

Ethical Culture Building: A Modern Business Imperative

RESEARCH REPORT



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In response to the feedback gathered in the ECOA 2006 Member Survey, we have accelerated efforts to provide top-line research to all our members. As part of our new research agenda, we are pleased to present the enclosed report, **Ethical Culture Building: A Modern Business Imperative**.

Developing an ethical organizational culture is more important than ever. The Federal Sentencing Guidelines define an effective compliance and ethics program as one that promotes an organizational culture that encourages ethical conduct and a commitment to compliance with the law. We know that many of our members struggle with the issue of developing an ethical culture and often lack tangible advice and evidence needed to achieve that goal. The enclosed report will serve as an invaluable guide in defining, building, and assessing an ethical culture in addition to demonstrating the relationship between workplace culture and legal compliance.

We hope **Ethical Culture Building: A Modern Business Imperative** will prove to be a valuable tool for you and your colleagues. Tapping the research alliance the ECOA formed with the Ethics Resource Center last year, we plan to produce many more research projects on the issues that concern our members most.

Please note that this report and other new research provided to our members, often at no charge, is supported by donations to the ECOA Foundation. If you or your company would like to support a specific research project or provide general support to ECOA Foundation projects, please contact Keith Darcy, executive director, at 781-647-9333. Opportunities to support the foundation occur at all levels; we are eager to give you more information on ways to become involved.

The ECOA Foundation and Board of Directors extend their appreciation to ERC for the research, development, and writing of this report.



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Executive Summary

An ethics program that exists on paper but never in the hearts, minds, and actions of the organization's employees creates a breeding ground for violations. Learning a lesson from the ethics scandals that have toppled many once-great companies, legislators and regulators have begun holding business leaders accountable for not only ensuring that they have the appropriate mechanisms in place (the ethics program), but also to ensure that they have created the appropriate culture. Legislation such as the Sarbanes-Oxley Act and the revisions to the Federal Sentencing Guidelines for Organizations have set a new standard for organizations: there will be consequences for organizations that are not conscious about the type of culture they develop.

“There will be consequences for organizations that are not conscious about the type of culture they develop.”

Business leaders have thus been handed a heavy responsibility, but one for which they are especially well suited. Leaders have the power to shape the culture of their organizations. What is needed in the business world is a better understanding of what ethical culture means and how business leaders can make the most impact.

The goal of this paper is to highlight key concepts and important findings from the existing body of research on ethical culture. The first section presents two distinct but related concepts: ethical culture and ethical climate. Next, ways in which ethical climate and ethical culture impact organizations and the behavior of employees are examined. In the third section, the origins of ethical culture and climate are explored and a deeper understanding of the role of leadership is gained. Finally, there is a discussion of strategies for leaders to improve and manage ethical culture and climate in their organizations.

What Is “Ethical Culture?”

What is generally referred to as “ethical culture” is actually a concept that integrates two distinct systems—ethical culture and ethical climate. It is imperative to take an in-depth look at both systems in order to fully understand “ethical culture.”

Ethical Culture

Ethical culture looks (anthropologically) at how an organization demonstrates and teaches the extent to which it regards its values. Specifically, the ethical culture of an organization:

- teaches employees whether doing the right thing matters;
- makes doing what is right expected; and
- includes formal ethics program elements, reward and punishment systems, and organizational myths.

Ethical Climate

Ethical climate is concerned with the “collective personality” of the organization. It is the psychological view of the organization. Ethical climate particularly focuses on:

- ethics-related attitudes,
- perceptions, and
- decision-making processes in an organization.

What Is the Impact of Ethical Climate and Culture?

In organizations where the formal and informal structures—derived from the ethical climate and culture — encourage ethical behavior, employee behavior will be more ethical. Specifically, ethical climate and culture impact the following:

- Employees' organizational commitment;
- Employee satisfaction;
- Rates of misconduct;
- Employees' perceptions of leadership;
- Employee performance; and
- Organization's expenses.

Furthermore, the effects of the ethical climate and culture on ethical behavior are even supported across cultures.

How Do Ethical Cultures and Climates Form?

Both ethical culture and climate are subsets of the larger organizational culture/climate and as such, are influenced by the factors that shape the organization overall. In particular, ethical culture and climate are formed through:

- The organizational life cycle;
- The organizational leaders' beliefs and actions; and
- The formal and informal organizational mechanisms.

What's a Leader to Do?

Leaders should work to create a values-based ethics program that also encourages compliance with the law. Additionally, they must demonstrate their concern for the interests of internal and external stakeholders and commit to making the needs of others a business priority (Trevino, et al., 1999). Finally, they must remember that ethical leadership requires modeling, coaching, and careful communication. In order to demonstrate their commitment to ethics and to promote ethics in the culture and climate of their organization, leaders should:

- walk the walk;
- keep people in the loop;
- encourage thoughtful dissent;
- show them that you care;
- don't sweep problems under the rug;
- celebrate the successes;
- be fair;
- make ethics a priority;
- make the tough calls; and
- get the right people, and keep them.

Ethical commitment must not be just platitudes and plaques. As both research and experience prove, ethics programs that serve merely as "window dressings" do no good—and may even be harmful. In order to ensure a positive ethical climate and culture, we must develop and implement performance objectives related to this critical organizational task. A holistic approach to ethics assessment and evaluation involves several elements:

- performance evaluations;
- baseline assessment; and
- regular re-assessment and benchmarking.

Conclusion

Maintaining a strong ethical culture is essential for complying with the laws and regulations, but this alone cannot be the motivation for ethical culture building. Beyond the large impact an organization's culture has on the bottom line, the development of programs to foster ethical conduct must maintain a focus on fairness, encouragement, and communication at all employee levels. Along these lines, employees must be given the appropriate tools and models to align their behavior with company culture and engage in ethical decision-making.

