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B. Todd Jones, Chairman
Advisory Group on Organizational Guidelines
Office of Public Affairs
United States Sentencing Commission
One Columbus Circle, N.E.
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Washington, D.C. 20002

Dear Mr. Jones:

Thank you for inviting me to testify at the November 14, 2002 public hearing of the Ad Hoc Advisory Group on Organizational Guidelines. My research has focused on strategies for building responsible companies-companies that conduct their business responsibly in relation to their core constituencies and the broader community-rather than ethics and compliance programs *per se*. So my work is not directly responsive to the questions posed by the Advisory Group. Still, my comments may be of some relevance to the Advisory Group's inquiry given the overall philosophy of the guidelines which, as I understand it, is to encourage and reward responsible corporate behavior-at least insofar as it involves behavior required by law.

In passing, I note that this philosophy appears to rest on two rationales. One has to do with moral culpability and just deserts: companies that have made a serious, good faith, and reasonably-likely-to-succeed effort to fulfill their responsibilities under the law (even though convicted of wrongdoing) deserve to be punished less severely than those that have not. The other rationale is pragmatic: by rewarding companies that have made such efforts, the guidelines will encourage more companies to do so and thereby increase the overall level of legal compliance among corporations subject to U.S. laws.

One issue I have explored through a number of case studies is the origin of misconduct in large companies. In selecting these studies, my focus has been principally on corporate misconduct-that is, misconduct undertaken in the company's name or on its behalf rather than misconduct against the company. And I have looked principally at companies that are well-

regarded-at least prior to the misconduct. Virtually all of these cases have involved an untidy mixture of “unlawful,” “arguably unlawful,” and “questionable but lawful” acts and activities (as analyzed after the fact)-and thus defy the neat separation of law and ethics favored by some.

A theme that runs through these cases is the potency of the performance goals and targets set by management (and ultimately by the board of directors). Often backed by strong financial incentives, these goals are powerful drivers of behavior and, by tradition, have not included legal compliance, code of conduct, or other ethics-related components. As a result, and particularly when short-term financial opportunities or pressures are strong, concerns about legality, ethics, and values naturally recede into the background if they are viewed as important at all. Individuals who achieve their targets are often handsomely rewarded with little or no inquiry into the legitimacy of the methods used, while those who raise questions about dubious tactics are shunted to the sidelines or worse. Most of these cases involve a mix of factors that, in summary, amount to (1) opportunities for goal-enhancing misconduct (though it is rarely characterized as such by its proponents); (2) strong reasons and incentives to pursue these opportunities; and (3) comparatively weak reasons and incentives to forego or avoid them. As this analysis suggests, the problem at its root is a skewed sense of priorities fostered by a too-narrow conception of performance that is typically reinforced by the company’s formal and informal systems.

Based on these case studies as well as studies of companies that have sought to conduct themselves responsibly, I have concluded that responsible corporate behavior is the result of multiple factors falling under three broad headings:

1. The company’s leadership: e.g., whether the leaders have the requisite skills and capabilities; whether they set appropriate goals and targets; whether they exemplify the standards and values they espouse for the organization
2. The company’s design: e.g., whether appropriate considerations are woven into the company’s core systems for planning, execution, and performance assessment; whether the requisite attitudes, skills, and capabilities are developed through the company’s systems for hiring, training, and advancement; whether appropriate accountabilities are assigned and included in the company’s performance evaluation and reward systems
3. The company’s decision making: e.g., whether the company’s decision processes incorporate an appropriate set of considerations; the nature of the analytic frameworks used and whether they include the requisite types of analysis and reasoning

In the schema I suggest, which likens society to a civic association, companies may choose their level of responsibility or ethical commitment: they may elect to be “dues payers” that comply with the law and avoid gross wrongdoing; they may elect to be “sustaining members” that adhere to generally accepted ethical standards and practice an ethic of mutuality; or they may choose to be “sponsoring members” that, in addition to complying with law and generally accepted ethical standards, also practice an ethic of contribution. (Each level encompasses the prior levels.) Whatever level of responsibility companies choose, however, must be matched with the requisite leadership qualities, organizational attributes, and decision making skills needed for that level. In the end, management must create a context in which individuals and groups have the opportunity, ability, and desire to act responsibly as defined by the chosen standard.

These general observations, which are more fully developed elsewhere, lead to several suggestions regarding the issues before the Advisory Group:

- The temptation to offer ever more detailed specifications for acceptable compliance programs should be resisted. There is no “one right way” to build a responsible, law-abiding company. While general features can be outlined, the design details are best worked out in the context of an organization’s specific legal and other responsibilities. Moreover, many factors interact with one another in shaping the behavior of a company and its employees. Equally or perhaps even more important than the ethics or compliance program *per se* are the quality of the company’s leadership, the design of its performance management and compensation systems, and the quality of its decision making processes.
- At the level of general features, a striking omission from the hallmarks of an “effective program” is evidence of effectiveness. Given that flexibility in program design is necessary and desirable, it would seem appropriate to require companies to develop their own tools and measures of their program’s effectiveness and to present evidence of effectiveness as part of their application for benefits under the guidelines. A significant unknown is the extent to which compliance and ethics programs actually do contribute to reducing crime and promoting law-abiding behavior. To my knowledge, there is no currently available, tested, and widely accepted tool or method for assessing a company’s level of legal compliance or ethical performance more generally. By requiring companies to develop their own assessment methods, the Sentencing Commission would not only give substance to the requirement of an “effective program,” but it would also stimulate innovation in this important area.

- In addition, and at the level of general features, the Commission should consider requiring a board-level committee to oversee the company's compliance and ethics efforts. To the extent that program officers may lack the clout necessary to address misconduct occurring at more senior levels of the organization and given the importance of leadership quality for corporate responsibility, board-level oversight would appear to be crucial. Moreover, in the absence of good measures of program effectiveness, board-level oversight would help assure the vitality and seriousness of corporate responsibility efforts, especially those related to ethics, legal compliance, and other areas not covered by traditional conceptions of financial responsibility.
- Finally, the centrality of performance assessment and compensation to the effective functioning of any organization suggests that ethics and compliance-related criteria should be included among the criteria used to evaluate and reward individual, business unit, and corporate performance.

I hope these comments are helpful to the Advisory Group and look forward to answering any questions at the hearing on November 14.

Sincerely,

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