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WEB EXCLUSIVE

A Global Leader's Guide to Managing Business Conduct

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by Lynn S. Paine, Rohit Deshpandé, and Joshua D. Margolis

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MANAGERS WORKING OUTSIDE their home environments often find that their companies' norms are inconsistent with practices followed by other businesses in the area. In response, many follow the time-honored advice given in the fourth century by the bishop of Milan to Augustine of Hippo: When in Rome, do as the Romans do.

But that's a perilous approach. Consider the outrage in the United States when the media reported that BP oil rigs in the Gulf of Mexico lacked safeguards required on similar machinery in Norway and Brazil—even though the failed equipment in the Gulf met U.S. legal requirements. Or the worldwide outcry over working conditions at Foxconn in China after some employees committed suicide, although the company's factories were arguably no worse than thousands of others nearby. Or consider the hot water that Siemens, Lucent, and DaimlerChrysler landed in after paying bribes and making various types of side payments that were common in the countries where the companies were operating.

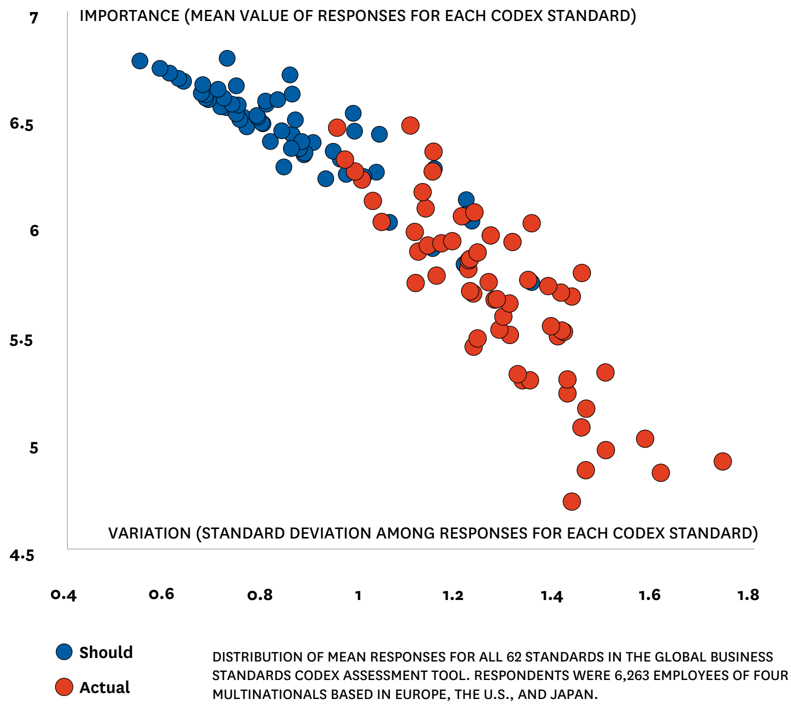
These and other incidents show that conformance with local law and practice does not guarantee stakeholder or public approval of a corporation's behavior. But does that mean companies should automatically default to their home-country practices?

Our research suggests that the answer is no. In surveys of more than 6,200 employees from the top ranks to the front lines of four leading multinationals based in the U.S., Europe, and Japan, we found a strong consensus on basic standards of conduct that companies should follow worldwide. Our findings indicate, further, that meeting those standards will require new approaches to managing business conduct. The compliance and ethics programs of most companies today fall short of addressing multinationals' basic responsibilities—such as developing their people or delivering high-quality products—let alone such vexing issues as how to stay competitive in markets where rivals follow different rules. Instead of intensifying their focus on compliance, companies must bring to the management of business conduct the same performance tools and concepts that they use to manage quality, innovation, and financial results. Leaders need an approach that is guided by global standards, informed by systematic data, grounded in the business context, and focused on positive goals.

This need is particularly acute right now. Despite the widespread adoption of ethics programs by companies around the world in recent decades, failures of corporate responsibility are all too frequent and public trust in business remains distressingly low. At the same time, expectations continue to rise. The UK created a new antibribery law that took effect July 1, 2011, and broadens the range of companies—both domestic and foreign—that can be prosecuted in the UK for bribery or

The Conduct Gap

Surveys we conducted at leading multinational corporations show that employees tend to agree on what companies should do, but many believe their employers don't fully live up to those standards; we also found greater consensus among employees on what companies should do as compared with what their own companies actually do.



DISTRIBUTION OF MEAN RESPONSES FOR ALL 62 STANDARDS IN THE GLOBAL BUSINESS STANDARDS CODEX ASSESSMENT TOOL. RESPONDENTS WERE 6,263 EMPLOYEES OF FOUR MULTINATIONALS BASED IN EUROPE, THE U.S., AND JAPAN.

for failure to prevent bribery by an associated person or entity, regardless of where the offending act took place.