The attitudes, choices, and actions of business leaders play a primary role in the creation of an organization's ethical culture and climate; expectations for employees' ethical behavior can only be set as high as the organization's leadership is willing to meet. A leader's ability to consistently promote ethical conduct in an organization is critical to ensuring that employees understand how to make "doing what is right" a priority.

Introduction

Largely because of technology, business now moves more quickly than ever before. There is greater access to information and there are more frequent mergers and acquisitions. The structure of organizations also allows for greater creativity and innovation; employees have more independence and management is less hierarchical. All of these increase potential for extraordinary, new developments at an unprecedented rate.

“There is no such thing as a value-less organization.”

Unfortunately, the factors and structures that facilitate this exciting progress are the same ones that make today’s business environment so dangerous (Soule, 2005). “Contemporary operating conditions do not cause unethical conduct, but they make it far more difficult to prevent and considerably more punishing when it does occur” (Soule, 2005, p. 6). Freeing employees to optimize their potential can lead to more troublesome misconduct because greater freedom means greater possibility for abuse. Meanwhile, a less hierarchical structure makes oversight more difficult. As noted in Edward Soule’s white paper developed by the Business-Higher Education Forum, “*Enron revealed something disconcerting about today’s organizational setting: a relatively small band of pirates can plunder in ways that used to require military force*” (Soule, 2005, p. 22).

Control functions will never be able to keep up with individuals’ ability to find loopholes; audit alone could never—and will never—be enough (Soule, 2005). But there is hope. “With a function akin to the immune system, organizations with strong ethical cultures tend to self-correct from errant misbehavior and fortify against future encroachments... [because] members ‘get it under their skin’ that they are working at... a place where personal integrity, ethics, and playing by the rules really matter” (Soule, 2005, p. 6). The contemporary business environment *requires* that we pay attention to ethical culture. Ethical culture building must be a key component of every organization’s compliance and risk management strategy.

Whether or not proactive steps are taken to develop and maintain an ethical culture, one will form; there is no such thing as a value-less organization. In the absence of intentional efforts to create a positive ethical culture, the broader business environment will fill the void, resulting in a culture most focused on self-interest, which leads to increased misconduct and lower organizational commitment. “In order to balance the influences of this broad self-interested business environment, individual firms must create a sub-context in which moral values other than egoism are encouraged and rewarded” (Trevino, Butterfield & McCabe, 2001, p. 334).

Good Ethics, Good Business

Giving care and attention to an organization’s ethical culture also makes good business sense. To protect themselves from more substantial fines and penalties, organizations should adhere to the guidelines of the United States Sentencing Commission, which direct organizations to “promote an organizational *culture* that encourages ethical conduct and a commitment to compliance with the law” [USSC §8B2.1(a)(1)].

“Giving care and attention to an organization’s ethical culture also makes good business sense.”

In addition to avoiding or reducing punishments, research proves that companies committed to high ethical standards reap the benefits. In Texas, the Austin City Auditor’s Office examined the ethical culture of city departments and successfully documented the fiscal benefits of a strong organizational commitment to ethical conduct. Specifically, the audit found evidence that fiscal and administrative benefits, such as cost reduction and performance, were directly and positively related to stronger ethical climates and cultures (Waring, 2004).

Further research shows that a strong ethical culture creates a happier, healthier organization. Critical studies (Trevino, Weaver, Gibson & Toffler, 1999; Trevino, et al., 2001, Ethics Resource Center, 2005¹) connect positive, ethical cultures to:

- lower rates of observed misconduct;
- reduced pressure to compromise standards;
- increased reporting of misconduct to leadership;
- greater satisfaction with management’s response to misconduct;
- greater satisfaction with the organization as a whole;
- lowered exposure to situations inviting misconduct; and
- increased sense of preparedness to handle situations inviting misconduct.

¹ A follow up research report analyzing the 2005 NBES data, “Critical Elements of an Organizational Ethical Culture,” published by ERC in partnership with Working Values, makes the connection between cultural factors and positive outcomes. For example, the study links certain ethics-related actions to being 26% less likely to observe at least one form of misconduct and 14% more likely to be satisfied with the organization.

Think for a moment about the impact of these connections. The relationship between ethical culture and satisfaction, for example, is not surprising; it makes sense that employees are more engaged and want to work in places that don't undermine or ask them to ignore their personal values. Now, consider the business implications of this relationship. It is estimated that *80% of employees leave their jobs because of poor management practices or toxic cultures*. Imagine how an improved ethical culture can enhance an organization's retention rate, allowing it to hold on to valued employees (Wellspring, 2006).

Research reveals that the culture of a company, even more than structural components, drives how employees conduct themselves. The ethical dimension of a company's culture, therefore, has a strong influence on the extent to which employees adhere to organizational standards and align their work with the core values and vision of the organization. A strong, ethical culture is essential for complying with laws and regulations, increases productivity and employee retention, and serves as the foundation for an enduring, successful company.

Also, ethical culture teaches employees how to "do the right thing." Research demonstrates that 86% of *managers* act at work based on moral standards that they perceive in their workplace [emphasis added] (Weber, 1998, as cited in Soule, 2005, p. 25). People want to do what is right and they want to be "normal"—with "normal" being defined by the standards, beliefs, and attitudes of those around them. Even those who come in to work with strong character and an ethical compass need guidance and support:

No matter how strong their values, employees can not be expected to be naturally familiar with all of the laws and regulations that pertain to their work. Nor can they be expected to be automatically aware of the ethical ambiguities that they might face in a particular industry or position. However if employees are aware of relevant ethical and legal issues, they will be more likely to ask the right questions and ultimately do the right thing when faced with a dilemma. Many people do the wrong thing simply because they are unaware—they don't know that they should be concerned or ask for help. (Trevino, et al., 1999)

A strong, ethical culture is essential to meeting both society's expectations of business and business objectives. The importance of ethical culture needs to probe several key questions:

- What is "ethical culture?"
- To what extent does ethical culture impact employee behavior and in what ways?
- How are ethical cultures created?
- How can companies promote more ethical workplace cultures?

