Tone at the top:
The first ingredient in a world-class ethics and compliance program

Background

During the 1990s, the bulls were running wild. NASDAQ rose from 329.8 in October 1990 to its historical high of 5,048.62 in March 2000[1] and the Dow Jones Industrial Average rose from 2,442.33 to 9,928.82 in the same time period[2]. The dramatic rise in market value may have caused stakeholders – such as regulators and investors – to hesitate in questioning the underpinnings and legitimacy of the bull market.

When a number of high profile corporate scandals were exposed, there was a devastating loss of trust; it was as if the public had been trampled by those same bulls. NASDAQ fell to 1,114.11 in October 2002[3], losing nearly 80% of its value, while corporate stocks on all exchanges collectively lost $7 trillion in market value[4]. Painfully, these scandals exposed widespread arrogance, fraud, conflicts-of-interest, preferential treatment, and a collective failure among the gatekeepers charged with oversight and maintaining the public trust.

The public and Congress questioned where the leaders were and who held the reins. In response, Congress passed The Sarbanes-Oxley Act of 2002, demanding greater accountability by boards and top executives. In particular, this law offered the platform to popularize the term "tone at the top," clearly an element missing in the aforementioned scandals. In addition, the 2004 amendments to the U.S. Federal Sentencing Guidelines created powerful incentives for corporations to "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law[5]."

Fast forward to 2008 when a global economic tsunami followed failures in the financial services industry and the nationalization and recapitalization of banks and other proud institutions. The world stood as a powerless witness to the loss of more than 30 million jobs worldwide[6] and a 37% decline in the value of global equities[7]. In its wake, the meltdown exposed bribery and corruption, fraud, insider trading, conflicts-of-interest, money laundering, price fixing and Ponzi schemes on an unthinkable scale. Then President-elect Obama spoke to us about "reckless greed and irresponsibility."

In response, Congress passed the expansive new requirements in the Dodd-Frank Wall Street Reform and Consumer Protection Act, coinciding with an unprecedented level of cross-border cooperation of regulators and prosecutors globally. Then in March 2010, the Organisation for Economic Co-operation and Development (OECD) issued its Good Practice Guidance urging companies to promote a comprehensive system of ethics and a culture of integrity, to which 45 nations have become signatories. In May 2013, The Committee of Sponsoring Organizations of the Treadway Commission (COSO) adopted provisions to its original guidance promoting ethics and culture as integral to a comprehensive framework for reputation risk management. All three place "tone at the top" as the starting point.

So what is "tone at the top," and what does it really mean?

1 NASDAQ composite on Google Finance. https://www.google.com/finance/historical?q=INDEXNASDAQ%3A.IXIC&ei=GCzqU6i6BIj1qQH0moGQAQ.
2 http://www.sec.gov/Archives/edgar/data/357298/000035729801500016/dowjones.html.
3 NASDAQ composite on Google Finance. https://www.google.com/finance/historical?q=INDEXNASDAQ%3A.IXIC&ei=GCzqU6i6BIj1qQH0moGQAQ.
4 Seth W. Feaster. "The Incredible Shrinking Stock Market." The New York Times. July 21, 2002.
5 http://www.ussc.gov/sites/default/files/pdf/amendment-process/official-text-amendments/20040501_Amendments.pdf
6 Verick and Islam. "The Great Recession of 2008-2009: Causes, consequences and policy responses." International Labor Office, 2010: 16. http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_policy/documents/publication/wcms_174964.pdf.
7 Bartram and Bodnar. "No Place To Hide: The Global Crisis in Equity Markets in 2008/09." Presentation at the BSI Gamma Conference on Lessons From the Financial Crisis for Banking and Money Management, November 11, 2009: 9.

