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Integrity, business ethics and the resilient organisation

A vital aspect of resilience is an organisation's ability to demonstrate integrity and embed ethical business through alignment of corporate purpose and personal values

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Business conduct under the spotlight

Today, the conduct demonstrated by private and public sector organisations is under close scrutiny in the UK and across the world. From the LIBOR scandal to the furore over multinationals' tax affairs, and from the execution of corrupt officials in China to the US Government's crackdown on insider trading, the focus on organisations' integrity and that of individuals acting in their name has arguably never been greater.

However, while such episodes have the common effect of undermining trust, they vary widely in nature. Some reflect unlawful behaviour while others are perfectly legal; some mirror organisations' inherent culture while others spring from rogue behaviour. Yet they are all seen as ethical failings.

This paper is the third in a series of publications where we have put the spotlight on risk. In the first paper, 'Black swans turn grey - the transformation of risk', we mapped out the new risk landscape and outlined new approaches to risk and uncertainty. In the second paper, 'Prospering in an era of uncertainty – the case for resilience', the focus was on the capacity of a firm to survive and thrive in a turbulent world. And in this third paper, we focus on the degree to which organisational culture, values and internal behavioural norms contribute to the risk resilience of the organisation and the relationship between business ethics, integrity and risk.

So, what do we mean by 'business ethics' and 'integrity'? We apply the following broad definitions throughout:

- ***Integrity*** – adherence to moral and ethical principles; soundness of moral character; honesty; and
- ***Business ethics*** – application of a set of moral values that are accepted by an organisation's stakeholders as the principles that should guide behaviour.

Stephen Carter brings this to life in his book "Integrity" defining integrity as requiring three steps: "discerning what is right and wrong; acting on what you have discerned, even at personal cost; and saying openly that you are acting on your understanding of right from wrong".

These definitions provide a useful basis for discussion but inevitably raise further questions. For example, the values of society change slowly but sudden shifts in accepted practices and normal behaviours are more frequent, so the norm against which integrity is measured is a complicated and moving target. What is 'ethical' is considered relative and contextual by some, but universal and absolute by others. And corporate practices and leadership behaviour that are widely regarded as ethical or simply unremarkable today may trigger outrage when viewed retrospectively in years to come.

Despite tensions between these contrasting views of ethics, several creditable attempts have been made to create reliable, guiding co-ordinates by which organisations can calibrate (and recalibrate) their ethical compass.

Notable contributors include the Institute of Business Ethics, founded in 1986, the think-tank Tomorrow's Company and the Corporate Philosopher Roger Steare. A further valuable source of thinking is the HOW Report from LRN, see overleaf.

Business conduct under the spotlight (cont'd)

The HOW Report: self-governance drives performance

This study identifies three business 'archetypes' that describe how companies operate: Blind Obedience, Informed Acquiescence, and Self-Governance. It finds that while only 3% of companies are Self-Governing, 43% fall into the Blind Obedience and 54% into the Informed Acquiescence archetypes. Those that are Self-Governing perform best on every one of the 14 performance outcomes in the study – including higher employee loyalty, customer satisfaction, and lower misconduct. Self-governing organisations are also more resilient and seen by their employees as beating the competition on innovation and financial performance.

The report also finds a marked disconnect between C-suite executives and the employees they lead. Worldwide, CEOs regard their companies as self-governing three times as often as the overall workforce: 10% versus 3%. Overall, the results suggest that companies need to be more deliberate and intentional in shaping their corporate character, and must focus on how things really work in their operations if they are to compete and succeed in today's business environment.

The HOW Report from LRN..

.. is based on a statistical analysis of responses from over 36000 employees in 18 countries.

Tomorrow's Company: The case for the 'board mandate'

According to Tomorrow's Company, the starting-point for sound corporate governance is for boards to establish their own 'board mandate'; a living statement about what the company stands for and how it wishes to be known to all of its stakeholders. This should capture the 'essence' of the 'character' and distinctiveness of the company, in terms of its essential purpose; its aspirations; the values by which it intends to operate; its attitude to integrity, risk, safety and the environment; its culture; its value proposition to investors; and plans for development. In Tomorrow's Company's view, this 'working charter' is an important innovation that can help boards navigate their way through the increasingly choppy waters of an ever more complex and challenging business environment.