A substantial body of research explores these questions. This paper will highlight key concepts and important findings from research. The first section presents two distinct but related concepts: ethical culture and ethical climate. Next, ways in which ethical climate and ethical culture impact organizations and the behavior of employees are examined. In the third section, the origins of ethical culture and climate are explored and a deeper understanding of the role of leadership is gained. Finally, there is a discussion of strategies for leaders to improve and manage ethical culture and climate in their organizations.

What Is "Ethical Culture?"

What is generally referred to as the ethical culture of an organization actually involves two distinct, yet interrelated, systems—ethical culture and ethical climate. The field of *ethical culture* is grounded in an anthropological worldview and, as a result, focuses on the formal and informal systems that influence behavior. On the other hand, the study of *ethical climate* is derived from psychology, and this seeks to investigate the collective "personality" of the organization. Although these two bodies of research originated from different disciplines, both examine the same broad concept: promoting ethical conduct in organizations.

"Ethical culture teaches employees *how* to do the right thing."

Ethical Culture

Clifford Geertz, a prominent theorist in the field of anthropology, defined culture as "an historically transmitted pattern of meanings embodied in symbols, a system of inherited conceptions... by which [people] communicate, perpetuate and develop their knowledge... and attitudes" (1973, p.5). Essentially, culture is non-biological inheritance. Parents' genes pass along brown eyes and dimples but, for example, the words and actions of caregivers shape children's understanding. Culture teaches children which behaviors garner social approval, how to react to strangers, whether to care about others' needs or merely their own, and so on. The essence of culture unifies values and priorities that both flow from and reinforce those values.

The literature on ethical culture developed out of the concept of organizational culture, which in turn developed out of the study of societal culture. Like societies, organizations develop their own cultures. In the workplace, everyday actions and decisions are laden with meaning; we learn what is valued and show what we value by our words and our actions.

Consider something as simple as the employee coffee break. In one organization, coffee breaks take place at appointed times, for a predetermined duration, and in a single, designated location. In another company, employees never take formal breaks and, instead, grab coffee and engage in chatty conversation in the halls throughout the day. Both organizations may have written policies regarding coffee breaks or maybe neither does, but either way it is clear that there is a “way things are done around here.” Do things the “right” way and you will be deemed responsible and respectful or friendly and collegial. On the other hand, employees who, even unintentionally, violate the culture may be deemed a lazy slacker or an aloof snob. Such judgments—based initially only on coffee break missteps—can eventually lead to the ostracization or even discipline of the culturally unaware employee. *When it comes to culture, perception creates reality.*

What then is “ethical” culture? Essentially, it is the extent to which an organization regards its values. Strong ethical cultures make doing what is right a priority. *Ethical culture is the (often unwritten) code of conduct by which employees learn what they should think and do* (ERC, 2005). The ethical culture of the organization communicates acceptable limits, how employees ought to treat others, whether it is acceptable to question authority figures, if it is safe to report observed misconduct, and the importance of compliance with controls and safeguards (ERC, 2005; Trevino in Soule, 2005). Linda Trevino, a leading scholar in the study of ethical culture, notes that ethical culture determines “how employees understand what is expected of them, and how things really get done” (Trevino, et al., 1999).

Ethical Climate

Stemming from the field of psychology, ethical climate is concerned with the “collective personality” of the organization. Ethical climate literature investigates the *ethics-related attitudes, perceptions, and decision-making processes* in an organization. Ethical climate includes several dimensions: self-interest, company profit, efficiency, friendship, team-interest, social responsibility, personal morality, rules and standard operating procedures, and laws and professional codes (Trevino et al., 2001). Just as ethical culture can be viewed as a subset of organizational culture literature, ethical climate is an outgrowth of work done on organizational climate.

The dominant theory of ethical climate was created by Victor and Cullen (1987, 1988), and most research to date has investigated the ethical climate of organizations using this theory and its measure, the Ethical Climate Questionnaire. Victor and Cullen’s theory is based on the assumption that *employees form collective perceptions of ethical events, ethical practices, and ethical procedures*. These collective perceptions depend on the ethical criteria used for organizational decision-making and the loci of analysis used in that decision-making process. In essence, they examined the answers to two questions:

1. What is the priority when making a decision: self-interest, joint or social interests, or universal ethical principles?²
2. Whose interests are considered when making a decision: oneself only, the group/organization, or humanity and society?

By multiplying the three ethical criteria³ (question 1) by the three loci of analysis⁴ (question 2), Victor and Cullen theorized that nine different ethical climate types existed. Additional research suggests five ethical climate types actually exist in organizations. It should also be noted that most organizations combine a number of different climates and there can also be subclimates by departments (Weber, 1995, as cited in Trevino, et al., 2001).

Victor and Cullen’s theory is not the only way of explaining and examining ethical climate. Vidaver-Cohen (1995/1998) proposed that the ethical climate of the organization can be more or less conducive to ethical behavior depending on where the ethical climate falls along a “*moral climate continuum*.” At one end of the continuum is the most ethical climate, where organizational norms always promote moral behavior, and at the other end of the continuum is the most unethical climate, where organizational norms never promote moral behavior. According to this theory, five dimensions define the ethical climate:

1. The prevailing norms for selecting organizational goals (goal emphasis);
2. How organizational goals should be attained (means emphasis);
3. How performance is rewarded (reward orientation);
4. How resources are allocated to perform specific tasks (task support); and
5. The type of relationships expected in the firm (socioemotional support).

