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Table of contents

Compliance: an over-looked business strategy

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Abstract: The purpose of this paper is to discuss the merits of self-regulation and the art of embedding it within an organisation, not as a secondary activity but as a core and fundamental business skill that ensures the survival of a business entity in the long term. The objective is achieved by considering compliance leadership as a strategy within a modern company. If the highest layer of stewardship of the firm (directors) explicitly accepts a conventional definition of business ethics (the law, best practice, a set of values in a specific hierarchy), then the author can measure this agreement and benchmark it against the highest known standards of corporate governance. Rational shareholders and managers will behave morally and find acceptable categorical imperatives to govern their behaviour. The delivery and preservation of long-term value demand that firms build capabilities to self-regulate and co-shape their environment, particularly if highly regulated. The paper suggests a way to organise the compliance leadership within some well-known business structures and present the idea that the chief executive officer of a firm who operates in a complex regulatory environment must make compliance a significant part if not the core element of his or her overall strategy. Some arguments highlighting weaknesses in the Kantian arguments have not been fully discussed. A global initiative that measures the relationship between ethical maturity and share price has not been undertaken in the writing of this paper. Twenty-first century management must ensure the health and resilience of their company's culture to successfully manage and overcome the daily ethical questions that arise across all levels and layers of the organisation as a first priority and that whole business models can be built around this mission. Regulators should be accountable for recognising cultural crisis within the firms they regulate in order to balance the reliance on quantitative measurements of success and to navigate the complexity of the largest players in the market. The paper builds on earlier research by the author that rational norms of behaviour are core business capabilities that will produce industry leaders that can change the risk landscape of the industries wherein these firms operate. This new leadership will be demanded by the rational shareholder and will transform firms into stakeholder firms capable of interacting with their environment and creating and sustaining value over the longest term.

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1 Introduction

In highly regulated environments, the rules of the country, the uncertainty around legislation, insufficient court precedents, and principle-based jurisdictions have created whole corporate functions whose full-time mission is to unravel the maze of guidelines and legal requirements and give business leaders assurance as to the correctness of their decisions. The legal department, the audit function, the risk function, and the compliance function all aim to become trusted partners of the business. The question is are these aspirations too low? Is there an ethical deficit? Are these functions ready and able to lead the business and create trust with stakeholders directly as a result of their prominent role?

Given the amount of technical expertise available to banks in particular, did an ethical deficit become a material bankruptcy? Why did regulators and regulated alike fail to recognise basic governance problems and why did alarm bells not ring when reasonable tests like sobriety, x-inefficiency, and bounded rationality clearly indicated that there were massive agency costs being forced on shareholders and stakeholders alike? The constant need to increase agency costs and add further layers of monitoring and control reflected the fact that the capabilities of the firms to understand ethical dilemmas was deteriorating, resulting in a circle of negative findings caused by

misunderstood regulation which in turn caused additional rules to be created.
The reality is that ethical behaviour is simple to understand but hard to apply across all levels of the organisation, particularly when the firm does not subscribe to the stakeholder approach. Kant argued about the dangers of forgetting concepts like duty, harm, and the realities of ethical dilemmas. Despite impressive mission statements, governance codes, and the inclusion of ethical values in the corporate documents of investment banks, brokers, traders, and insurers, the realities of what was going on behind closed doors are still sending shock after shock to the financial markets, and the impact of these business cultures eventually proved to destroy value in the long-term causing harm to shareholders and stakeholders alike.
The dissection of the root causes behind some of the spectacular failures we have witnessed may present us with a leadership and strategy challenge, rather than technical and financial re-calibrations. We may be ready to take guidance from our compliance strategists to re-build trust and recover lost market share, to fill the void left by many of the now defunct financial institutions, and transpose the analogies and lessons learned to other highly regulated industries that are highly vulnerable to the loss of public confidence and now more than ever the ghost of state intervention.

2 Ethical culture of a company

We begin from the premise that a new chief executive officer (CEO) must be ethically aware. He or she must be able to measure the ability of the current group of managers and employees to carry out a successful long-term mission from watchful, educated, and, in some cases, emotionally charged stakeholders. The way to measure this ability is by using a recognised metric to establish an ethical position and ethical goals to aspire that give him and shareholders confidence that although failures of integrity are possible, they are not probable. Among the existing metrics that have attempted to become global benchmarks, the ethical maturity index has the advantage of incorporating the core elements of several existing international and regional governance codes, and its application can tell us as much about the long-term prospects of a company as its current share price or dividend policy. This visible way of approaching the ethical culture of the firm sends a powerful message within and outside the organisation a value statement in itself.
Governance codes can show only a post-facto snapshot in time of the dynamics of human behaviour in a country, industry, market, or firm. The existence of this tangible set of rules or the social contract of the firm is essential but represents only part of the picture. The typical role of the compliance leadership has been to ensure that this formal set of rules is accurate, transparent, public, and updated in real time. Less often, it is tasked with an assurance role that aspires to understand if the set of identified rules is truly embedded in the organisation. But, we must go further and make a predictive judgement as to whether the formal framework has a real opportunity of long-term success given the company structure (addressed under a separate chapter in this paper) and also given the firm's ethical culture. It is essential to understand the latter to guarantee a certain behaviour consistent with the ethical expectations of regulators, shareholders, suppliers, clients, and consumers. Without this element, the compliance role is much diminished in both its value to the company and its motivation to the holder of this position of great responsibility. The fact that compliance leaders may have failed to persuade executive teams to recognise this strategic opportunity is certainly open to criticism. But, it is equally true that unless the compliance leaders are first perceived as first-choice industry leaders inside the closed doors of the boards of directors, this will be a difficult opportunity to seize to the detriment of the firm.
If we accept that the ethical culture of a firm is largely driven from the top and, using an analogy from the legal and political science disciplines, if we compare a firm with our understanding of a democratic institution, we can quickly see that firms may be democratic in their aspirations, theory, and general makeup (the Annual General Meeting of all shareholders being the best example of democratic principles applied to a firm), but they may not be democratic in the way they are managed day to day. In keeping with this same analogy of forms of government, the multinational firm is more akin to an aristocracy than a democracy. In the former, followers choose leaders. In contrast, like in the aristocracies of old, the inherent nature of the firm and the way means