In this article, we offer guidelines for navigating the increasingly rugged ethical terrain that multinationals face every day.

Identify Your Conduct Gaps

Government officials and members of the public aren't the only ones calling for better business conduct. Employees, too, see a need for improvement in corporate behavior. Surveys we conducted in 2006 and 2007 at some of the world's leading global corporations reveal that while there is a strong consensus on the standards that should be met, many employees feel that their companies don't fully live up to those standards. (See the exhibit "The Conduct Gap.")

The surveys, whose findings have been supported by a companion study of global executives that has 880 respondents to date, show that employees from every level in those organizations strongly support adherence to the 62 standards in the Global Business Standards Codex, which we developed some years ago on the basis of leading codes of corporate conduct. These standards, described in our 2005 HBR article "Up to Code," cover all of a company's responsibilities, from respecting employees' dignity to refraining from bribery to creating innovative products and technologies.

Despite wide differences in cultural origins and business environments, the employees, when asked the extent to which they thought companies should adhere to each of the standards, responded with an average value of 6.44 on a scale of 1 to 7. Even on items that we thought would be controversial—such as respecting dignity and human rights—we found strong support. These surveys bolster our earlier research, in which we hypothesized an emerging consensus on widely accepted standards of conduct for global companies, and they belie the assumption that relativism should guide cross-border business practices.

But the gap between "should" and "do" was troubling: The average score on adherence to the standards was just 5.68 on the same seven-point scale. Moreover, we found a greater range of responses on the actuals than on the shoulds, which means employee perceptions of what their companies do are more varied than their perceptions of what the companies should do. Although every company will have a different profile of gaps between its conduct and what employees feel that conduct should be, we observed three patterns that we suspect are widespread.

The Global Business Standards Project

In response to a lack of clear, comprehensive guidelines for the conduct of global companies, we set out in 2004 to create a business-ethics index that companies could use to benchmark their behavior over time.

As a first step, we systematically analyzed a select group of codes of corporate conduct. Distilling precepts from 23 sources, including 14 of the world's largest companies and institutions—among them the United Nations, the OECD, the Global Reporting Initiative, and the Caux Round Table—we created the Global Business Standards Codex, a compilation of widely endorsed standards.

We then conducted multilanguage field surveys to determine the extent to which businesspeople around the world believe that companies should—and do—adhere to these standards. Two data sets emerged from this work, which drew on respondents from some 23 countries and regions: findings from 880 executives in Harvard Business School's Advanced Management Program (2006 to the present), and survey results from more than 6,200 employees of four leading global companies (2006 and 2007).

The altitude effect. Those at the top of the corporate hierarchy generally have a more positive view of their companies' conduct. For the bulk of the standards, respondents who identified themselves as corporate or division-level executives reported smaller gaps between "should" and "do" than those who identified themselves as middle management, junior management, or nonmanagement employees. The altitude effect was most pronounced for employee-related issues, but it was also strongly in evidence for basic standards of business integrity such as fair dealing and promise keeping and for basic standards of human welfare such as protecting health and safety. Whether the rosier view from the top indicates that executives are better informed or that they are merely out of touch, the discrepancy between their assessments and those offered by other employees is cause for some concern. At the very least, it indicates that executives need to rely on more than their own views to assess their companies' ethical performance.

Basics matter. We found that gaps for standards of business integrity were among the widest. Although environmental issues emerged, somewhat predictably, with wide gaps, we also found larger-than-average gaps for fair dealing, promise keeping, and conflict-of-interest disclosure. These findings are a reminder that business leaders must remain vigilant about basic business integrity even as they strive to meet emerging standards of corporate citizenship concerning the environment, human rights, and supplier practices.

Employees are an early-alert system. Gaps relating to fair compensation, responsiveness to employees' concerns, communication with employees, and developing employees' skills topped the list. In the next tier, not far below, were gaps relating to free association, employee dignity, equal employment opportunity, and employment dislocations. Employees may well be most sensitive to practices that affect them, but that shouldn't provide much solace to executives. A large body of research has consistently shown that employees who feel mistreated exact a cost from the company, and many companies espouse the importance of treating employees the way they want employees to treat customers. The sizable gaps we found on employee standards may be an early warning of brewing trouble.

Develop Data-Driven Tools

With governments, the public, and employees expressing a desire to see better corporate behavior, how can companies take measurable steps to improve their conduct?

While many executives say that their companies adhere to the highest ethical standards, very few have data to assess the stringency of those standards or even a way to determine what standards their companies actually follow. Instead they typically point with pride to the company's written code, the excellent people the company hires, or how some particular misdeed was handled.