² Their three *ethical criterion dimensions* coincide with different stage of cognitive moral development as defined by Lawrence Kohlberg. Although Kohlberg identified six stages, Victor and Cullen utilize his broader pre-conventional, conventional, and post-conventional typology. See Kohlberg (1967) for information about the levels of cognitive moral development.

³ Referred to by Victor and Cullen as egoistic, benevolence, and principled, respectively.

⁴ Referred to by Victor and Cullen as individual, local, and cosmopolitan, respectively.

According to this theory, an organization with a positive ethical climate takes a socioeconomic perspective and observes communitarian principles. These principles affect and are affected by political, technical, and cultural organizational processes, such as:

1. Equitable power distribution, democratic decision processes, and a stakeholder-oriented strategy (political processes);
2. Socioeconomic production and an integrated structure (technical processes); and
3. Formalized attention to moral concern and an informally reinforced moral perspective (cultural organizational processes).

More recently, Arnaud and Schminke (under review) have investigated ethical culture using a psychological process model. Essentially, this model assumes that organizations form collective personalities and, as a result, when it comes to moral situations, go through the same process⁵ an individual would. This model focuses on four dimensions of ethical climate:

1. Collective moral sensitivity: being aware of moral situations
2. Collective moral judgment: deciding the moral course of action
3. Collective moral motivation: caring about doing what is moral
4. Collective moral character: acting upon moral judgment and commitment by doing what is right.

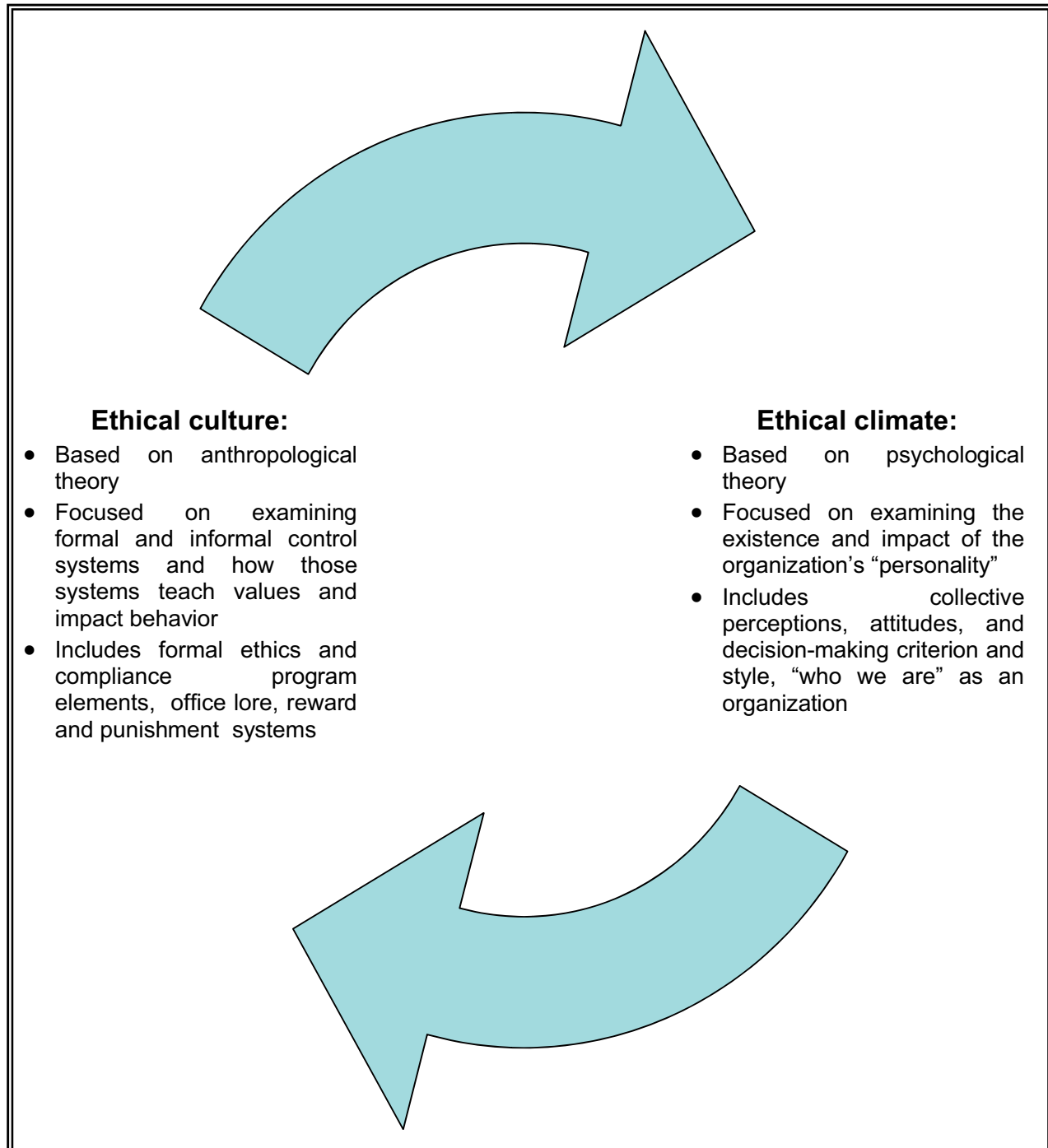
Ethical Culture and Climate: How They Interact and What Makes Each Unique

It makes sense in everyday situations to refer to the ethical commitment of an organization as its “ethical culture.” However, as we have seen, ethical climate research and ethical culture research are distinct fields of study. As described by Trevino, et al., (2001), ethical climate refers to the “broad normative characteristics and qualities that tell people what kind of organization this is—essentially what the organization values...” (p. 308). On the other hand, ethical culture includes “formal and informal control systems (e.g. rules, rewards, and norms) that are aimed more specifically at influencing behavior” (Trevino, et al., 2001, p. 308). While there is obviously a great deal of overlap and similarity between ethical climate and culture, these two facets of the ethical life of organizations remain distinct. Figure 1 portrays how the two interact and includes brief descriptions of each.