Tone at the top

Without question, reputation risks today are at least as great as strategic, operating and financial risks. Sometimes, all it takes is a rumor or hint of impropriety or malfeasance, or a social media post "gone viral," to negatively impact shareholder value and damage, or worse, destroy, corporate and brand reputations in an instant. How can chief executive officers ("CEOs") create the right tone at the top? What role should the board play? How about the chief compliance officer ("CCO")? How does tone at the top cascade to the middle and beyond?

In the context of an ethics and compliance program, the tone at the top sets an organization's guiding values and ethical climate. Properly fed and nurtured, it is the foundation upon which the culture of an enterprise is built. Ultimately, it is the glue that holds an organization together.

The board, the CEO, and the CCO play critical roles in setting the tone at the top.

The board

The starting point for setting the tone begins with the organization's governing authority – most frequently this means the board of directors. The board's most fundamental tasks would typically include hiring the CEO, approving strategy, monitoring execution of the plan, setting risk appetite, and exercising appropriate oversight regarding risk mitigations, all with the underlying goal of preserving and creating shareholder value.

The board sets the tone of the organization in the way that it executes each of these responsibilities. However, perhaps no single decision drives tone at the top more than the selection of the CEO. That process must necessarily focus on competence, character, and chemistry and raises questions such as the following;

- Does the prospective CEO have the requisite skills and experience to move the organization forward?
- Does this person possess the character and moral fiber to model and contribute to the development of a values-centered enterprise and strategy?
- Does the CEO have the chemistry and communication skills necessary to rally others to successfully and consistently deliver on the organization's value proposition to all stakeholders?

Boards must provide appropriate weight to each of these considerations. Too often, the CEO selection process focuses mostly on competence, with less thought given to character and chemistry.

Once selected, the board is accountable to monitor the CEO's performance based upon appropriate metrics for competence, character, and chemistry. In summary, the governing authority must ensure that ethical objectives are built into the actions and the strategy of the organization, and that they are not merely a statement of good intentions.

The CEO

Establishing the right tone at the top is much more than a system of compliance. Establishing the right tone is essential to fortifying the organization's reputation and its relationship with all stakeholders. The street is littered with corporate failures and sub-optimal performance from CEOs who have neglected to prioritize the development of a culture of integrity. The CEO is the face of the organization, the figurehead to whom employees ultimately look for vision, guidance, and leadership. Leadership derives from trust, and trust is built upon a common understanding between people[8]. Leadership, therefore, is relational, not transactional.

Tone at the top demands that leaders – and especially the CEO – find ways to connect with people inside and outside the organization. Leaders must openly communicate their values on an ongoing and transparent basis, using different platforms and distribution systems. People are suspicious of leaders who are closed about their values or standards. Stakeholders assume if you value nothing, you'll value anything. While leaders must establish core values and principles, a CEO's behavior tells employees what counts, and what's rewarded and punished. Unfortunately, many companies under-communicate values by a significant factor.

Developing a sense of shared values – a set of beliefs against which all decisions can be measured and tested – is increasingly the basis on which long-term strategies and successful implementations are built. Failure to align ethics and values to business strategies and operating plans bears potentially heavy costs[9].

8 Darcy, K.T. A Companion to Business Ethics, edited by Robert E. Frederick, "Ethics and Corporate Leadership," Blackwell Publishers Inc., 1999: 405.
9 Ibid, 405.

The CCO

Clearly, the chief compliance officer plays a critical role in setting and reinforcing the tone at the top. The person selected for this role must be beyond reproach – someone whose integrity is clear and who can earn the respect of personnel at all levels. The character and stature of the person the board and executive management team select to hold the CCO position is a powerful statement about the organization's commitment to ethics and compliance, as does the organizational positioning of the person within the executive leadership team.

The CCO contributes to tone at the top in both direct and indirect ways. The CCO has a built-in platform for reinforcing the organization's values, balancing the messaging related to sales and growth. The CCO is also the leader that employees seek out when they have ethical concerns. Therefore, he or she plays a crucial role in creating a "speak up" culture – an essential element of tone at the top.

