-083 (2009). See also EthicalSystem.org's Behavioral Science One Sheets, *Goals Gone Wild: How Aggressive Goal Setting Can Lead to Unethical Behavior* (Winter 2017).

19. Rosenzweig, Phil. Left Brain, Right Stuff: How Leaders Make Winning Decisions at Chapter 8 (2014) (noting that leaders "may need to instill in others a level of confidence that might seem exaggerated, but is necessary for high performance... Ultimately, the duty of a leader is to inspire others, and for that, the ability to personify confidence is essential.").

20. This quote is attributed principally to sociologist William Bruce Cameron, according to *Quote Investigator*.

21. U.S. Department of Justice, Fraud Section, *Evaluation of Corporate Compliance Programs* (2017)

22. UK Ministry of Justice, *The Bribery Act 2010 Guidance* (see in particular Principle 2 - Top Level Commitment).

23. Office of the Comptroller General, *Integrity Program: Guidelines for Legal Entities* (October 2015) (see in particular Pillar 1, which notes that senior leaders can promote integrity by "include[ing] the assessment of the effectiveness of integrity actions as a permanent or frequent agenda in its meetings or conferences with managers and other members of the company's middle management."

24. Varges, Gabe Shawn. "Incentives and Disciplinary Procedures to Promote and Protect the Compliance Program," in Compliance Practice Guide: The Next Generation (C. Basri, ed. 2017) (noting that "historically at most companies the design of such [compensation and reward] systems and the setting of compensation levels has been considered a sensitive domain restricted to a fairly small circle of senior decision-makers.").

ECI 2019 EVENTS

JANUARY 2019 ECI FELLOWS MEETING

Leading E&C

January 9 – 10, 2019

National Harbor, Oxon Hill, MD

Leading the E&C function in an organization is no easy task. Our January Fellows meeting is designed to inspire and inform you as chief visionary, strategist, and manager of your function. We will also explore ways that you can enhance your career and broaden your personal impact.

Consider sending: (Members-only) Senior E&C practitioners, CECOs, Chief Compliance Officers

EUROPEAN BUSINESS ETHICS FORUM (EBEF)

January 30 – February 2, 2019

Paris, France

For the 16th year, this 2-day Forum will bring together those who are responsible for the ethics, compliance or business conduct programs within their organizations. Participants share with their peers practical information, experiences relating to current best practices and some of the challenges in doing business ethically around the globe.

Consider sending: Senior E&C leaders, Corporate Social Responsibility leaders

SPRING 2019 BEST PRACTICE FORUM

Technology in E&C

February 27 – 28, 2019

Phoenix, AZ

Technology is changing the way we live and work. How can you make the most of it to advance your E&C program? This event is designed to equip you to utilize new technologies in your organization, even if you have a shoestring budget.

Consider sending: Technology-facing E&C practitioners, E&C team members in digital media, training and strategic planning, CTOs, IT

IMPACT 2019

April 30 – May 2, 2019

E2C Live to be offered Monday, April 29

Dallas, TX

Join your peers for the ultimate industry best practice event. You will learn from renowned keynote speakers, and leverage the experiences of your peers in breakout sessions & hands-on workshops. Return to your organization with a toolkit filled with resources that you can use to lead initiatives that will improve the quality of your E&C program.

Consider sending: All levels of E&C practitioners, members of HR, senior E&C leaders, compliance and risk

MANAGING ETHICS IN ORGANIZATIONS (MEO)

June 10 – 14, 2019

Boston, MA

For over 20 years the Managing Ethics in Organizations (MEO) course has provided an intensive course for rising E&C leaders, taught by the "who's who" of E&C. Many past participants have gone on to serve as a Chief Ethics & Compliance Officer or similar leadership position. Join us this year as we celebrate the retirement of Mike Hoffman, the namesake of our partner organization for this event (the W. Michael Hoffman Center for Business Ethics at Bentley University).

Consider sending: Directors, managers, and investigators in E&C, all rising E&C leaders, aspiring CECOs

JULY 2019 ECI FELLOWS MEETING

Why We Do What We Do: Exploring the World of Behavioral Ethics

July 10 – 11, 2019

National Harbor, Oxon Hill, MD

A new field of scientific study has emerged, seeking to understand how people actually behave when facing an ethical dilemma. In our July Fellows meeting we will hear from leading researchers in this exciting new area, and apply their insights to your E&C program.

Consider sending: (Members-only) Senior E&C leaders, CECOs

FALL 2019 BEST PRACTICE FORUM

Preventing Retaliation in the Workplace

November 5 – 6, 2019

Atlanta, GA

It's the perennial problem – the more an organization is successful in encouraging employees to raise concerns, the more retaliation occurs in the workplace. Eventually, employees' fear of retaliation has a silencing effect. This forum is designed to be an in-depth facilitated town-hall discussion to identify the causes of workplace retaliation, followed by conversation and best-practice sharing to identify solutions. We'll be joined by a panel of thought leaders whose expertise will help inform the conversation.

Consider sending: E&C helpline team, E&C leaders, HR team, E&C investigators and advisors

JOIN A WORKING GROUP

Are you looking to gain new ideas and discuss the ways your organization can advance your efforts around a certain topic? The ECI is working on forming new groups for 2019 and would like to hear from you!

Submit a topic recommendation to Casey Williams at **Casey@ethics.org** to be considered for a new 2019 working group.

ECI ethics & compliance initiative™

2650 Park Tower Drive, Suite 802
Vienna, VA 22180

703.647.2185

ethics@ethics.org

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