⁵ Arnaud and Schminke’s model extends James Rest’s Four-Component Model from the individual to the organization. For more on this theory, see Rest (1986).

⁶ The descriptions in Figure 1 draw from definitions posed by Trevino & Youngblood (1990) and ERC (2005). Formal programs include: a code of conduct/ethics, training, discipline for misconduct, anonymous mechanisms for reporting, vehicles to seek advice about ethics issues, and ethics evaluation as a component of employee reviews.

Figure 1. Interaction between and Qualities of Ethical Culture and Ethical Climate⁶



What Is the Impact of Ethical Climate and Culture?

“Culture helps to establish what is considered legitimate or unacceptable in an organization. Whether defined as an informal organizational control system... or an instrument of domination, organizational culture is thought to provide direction for day-to-day behavior” (Trevino, et al., 2001). Employee behavior is expected to be more ethical when both formal and informal elements of the ethical culture promote ethical conduct. Ethical conduct is most prevalent in organizations where leaders and norms encourage and support ethical conduct and where ethical conduct is rewarded and unethical behavior is punished.

“Culture helps to establish what is considered legitimate or unacceptable in an organization.”
(Trevino, et al., 2001)

In 2005, the ERC conducted the National Business Ethics Survey® (NBES), a telephone survey of over 3,000 employees living in the United States. The 2005 NBES revealed that ethical culture is closely linked to ethical outcomes, especially in organizations that already have a strong culture⁷. As a part of the survey, ERC asked respondents about ethics-related actions (ERAs), for example:

- Whether top management communicates ethics as a priority;
- Whether middle management sets a good example of ethical conduct;
- Whether supervisors keep commitments;
- Whether coworkers support following organizational standards; and
- Whether all management levels are held accountable to the standards of the organization.

Its findings demonstrate that there is a relationship between ethical culture and outcomes:

- Where management displays more ERAs, there are fewer instances of observed misconduct;
- Where management displays more ERAs, there is less pressure to compromise ethical standards; and
- Where management displays ERAs, there is increased reporting of misconduct that has been observed.

A Trevino, et al., (1999) study also demonstrated the profound impact ethical culture has on ethical behavior. They surveyed 10,000 employees at all levels from six large U.S. companies in order to investigate the relationships between ethics program types⁸, formal and informal ethics program elements⁹, loci of organizational focus¹⁰, and seven outcomes relevant to effective ethics/compliance management:

1. Extent of unethical/illegal behavior;
2. Employee awareness of ethical/legal issues that arise at work;
3. Amount of ethics/compliance advice sought within the company;
4. Willingness to deliver bad news to management;
5. Observed ethics/compliance violations which were reported in the organization;
6. Perception that there was better decision making in the company because of the ethics/compliance program; and
7. Employee commitment to the organization.

⁷ Findings from the 2005 NBES suggest that formal ethics and compliance program elements do have an impact because they shape the culture. That being said, programs elements are less significant than culture and their significance seems to decrease over time as the culture becomes embedded.

⁸ Trevino, et al., identified four ethics program types: value-based, compliance focus, external stakeholder focus, or focus on protecting top management.

⁹ Formal and informal ethics program elements included: having a code, ethics as a part of formal performance evaluation, perception that company works hard to detect violators, perception that company follows up on ethical concerns raised by employees, perception that there is consistency between ethics/compliance policies and actual organizational practices, leadership (both supervisors and executive management), reward and punishment systems, perceived fairness, ethics as a topic of conversation in the organization, and perceived demand for unquestioning obedience to authority.

¹⁰ The three loci of organizational focus included perceived organizational focus on employees, community, or self-interest.

¹¹ In this case, leadership refers to all forms of leaders from executive to managers and supervisors. According to this study, “Employees paint all leaders with the same broad ethical brush. When it comes to ethics, leaders are leaders...” (Trevino, et al., 1999, p. 142).

¹² The non-code respondent category includes both those whose organizations lacked a code and those whose organizations have a code which was unknown or forgotten.

¹³ Positive climates include those focused on independent decision-making, care for employees and/or the community, and/or legal or professional standards.

Their research revealed that static, formal program elements (e.g., a code and ethics officer) had a far less significant impact on outcomes than employees' perceptions about leadership, consistency, and follow-through, as well as the rationale for the ethics program. Although several factors had an impact on all outcomes, a few emerged as being the most powerful, especially in terms of misconduct:

- Leadership¹¹;
- Perceptions about fairness;
- Perception that ethics is discussed in the organization;
- Perception that ethical behavior is rewarded;
- Perception of expectation of unquestioning obedience to authority (negative impact); and
- Focus on self-interest rather than concern for employees and/or the community (negative impact).

A more recent study by Trevino, et al., (2001), using a questionnaire sent to alumni of two colleges, examined both ethical climate and culture. Table 1 summarizes these findings. As illustrated below, they learned that, *when respondents indicated that they had a code of conduct, the ethical culture of the organization was a better predictor of behavior; however, ethical climate was the more critical predictor for non-code respondents*¹². For code-organization respondents, the most significant climate factor was self-interest and the most critical ethical culture dimensions were the overall ethical environment and the perceived requirement for obedience to authority. For non-code respondents, a climate focused on self-interest was the most significant variable (negative correlation), but the climate focusing on legal and professional standards (positive correlation) also impacted misconduct rates.