How do business ethics and integrity link to resilience?

Whatever approach an organisation takes to fostering and demonstrating ethical behaviour, it's clear that the price of getting this wrong can be very high, potentially damaging the licence to operate, even when business is in full legal compliance. For this reason, we can see that business ethics are strongly correlated with business resilience. So what is resilience?

In "Prospering in an era of uncertainty – The case for resilience," we put forward the view that resilience is not a capability that an organisation develops in isolation, like risk management, but a characteristic of the wider system in which the firm operates. And the bedrock of resilience is provided by the extent to which these values, and the organisation's resulting cultural and behavioural norms, are aligned with the evolving norms and changing expectations in wider society.

Within these parameters the paper proposed that organisational resilience springs from two practical forms of responsiveness. The first of these is the 'buffer', which provides the breathing-space to absorb shocks and mount a considered response. The second is 'adaptive capacity', which combines strategic flexibility and organisational agility with a culture that supports learning and renewal.

If buffers are pre-requisites for survival or 'bouncing back' in a turbulent and uncertain world, then adaptive capacity provides the momentum for 'springing forward' to exploit opportunities to avert a crisis or transform during it.

So, how does business ethics and integrity contribute to this adaptive capacity and what role does it play in managing the resilience of an organisation? The diagram below shows how adaptive capacity can be analysed across four dimensions, the "four A's" of organisational resilience.

Alignment

- Strategy and risk alignment
- Leadership structures and alignment with incentives
- Collaboration with partners and customers

1

Awareness

- Risk appetite and tolerance
- External stimuli
- Customer and employee experience
- Performance and risk measures

2

Ability

- Appropriate diversity
- Learning from experience
- Internal networks
- Routines and habits

3

Agility

- Simplicity trumps complexity
- Continuous improvement culture
- Strong communities of practice
- Consistency and transparency

4

Applying a resilience lens to challenge the business

These four dimensions provide a practical context in which organisations can challenge themselves over the role of integrity and business ethics in forming a buffer or springboard for resilience. By answering the following questions, organisations can assess the adaptive capacity of their resilience through the lens of business ethics and integrity:

Alignment:

- Are we really as 'good' as the board thinks we are?
- Does our management rhetoric match the reality of others' experience when they come into contact with us?
- Do we really have the right feedback loops in place such as internal people surveys, customer surveys and so on, and are we actively listening and acting on what we hear?
- Can we manage disagreement as an asset, or is it always a liability for future performance management?
- Are the ethical preferences of individual managers and employees aligned with the values of the organisation?
- Do managers and employees behave consistently at home and at work based on a congruent set of values and ethical principles?

Awareness:

- As social norms evolve, are the ethical standards and everyday practices followed in our business keeping pace? For example, is paying tax based just on a legal duty or a moral one, and are we reflecting this shift?
- How effectively do we track and address these changes?
- Are we transparent about who we have relationships with as a business, and whether these relationships are appropriate?

Ability:

- How effectively do we manage our relationships with staff, investors and other stakeholders whose trust is important to us?
- How can we manage these relationships more effectively?
- How good are we at understanding and managing complex environments and systems that have infinite shades of grey rather than dualistic black and white?
- How do we measure the behaviours of our people so that we can track and monitor our ability to apply ethical principles in line with our strategy and values?

Agility:

- How good are we at adapting our modes of management to different situations?
- What are the occasions when we have done this well versus when have we failed? How have responded to this failure – what do we do differently?
- What changes in culture, behaviour, organisational structure and/or incentives could we make to improve our agility and adaptability?

While seeking to answer these questions, boards can reveal some interesting perspectives about themselves, their businesses and how business is done. Our stated definition of integrity as "adherence to moral and ethical principles" links it clearly to the Awareness and Alignment aspects of resilience. At the same time, our definition of business ethics as "principles that should guide behaviour", links it to the organisation's Ability and Agility to adapt to new contexts.