Such unsubstantiated claims would be unacceptable in any other aspect of business. An executive who claimed that his company's sales were among the best in the industry but whose only evidence was the company's written sales plan, its great salespeople, or last week's big sale would quickly be shown the door and perhaps even sued for fraud or negligence. The lack of data and rigor in assessing and managing business conduct is tolerated because many assume that ethics and conduct are "soft" topics not amenable to measurement or evaluation.

To be sure, many companies do track the use of their hotlines and collect data on alleged code-of-conduct violations. And some companies do survey employees on their perceptions of company values or adherence to espoused standards. What is largely lacking, however, is a systematic approach to assessing company performance on the standards of conduct that are expected of leading companies today.

To address this problem and help leaders more accurately gauge their companies' ethical performance, we developed an assessment tool based on the Global Business Standards Codex to survey the four global companies. Compared with more-common assessment tools, this one has several important features. First, it is based on objective rather than subjective standards (those that the company has chosen) that we have found to be widely accepted by diverse business, government, and multisector groups. Second, it generates data from throughout the company—up and down the hierarchy and across multiple units—and covers multiple dimensions of performance. Third, it focuses not just on negative standards and the prevalence of misconduct but on positive standards and the company's performance against affirmative benchmarks.

The codex assessment tool allows business leaders to construct an organization-wide picture of the company's ethical strengths, weaknesses, and performance. Admittedly, it captures perceptions and beliefs rather than actual behavior, and perceptions can be mistaken. (An independent third-party assessment would be useful additional input.) But perceptions from a broad and diverse group of employees are a useful first approximation of actual conduct—and perceptions are crucial in and of themselves, because they drive attitudes and opinions within the company. They are also useful for helping managers take three necessary steps: identifying issues that need further inquiry, pinpointing potential risks to the company and its reputation, and finding areas of strength and opportunities for learning.

Go Beyond Compliance-as-Usual

Over the past two decades, many executives have appointed chief compliance officers and established programs to foster adherence to their companies' codes of conduct. A typical compliance program comprises best-practice elements—from a defined set of conduct standards and policies to an implementation and oversight structure that goes all the way up to the board of directors, often via the board's audit committee or a compliance committee. Companies that follow such programs communicate their standards to employees, appoint ombudspeople, set up anonymous hotlines, and install monitoring and auditing processes to ferret out code violations and risks. They are quick to respond to violations by going after the causes and the offenders.

These programs are predicated on a well-functioning legal system, and their approach to influencing behavior relies heavily on the lawyer's tool kit of rules and penalties. Violations are presumed to originate with individuals acting against otherwise prevailing norms, so the idea is to detect and deter breaches by fostering transparency and strengthening disincentives. The apparatus is focused on activities inside the organization and is largely indifferent to the economic and societal context in which the organization operates. Moreover, it is much the same whatever the business and whatever the content of the code.

But this approach seems markedly out of step with other areas of business practice. Our research suggests the need for richer tools and a more contextual approach to improving ethical performance. When we delved more deeply into the gaps between "should" and "do," we found that aspects of the broader context in which respondents were working related to the size of the gaps they reported. In particular, we found that employees in the emerging markets of China, India, Brazil, and Southeast Asia reported larger gaps than those in the United States, the UK, Western Europe, and Japan. More generally, those in low-income countries reported larger gaps than those in middle- and high-income ones. The discrepancy between emerging and developed markets was in evidence across a wide range of areas—from competitive practices and employee development to community relations and anticorruption efforts. In only one area—providing customers with accurate information about products and services—did developed-market respondents report significantly larger gaps than emerging-market respondents.

Gaps associated with broad contextual factors such as the economic and legal environments are difficult to address with a compliance program focused on detecting and deterring individual violators. For such factors, low adherence to the codex standards may have more to do with the environment in which people are working than with deficiencies in the character or motivation of particular individuals, so replacing one set of employees with another is unlikely to make much of a difference. What's needed is a multifaceted response that takes account of how legal or economic differences shape behavior and support (or discourage) adherence to the standards in question.

Consider the large gaps for workplace health and safety that we found in some regions. As many companies have learned, an effective program for improving workplace safety may include investment in equipment and infrastructure, redesign of facilities, changes in work processes, education and training of employees, and modification of performance measures. Engagement with external parties—to establish standards, improve enforcement practices, and focus public attention on safety—may also be required. None of these elements is included in the typical compliance tool kit.

Similarly, efforts to combat bribery in an environment where corruption is widespread must be multifaceted. Instructing employees to "just say no" and punishing violators may work, but it carries a risk to the business and may drive corruption further underground. A more promising approach recognizes that the best protection against corruption is a superior product that adds value for the customer and is not readily available elsewhere. Excellent sales and marketing skills are also important, because without them sales personnel are much more dependent on supplying personal favors, gifts, and entertainment. As in the case of workplace safety, changes in internal processes may be required—for example, approvals for certain marketing expenses—and it may be essential to engage with external parties such as standard setters, regulatory officials, and anticorruption groups.