In terms of organizational commitment, ethical climate and ethical culture proved to be almost interchangeable in ability to predict employee attitudes. Trevino, et al., (2001) discovered that the most critical factors for employee commitment are overall ethical environment (the most consistent variable), demand for unquestioning obedience to authority, an employee-focused climate, and community-focused climate. For non-code respondents, a climate of self-interest also had an impact (negative relationship) as well.

Other studies have yielded similar results. Joseph and Deshpande's (1997) study examined the impact of ethical climate types on different aspects of job satisfaction using nurses in a large non-profit private hospital. They discovered that positive climate¹³ significantly influenced job satisfaction and satisfaction with pay, promotion, and supervisors. A 1994 study conducted by Wimbush and Shepard revealed that positive climates lead to more ethical behavior and positive organizational performance, while egoistic climates are linked to unethical behavior and poor organizational performance. These findings are confirmed by a later study (Peterson, 2002) involving 700 business school alumni that assessed the effect of the various ethical climate types on twelve different unethical behaviors and again linked positive climates to lower misconduct and negative climates to increased misconduct.

Table 1. Summary of Analysis of Impact of Ethical Culture and Climate

	Organizations with a code of conduct	Organizations with a code of conduct
Which is the better predictor of behavior?	Ethical culture	Ethical climate
Most significant ethical culture dimensions and ethical climate factors	<ul style="list-style-type: none"> • Overall ethical environment • Demand for obedience to authority (negative impact) • Egoistic climate grounded in self-interest (negative impact) 	<ul style="list-style-type: none"> • Egoistic climate grounded in self-interest (negative impact) • Climate that emphasizes importance of the law and professional standards
Factors impacting employee commitment	<ul style="list-style-type: none"> • Overall ethical environment • Demand for unquestioning obedience to authority • Benevolent climate focused on interests, needs, and well-being of employees • Benevolent climate focused on interests, needs, and well-being of the community 	<ul style="list-style-type: none"> • Overall ethical environment • Demand for unquestioning obedience to authority • Benevolent climate focused on interests, needs, and well-being of employees • Benevolent climate focused on interests, needs, and well-being of the community • Egoistic climate grounded in self-interest (negative impact)

Furthermore, the effect of the ethical climate and culture on ethical behavior remains consistent across cultures. Studies in the United States and in Taiwan (Schwepker and Hartline, 2005; and Shih and Chen, 2006) have also linked positive ethical cultures to reduced role conflict, which increases job satisfaction and employees' commitment to quality. For example, both a cross-cultural study using Israeli metal production plant employees (Vardi, 2001) and Deshpande, George, and Joseph's (2000) study of Russian managers yielded results similar to each other and to U.S. research.

As we have already seen, ethical climate and culture impact organizational commitment, employee satisfaction, and rates of misconduct. We should keep in mind that the organization's ethical climate and culture also impact the bottom line. Recall the findings of the Austin City Auditor's Office that revealed fiscal benefits resulting from organizational commitment to ethical conduct. Similarly, in a cross-cultural study involving U.S. and Mexican salespersons, researchers found a consistent positive relationship between ethical climate and performance (Weeks, Loe, Chonko, Martinez, & Wakefield, 2006). On the other hand, less ethical climates and cultures have specific costs, including more damage claims, complaints, lost-time injuries, and sick leave usage (Waring, 2004).

How Do Ethical Cultures and Climates Form?

With a better understanding of ethical climate and culture and an appreciation for their importance, it is appropriate to move toward investigating their origins and set the stage for the discussion of strategies that can be used to nurture and sustain the ethical climate and culture of an organization. As seen previously, ethical climate and culture can be described as a subset of the overall organizational culture. Therefore, in thinking about the development of ethical climate and culture, it is helpful to note that an organization's culture emerges via the following processes:

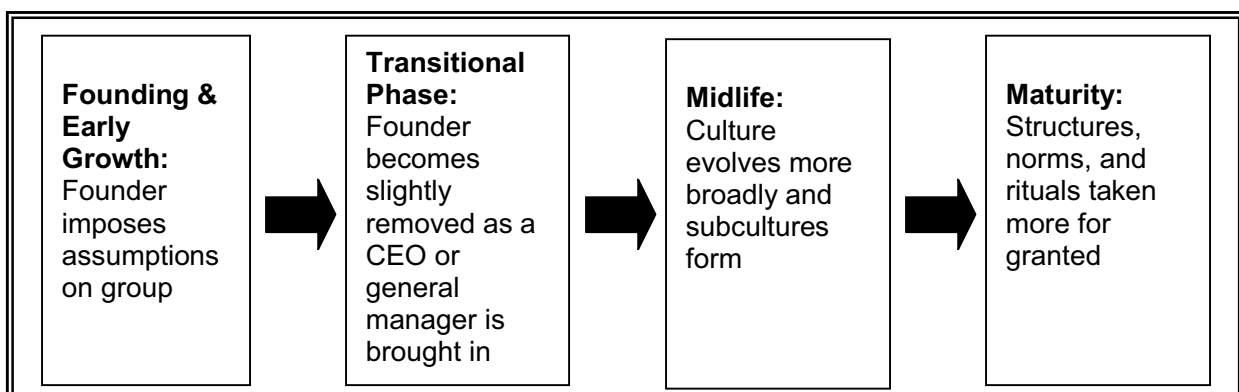
“The actions, words, and decisions of leaders set the tone in the organization.”