Behaviours come to the fore…

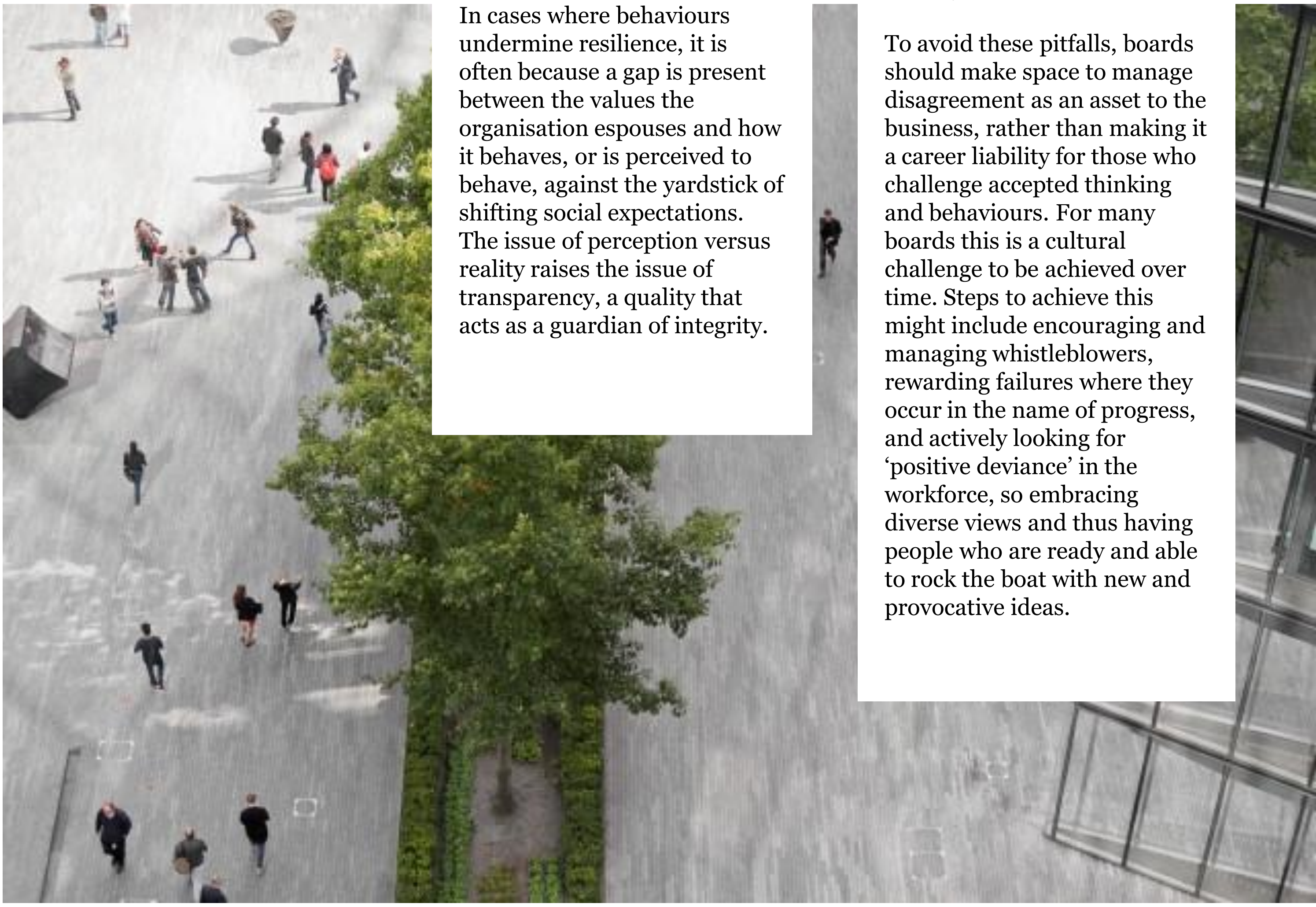
It is no coincidence that applying the resilience lens to both integrity and business ethics throws the spotlight onto behaviours. Boards need to be asking how everyone in the organisation is being encouraged and enabled to contribute to ‘building the future’ that the business wants to create, and whether the organisation is avoiding the often limiting traps of groupthink and box-ticking that can arise in a highly regulated and scrutinised business world.