The usual compliance tool kit is useful for reinforcing certain standards in certain operating environments, but as these examples show, business leaders will need a much more extensive set of tools to improve performance in many of the gap areas identified by our research. It is not enough to establish codes of conduct, oversight structures, reporting processes, and disciplinary systems. Managers also need to examine core aspects of the business and the operating environment and craft a performance-improvement plan that is tailored to those specifics using the full range of management tools at their disposal—from product, process, and plant design to employee training, development, and motivation; marketing strategy; external relations; and community engagement. Leaders must change the context within which people are working. To do so, they will need to go well beyond the activities performed by the typical compliance and ethics function.

Revise Your Mental Model

Many executives who are serious about business conduct view the challenge with the legalistic mentality that informs most compliance programs. This mentality is characterized by binary categories—ethical versus unethical, compliant versus noncompliant, legal versus illegal—that leave little room for degrees of performance or gradual improvement. It focuses on standards requiring or prohibiting actions that can be readily specified in advance, such as rules against bribery, insider trading, or collusion among competitors. Executives in this camp sometimes pride themselves on having zero tolerance for unethical behavior or for insisting that ethics are nonnegotiable; compliance must be immediate, and it must be complete.

Although compliance thinking and zero tolerance have their place, our research underscores the need for business leaders to see a profile of corporate conduct that is *broad, dynamic,* and *affirmative.*

By *broad,* we mean including not just "Thou shalt not..." but also the standards that have traditionally been called "imperfect duties." Unlike legalistic standards that require specific acts or omissions, imperfect duties allow for a significant degree of freedom in how they may be satisfied. Consider, for example, the codex standards on respecting employee dignity and on fair treatment of minority shareholders. The actions required to meet those standards cannot be easily stated in generic, auditable terms. A full third of the codex standards are of this indefinite type. (One-third are definite, and one-third are of a mixed character.) We found that in general, gaps are larger for indefinite than for definite standards. Indeed, among the largest gaps revealed in our multinational surveys, about half were associated with standards that are indefinite or mixed in nature—for example, providing employees with fair compensation, protecting the environment, helping employees develop skills and knowledge, and, among emerging-market respondents, cooperating with others to eliminate bribery and corruption. A company stuck in a compliance mind-set may be patrolling violations effectively while missing out on crucial opportunities to upgrade its performance in these ethical areas.

By *dynamic,* we mean capturing how performance shifts over time. As macroeconomic and industry conditions change, the pressures and opportunities that shape individual and company conduct also change. Periodic assessments of how the company is performing on the codex standards are crucial for spotting emerging risks and opportunities.

By *affirmative,* we mean treating ethics as goals to strive for rather than just lapses to avoid. Business leaders will need to think in terms of continuous improvement as they seek to create the conditions and institutions necessary to support adherence to the whole range of codex standards across differing operating contexts.

A broad, dynamic, and affirmative approach to managing business conduct represents a new way of looking at corporate ethics. For companies to foster this new way, a corporate-conduct dashboard may prove essential. Using data gathered with the codex assessment tool, managers can provide a snapshot of the company's performance on key indicators to make conduct issues across the organization visible to business leaders. The data can be aggregated in various ways. For instance, they can be organized to show the extent to which employees support the "should" consensus or how employees rate the company's performance on ethical principles or responsibilities to stakeholders.

The dashboard can also convey the largest gaps as seen by employees across the company and within different business units, regions, functions, and hierarchical levels. Depending on how the data are analyzed, it can allow for more-granular comparisons of gaps for particular standards—or topic areas—across various geographies and business units. For instance, results for the cluster of standards relating to the environment can be aggregated, and an indicator for environmental issues in different regions can be included in the dashboard.

A CODEX dashboard is only the beginning of a conversation. To understand what accounts for the findings that it captures, managers and directors will need to look beneath the surface and to interpret the indicators with care and judgment in light of other facts and data. Still, a codex dashboard can help executives shift from what they sense to what systematic data reveal and from a compliance-oriented review of hotline usage, investigations, and disciplinary actions to a more holistic examination of the company's overall performance on critical standards. Instead of debating whether a spike in reported cases is good (because it shows that employees are not afraid to use the reporting system) or bad (because misconduct is, in fact, escalating), business heads and board members can focus on where the threats and opportunities may lie and how the company can achieve its conduct goals.

With an enriched tool kit and new ways of thinking, business leaders can, we hope, improve their companies' ability to perform to the standards increasingly expected of multinationals the world over. We think that doing so is crucial for maintaining the public's trust in business and the free-market system.

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