- (1) Influence of founders and leadership (Schein, 1992); and
- (2) Organizational structures and socialization processes, which teach employees what is appropriate behavior in a particular setting and create a collective understanding of values, practices, and procedures related to ethics (Schneider and Reichers, 1983).

Leadership and the Organizational Life Cycle

The leader and the leader's role in the organizational culture change over time, as illustrated in Figure 2 (below). According to Edgar Schein (1992), the leader in organizational culture research, during the initial stages of an organization, the founder has almost total influence on the culture. It is his or her assumptions that determine the hiring of employees and shape what the organization stands for, its goals, and its behavioral norms. Over time, the influence of a single leader becomes diffused as various forms and kinds of leadership develop in the organization. Rather than leadership denoting a single individual, “leadership” refers to anyone in a position of power or authority.

Figure 2. Leadership and the Organizational Life Cycle



How Leadership Embeds Culture

The actions, words, and decisions of leaders set the tone in the organization. What they choose to care about and ignore makes a difference. Both the decisions they make and *how* they make those decisions has an impact on the context of the organization. Leaders have to communicate with the rest of the organization, explicitly or implicitly, but managing the communication is up to each individual leader (Schein, 1992).

Leaders sets priorities and creates a context by what they say and, more importantly, by what they do:

- How they react during (perceived) crises;¹⁴
- How they allocate resources;
- Their role modeling and coaching;
- What behavior they choose to reward and punish; and
- Their hiring, retention, promotion, and dismissal of employees—and the criteria they use for each.

One of the most powerful mechanisms that founders, leaders, managers, or even colleagues have available for communicating what they believe in or care about is what they *systematically* pay attention to (Davidson, 2006). This can mean anything from what they notice and comment on to what they measure, control, reward, and in other ways deal with. In addition, the types of questions they ask, how they set the agendas for meetings, and their emotional reactions also communicate their beliefs. Leaders can choose to be systematic, which is a powerful way of communicating a message—especially if they are totally consistent in their own behavior. The manner in which leaders and others deal with everyday decisions and with crises creates norms, values, and working procedures and reveals important underlying assumptions. As noted in several studies (Trevino, et al., 1999; Trevino, et al., 2001; and ERC, 2005), the actions, attitudes, and choices of leaders have a profound impact on the organization's ethical culture.

Leadership, Ethical Climate, and Ethical Culture

The ethical standards and values of business leaders are critical because they establish and enact the goals, policies, and practices that provide environmental cues, and thus play the primary role in the creation of the organization's climate and culture related to ethics. For almost all of the ethical climate types¹⁵, the ethical climate of the organization can be understood as an outgrowth of the personal values and motives of organizational founders and other early leaders. Research (Schminke, Ambrose & Neubaum, 2005) indicates that the relationship between leader moral development and ethical climate depends on the extent to which the leader utilizes his or her cognitive moral development (i.e., capacity for ethical reasoning). The influence of the leader's moral development seems to be stronger for those leaders whose moral actions are consistent with their moral reasoning, and, consistent with the organizational life cycle, the leader's moral development has a stronger influence in younger organizations (Schminke, et al., 2005).

The 2005 NBES also demonstrates the critical role of the leader in shaping an organization's ethical climate and culture. As noted above, the 2005 NBES measured the impact of several ethics-related actions (ERAs) on ethical outcomes and the ethical culture of the organization. Although ERAs by all management levels were met with more favorable outcomes, ERAs of top management had the most profound connection to favorable outcomes (see Table 2):

The organization's leaders have the primary role in communicating and demonstrating the true importance of ethical values to the organization's members. The actions of leadership send a clear message and, as a result, are a key factor in the development of an ethical value system. Leaders' daily decisions and actions communicate whether ethical behavior is a priority on par with other desired business outcomes.

¹⁴ Crises are particularly significant in terms of their impact on culture because the heightened emotional involvement during such periods increases the intensity of learning (Schein, 1992).

¹⁵ For the independence ethical climate type, the leader's influence is actually weaker initially and becomes more profound with time.

Table 2. Relationship between ERAs and Ethics Program Outcomes

Specific Outcomes of an Ethics Program	Observed Zero (0) ERAs	Observed 4 ERAs
Observed misconduct	87%	37%
Reporting observed misconduct	48%	64%
Satisfaction with reporting	8%	84%
Exposure to risk	66%	25%
Prepared for risk	46%	93%
Pressure to violate code	38%	4%

Formal and Informal Mechanisms that Shape Ethical Climate and Culture

Management-initiated control mechanisms and informal, employee-initiated control mechanisms shape the organization's ethical climate and culture by communicating which behaviors, decisions, and attitudes are rewarded and, therefore, considered desirable. Research reveals that formal controls, including enforcement of ethical codes and punishment for ethical violations, and informal controls, such as discussion of ethics and ethical climate, are vital to controlling ethical behavior and engendering proper employee perceptions and job responses (Schwepker and Hartline, 2005). Structural characteristics, including organizational policies and procedures, directly impact the emergence and change of ethical climates (Wimbush and Shepard, 1994) and affect the attraction, selection, and attrition of employees, further defining "what is/isn't done around here." As employees interact, they develop a collective understanding of the organization's values, practices, and procedures related to ethics. When new employees join the group, the ethical climate and culture are transmitted to them, perpetuating and strengthening that climate and culture.

What's a Leader to Do?

Research reveals several salient factors that shape the ethical climate and culture of an organization, including:

- Leadership's decisions and actions, especially in terms of promise-keeping and the decision to keep employees well-informed;
- Reward systems;
- Perception that the interests of employees and the community are a priority;
- Perception that there is a demand for unquestioning obedience to authority; and
- Example set by leadership, supervisors, and coworkers.