In cases where behaviours undermine resilience, it is often because a gap is present between the values the organisation espouses and how it behaves, or is perceived to behave, against the yardstick of shifting social expectations. The issue of perception versus reality raises the issue of transparency, a quality that acts as a guardian of integrity.

…with challenge emerging as an asset

Many organisations experience tensions at all levels around how transparent they need to be in relation to their risks or indeed the comprehension of the risk in the first place. This applies particularly when a new risk is identified, because more time must be spent on understanding, monitoring and managing it. The temptation is to hide or play down such risks to avoid facing uncomfortable facts and doing the work. However, this not only undermines transparency, but also weakens integrity, and thereby reduces resilience.

To avoid these pitfalls, boards should make space to manage disagreement as an asset to the business, rather than making it a career liability for those who challenge accepted thinking and behaviours. For many boards this is a cultural challenge to be achieved over time. Steps to achieve this might include encouraging and managing whistleblowers, rewarding failures where they occur in the name of progress, and actively looking for ‘positive deviance’ in the workforce, so embracing diverse views and thus having people who are ready and able to rock the boat with new and provocative ideas.



The predictability of risk: navigating through a shifting landscape

As well as managing the different levers to nurture the right behaviours and build organisational resilience, boards must also take account of a further critical dimension which is the constant evolution in the criteria against which society judges companies' trustworthiness.

Yesterday, today and tomorrow

Will today's concept of 'doing the right thing' stand the test of time? In some areas, such as safety, financial fair dealing and paying a reasonable amount of tax, the answer is probably 'yes'. Even then these have taken time to shift. For example in the health and safety world, thirty years ago, deaths in the workplace were an accepted part of heavy industry but now zero injuries is an aspiration of many companies. In other areas, the answer is almost inevitably no. Witness the fluctuating focus on issues like environmental responsibility, executive remuneration, employment conditions in third-party suppliers, and involvement in sectors such as tobacco, alcohol or defence.

Put simply, what was right in the past is not necessarily right now. And what is right today will not necessarily be right in the future. Also, such shifts do not necessarily reflect what is deemed right or wrong under the law. Partly as a result, 'good' businesses can end up doing what are perceived to be 'bad' things without trying or even intending to. This is not a recent development. With events ranging from Shell's planned deep-sea disposal of the Brent Spar in 1995 to the recent furore over multinationals' strategies for reducing their tax liabilities, no law was broken, yet there was a widely-shared sense that the action was not 'right'.

A further complication in business ethics is that companies may be sheltered from the external ethical implications and impacts of their activities, for example through the potential moral hazards resulting from insurance cover or from the implicit state guarantee for the banking industry. There is also the question of who will pay for more ethical behaviours and whether societies can avoid the privatisation of gains and socialising of losses.

Best practice or just current practice?

Such tensions underline that any currently accepted 'best practice' in terms of values and behaviour is subjective, relative and transitory, and certainly cannot be relied upon to protect a company over the long term. Like its corporate strategy, an organisation's integrity and ethics need to be continually tested and reassessed against a changing environment, and must evolve to keep pace. Otherwise it faces a seismic shock when the resulting mismatch is suddenly exposed.

So, when management are seeking to embed a culture of 'doing the right thing' and are trying to sustain a competitive edge in the marketplace, historical information and experience are not a reliable guide to the future. As we've seen, there are many instances of what were historically acceptable practices creating reputational and legal liabilities in the present and more are emerging all the time.

Even codified best practices such as regulated and voluntary principles are unreliable, as they are actually retrospective. Having been developed based on yesterday's challenges and problems, they will eventually be judged under tomorrow's values.

Can integrity be future-proofed?

Given this exposure to shifting criteria, can any organisation ever future-proof its own values and behaviour against criticisms levelled with the benefit of hindsight in years to come? In our view, it is impossible to remove this risk entirely. But the best protection is to ensure that the organisation operates on the basis of a clear and explicit view of its purpose and of the future it is trying to create, as proposed in Tomorrow's Company's 'board mandate'.