In addition, the best CCOs seek out opportunities for the CEO to convey key ethics and compliance messages in both internal and external communications. He or she also proactively assists the board in both understanding and executing their role in setting the tone at the top.

Beyond the roles described above, the board and executive management help translate the "tone at the top" to a healthy "mood in the middle" by ensuring certain organizational practices are in place at all levels, including among others:

- **Recruiting and screening methodologies** – It begins with intake channels and screening for people's character, competence, and chemistry. Everyone in the hiring process should recruit for character first.
- **Socialization and training** – Organizations should create a seamless integration – beginning in orientation – to foster an ethical culture. Mentoring and additional training must offer consistent messages about what's valued.
- **Reward systems** – You get what you measure. Recognition and rewards should be aligned with desired values and behaviors. Everyone must be reviewed not only for what they do, but how they do it. Moreover, employees with the courage to step forward with ethical concerns must be appropriately recognized and rewarded to help encourage others to follow suit.
- **Employee exits** – People leaving the organization should be treated equal to how they were brought in. It sends a message regarding how people are valued.

Unique challenges

In creating the right tone, certain issues require special attention from the board and senior leaders. These unique challenges include:

- **Mergers and acquisitions** – Cultural integration is essential to a successful combination, especially in mitigating risks to the combined entity. Leaders must ensure that acquired employees don't feel plundered, exploited, or occupied.
- **Autonomous and decentralized operations** – The further away from headquarters, the greater the likelihood that something gets "lost in translation." Take time to understand and respect other peoples' cultures, and pay special attention to business units or individuals that operate with significant autonomy. Neither moral imperialism nor moral relativism works. Co-create a new understanding.
- **Discontents** – Nothing will undermine tone quicker than not addressing and dealing with individuals whose actions are contrary to the organization's beliefs.
- **Institutionalization** – Institutionalization of values is often the first step toward bureaucracy. The senior leadership helps set the tone at the top by keeping values and culture "fresh."

There is also another reality that must be recognized in developing tone. Given the proliferation of social media and mobile technologies, there are conversations going on between and among all stakeholders at any given moment. The world is becoming increasingly transparent. As a result, the gaps between a leader's words and actions can "go viral" in a nanosecond, thus undermining efforts to build a consistent message and tone. Where there are actions that cannot be spoken about, or words that cannot be put into action, the moral development of the enterprise will be undermined by cynicism.

Conclusion

For organizational leaders, managing in today's world is becoming increasingly challenging and more complex. Risks are increasing, competition is intense, and economic activity is fragile and uneven. For organizations to succeed, it requires the collective efforts of the entire enterprise, operating from the same understanding of strategy, purpose, and values.

At its most basic level, an organization is a community of people with common interests and shared values banded together to achieve a common goal[10]. Increasingly employees are saying they want to be identified with an organization that stands for something more than quarterly earnings. They want to work for an organization whose values align with their own. They want to take pride in what they produce. They want to admire the people with whom they work[11].

Creating and maintaining the right tone at the top is an essential first step in creating an enduring enterprise anchored to an effective ethics and compliance program.

Reinforcing tone at the top

Walk the talk: Implement and publish board operating principles that align with the company's values, and provide specific responsibilities for acting in an ethical manner at all times.

Remember the water cooler: When making difficult decisions about unethical behavior involving anyone in a management role, assume both the ethical breach, and your response to it, will be widely known within the organization. Think about how the decision may reinforce – or conflict with – the company's stated values.

Keep an ear to the ground: Use new technologies to monitor the corporate buzz. What are your employees, customers, and other stakeholders saying about the company's culture in social media and other digital platforms?

Reward for principled performance: Include ethics and compliance in performance goals for C-Suite executives, and tie those goals to compensation.

Build an ethical corporate ladder: Consider the ethics and compliance track record when promoting people into senior leadership roles, particularly as part of succession planning.

10 Ibid., 407.
11 Ibid., 406.

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