"Leaders should work to create a values-based ethics program."

Also, the development of ethical culture involves related processes and influences: founders and leadership, and organizational structures and socialization. As a result, it is much easier to understand and envision proposed strategies for promoting a positive ethical climate and culture: leadership and systematic management.

Leadership and Management

When it comes to leadership and ethical climate and culture management, the research¹⁶ clearly aligns. All agree that leaders set the tone—through their words and, especially, their actions. Leaders should work to create a values-based ethics program that also encourages compliance with the law. Furthermore, they must demonstrate their concern for the interests of internal and external stakeholders and commit to making the needs of others a business priority (Trevino, et al., 1999). Finally, leaders must remember that ethical leadership requires modeling, coaching, and careful communication.

¹⁶ E.g., Trevino, et al., 1999, the ERC's 2005 NBES, the findings of the Business-Higher Education Forum Ethics Initiative working group (Soule, 2005), and the results of a Trevino, et al., 2001 study.

In order to demonstrate their commitment to ethics and to promote ethics in the culture and climate of their organizations, leaders should:

Walk the walk. Set the stage by setting the example. First and foremost, leaders must demonstrate integrity, model ethical commitment, and set a good example by keeping promises and commitments and adhering to organizational values.

Keep people in the loop. Help employees feel informed and provide information about what is going on. Open communication engenders trust and ensures that your priorities are also your employees’.

Encourage thoughtful dissent. Employees are not drones and shouldn’t get the impression that you think they are. Recognize that it takes courage to question something a leader says or does. Be open to honest questions and valid concerns. Acknowledge and correct your mistakes.

Show them that you care. Employees want to know that leadership thinks about something more than the bottom line. They want to know they you care about their needs and interests, as well as those of your community. Make stakeholder satisfaction a priority and back that up with action.

Don’t sweep problems under the rug. Address problems in a thoughtful manner that’s consistent with your values. Effectively deal with ethical issues that arise and then communicate that you have.

Celebrate the successes. Research shows that the carrot is more important than the stick. Recognize and reward ethical behavior. Ensure that the ethical heroes in your organization receive as much press as the business superstars.

Be fair. For many employees, ethics is synonymous with fairness, so exercise standards consistently and hold all levels of management accountable to the standards of the organization.

Make ethics a priority. Evaluate the extent to which ethics is consistent with your strategic objectives and plans. If ethical-culture building is not already a part of your long-term goals, reshape your strategy to be consistent with ethical ends and means. Be clear, in word and deed, that ethics is as important as meeting budget projections.

Make the tough calls. Demonstrate an unwavering commitment to upholding organizational values—even when it is particularly challenging.

Get the right people on the bus and keep them. Ethical climate and culture influence the ethical commitment and behavior of employees, but it is also true that people shape and transmit the culture and climate. Create and sustain a culture and climate of character by making ethical commitment a priority in hiring and a condition for retention.

Measure to Manage

Although leadership plays an essential role in climate and culture, Soule reminds us that leadership lacks: accountability, specific performance objectives, and assessment (2005). Ethical commitment must be more than platitudes and plaques; as both research and experience prove, ethics programs that serve merely as “window dressing” do no good—and may even be harmful. In order to ensure a positive ethical climate and culture, we must develop and implement performance objectives related to this critical organizational task. Such objectives will communicate the importance of ethics, focus attention on ethics, and allow leaders, managers, and employees to vest responsibility for ethics, so that there is accountability. Additionally, creating and acting upon ethical climate and culture criteria will make it easier to reward ethical conduct, which we know to be a critical element in the development of ethical climate and culture.

A holistic approach to ethics assessment and evaluation involves several elements:

Performance evaluations for individuals, groups, and the organization as a whole. Ethics should be a regular part of performance reviews at all levels. By making ethics goals a strategic, measurable objective, an organization can ensure that ethics is a priority, that there are consequences for ethical failings, and that ethical actions are rewarded. Furthermore, such evaluations will help in assessing the effectiveness of the ethics program.

Baseline assessment of the ethical climate and culture of the organization, which provides insight into the current perceptions of employees and the source of those ideas, ideals, and beliefs. Interviews, surveys, and focus groups will help reveal more about the ethical climate and culture of the organization and provide an understanding of what influences employees’ choices and actions. This will provide the organization with tools necessary to better develop ethics performance objectives and to effectively allocate efforts and resources. Because perceptions about ethics are “rosier at the top” (ERC, 2005), it is important to gather information

from all employee levels, as well as different functions, divisions, and departments. Also, this data should be used as a baseline for longitudinal evaluation to track the organization's progress over time.

Regular re-assessment and benchmarking, which allows an organization to identify new issues and areas of vulnerability. Benchmarking against other organizations will give context to the findings and more meaning to the data. In addition to benchmarking against other organizations, longitudinal comparisons within one's own organization will help in identifying trends and determining whether ethics initiatives are achieving their goals.

Conclusion

Within an organization, ethical culture building is a key component of compliance, risk management, and overall business strategy. The attitudes, choices, and actions of business leaders play a primary role in the creation of an organization's ethical culture and climate. A leader's ability to consistently promote ethical conduct in an organization is critical to ensuring that employees understand how to make "doing what is right" a priority. However, in a time of corporate scandals and less hierarchical management, it has become evident that fostering an ethical culture and an ethical climate within an organization is no simple task. But the challenge should not deter us. It is a noble—and important—endeavor. Ethical culture building is good for employees, for the health of a given organization, and for each company's bottom line. And, quite simply, it is the right thing to do.

"Ethical culture building is good for employees, for the health of a given organization, and for each company's bottom line."

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