If, supported and guided by its mandate, the board is comfortable today that the organisation and its people are behaving in a way consistent with its stated values, then it has a robust position from which to defend that behaviour tomorrow, no matter how social morals and expectations may have shifted in the meantime. A company that can demonstrate a consistent track record of behaviour against publicly-espoused, long-term values will be given much more leeway if history judges that it was misguided. And this leeway will act as an important buffer supporting resilience.

One integral step in moving towards future-proofing integrity is to embed measurement of behaviours as a way to assess how ethical principles and values are being deployed across the business. Experience tells us that leadership actions, not just the tone from top, are the way to drive behavioural change across and down organisations – but how is this monitored and tracked in critical moments where decisions are made further down the organisation? A key part of building resilience is to have transparency and clarity to assess how actions and behaviours at all levels are aligned to the board mandate, strategy and corporate purpose.

Bringing risk appetite to life: embedding alignment with the board mandate, strategy and values

To be effective, the board mandate must include an explicit risk appetite and it is vital to make this appetite an integral part of the behavioural norms that translate culture and values into actions. Boards can set the right tone for decisions, by ensuring their people look at information of sufficient quality and about the right things, use the right processes to generate insights, and see the stories behind the numbers. To make this work there is a need for both a board conversation that sets parameters and guidelines for the organisation as a whole, and a cascaded series of conversations between leaders and their direct reports about what appetite there is for risk in their local accountabilities and performance targets.

Simply, it needs to be brought to life at the front line in relation to day to day decisions, ethical dilemmas and trade-offs.

Organisations that understand these dynamics can quantify risk appetite and tolerance to clarify and cascade measures to the front line about freedom, barriers and limits, blended with traditional delegation and checks and balances.

So where should business start?

For a board, a first step in assessing how business ethics and integrity is aligned to its mandate and strategy is to challenge themselves as to where they stand against some simple assertions, as outlined below. Which of these statements are true for the whole organisation?

- Our values apply consistently at all levels.
- Our organisation has a common set of values that are communicated, understood and aligned with our strategy.
- We conduct a regular and thorough review of our values, involving stakeholders outside the organisation as well as employees at every level.
- There is an unambiguous congruence between what we tell the world and the way we behave.
- Our people believe that their leaders demonstrate integrity and lead by example.
- People feel confident and appreciated enough to bring their true selves to work.
- People at every level genuinely know what doing it right means and believe that doing it right will deliver better business.
- Our business has a consistent decision making framework addressing ethical and business integrity issues.
- We measure the decision-making effectiveness and ethical behaviours of our people and our business as part of our future-proofing of integrity.

Future thinking on business ethics: taking our ideas forward

The purpose of this paper is to shine a light on the suggested relationship between business ethics, integrity and risk resilience. What is undisputed is the need for organisations to understand the critical role of managing risk in a turbulent and uncertain world and the opportunity to adapt and build capacity for survival. We propose that tackling business ethics and integrity is an essential step to enhancing organisational resilience and, whilst are still questions to be answered, the fact that a relationship exists between these components is clear.

For example, if an organisation empowers and trusts its people to take decisions based on a set of shared ethical values, what happens when they get those choices wrong, either in ethical or commercial terms? How should organisations judge the difference between a mistake (negative) and the opportunities presented by change and learning from failure (positive)? And how do these judgements manifest themselves through their impact on everyday decisions and behaviours across the organisation?

At the same time, it is important to emphasise that integrity, like liberty, requires constant vigilance. Informal arrangements and understandings that may be essential for an organised system to function can easily become systems in which private benefits are achieved at public expense. Experience shows that confidentiality can become secrecy and discretion can become a cover-up.

At PwC, we're engaging with boards and leadership teams on such issues, with the ultimate aim of enabling steps to open and align the performance and strategy of their businesses in a way that enhances ethics and integrity. The key here is active engagement and measurement. Companies and their industries need to be actively in business to create 'better markets', and to start to measure changes in behaviours, evidence the change, and develop and use 'reinforcers' to sustain the momentum of the resulting positive movement in behaviours.

The interconnected nature between ethics, integrity and resilience across organisations, sectors and societies means this a journey that no business can undertake alone.

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