that leaders choose followers. Therefore, it is right to assume directors exercise a serious degree of control over the destiny of the firm from the day of their appointment. Of course, given this unbalanced quota of power, the formal controls must first be defined, agreed, and applied top-down to be effective. This implementation is not enough to guarantee timely information on breaches of integrity to shareholders but it sets strong foundations capable of sustaining the firm during good times, bad times, and critical times.

The normal controls and checks and balances that allow scrutiny from a principal-agent point of view at the highest level do not really suffice to exercise a meaningful deterrent from running the company in a manner that contravenes shareholders' interest unless the ranks are also given a tool that can be used to influence and benchmark the conduct of their leaders in a more independent manner. One such tool might be a governance code that allows behaviour of management to be compared against a code of conduct that makes it possible for every hierarchy in the company to exercise a level of scrutiny that will be proactive rather than reactive, no less because of the natural competition to reach the top positions in the organisation that will drive the reporting lines to spot and highlight any clear weaknesses of leadership, if only because of the natural ambition of the best performers in the organisation. This is also a very significant reason why an ethical code adds value to an organisation. It is not only a deterrent of incorrect behaviour but also an enabler for all members of the organisation to become custodians of the ethical legacy of the firm. If the highest layer of stewardship of the firm (directors) explicitly accepts a conventional definition of business ethics (the law, best practice, a set of values in a specific hierarchy), then we can measure this agreement and benchmark it against the highest known standards of corporate governance.

3 Companies and compliance

[17] Rossi (2008) questioned why firms were reluctant to invent or position themselves as compliance leaders. The typical leadership choices that shape the strategy of a firm involve market, cost, and product leadership. In reality, compliance leadership may outlive all others.

Cost is often cited as a reason not to be at the forefront of compliance and regulation but she suggested that the costs are more akin to R&D for product development (particularly true for financial services), brand investment which is key to marketing, or efficiency investment that avoids costly operational costs such as fines. When this core capability exists, it is often ignored as a source of competitive advantage, as if it were a risky proposal to be the first to recognise and adopt a regulatory evolution to achieve or sustain compliance leadership. After the collapse of Lehman Brothers in 2008, stakeholders were looking for such leadership in the marketplace. There were no clear winners, but the very survival of the financial system and each individual bank hung by the thin thread of trust that was almost completely torn by the magnitude of the crisis.

When successful companies become so big, complex, and strong that they are of national importance, they interact, influence, and ultimately depend on governmental action for their long-term prospects. Because governments in turn depend on the good will of the majority of their citizens, these governments are reluctant to assist companies that become political liabilities. Reputations are crucial when such decisions are being made. Yet, banking CEOs failed to recognise compliance as a strategy and reputations as their largest asset. They focused on traditional quantitative key performance indicators, most of which were extracted from the information held by their finance functions, and because they could not measure softer aspects of their architecture, such as ethics, culture, and compliance, they found themselves at the mercy of the markets, who were rather unmerciful.

In the process, they lost the priceless opportunity to continue to co-shape their business environment. Worse yet, they were seen to be incapable of doing so in the foreseeable future. Their future now lies in the hands of government bureaucrats and regional and global regulators. Yet, all of the institutions that failed had within their midst professionals and employees who could have saved their corporate futures if they had been enabled to take on more meaningful roles in the leadership of their companies. These chief compliance officers, chief risk officers, vice presidents of human resources, and similar had large departments, strong budgets, and important intelligence to share with their colleagues. All of these companies had access to these resources, out of necessity, because the environments in which these firms moved was highly regulated. But, none of these leaders became the CEO, although some of them were choices of last resort in the succession strategies of these banks.

These senior managers and executives were seen as consultants, specialists, and technicians, not as possible captains of industry that could manoeuvre complex environments even though many of them were in close touch with problems each of the functional managers declared beyond their capability to solve precisely because they involved the company stakeholders and were not only technical in nature. They had to do with company policy, the external environment, external relationships, and government oversight. These professionals could connect the dots in a way that perhaps only the CEO could - except they were trained to do it with clinical objectivity - because their bonuses were not tied to sales or profits but were connected instead to the value and accuracy of their analysis and opinion. These functions were seen, and still are, as supporting functions, rather than managers of core activities of the companies whose behaviours, opportunities, contracts, and threats they are commissioned to know inside out.

In general, the heads of assurance functions cannot force other heads of function to follow their recommendations, unless there is a proven breach of the law, or less seriously due to some degree of flexibility, of company policy. They are able, but not sufficiently enabled, to be the moral compass of the company, the industry, or the markets. Over the past two years, we all paid a dear price for this failure of vision within the banking sector. This price is almost unquantifiable and will be paid over generations.

During the boom years, ethical values and principles may have been overlooked as long-term profit prospects and the old-school way of doing business was not altered. Businesses, for example, forgot that compliance with those values and principles had a value that went beyond the ethical reasoning behind them and that the actually translated into a financial benefit for shareholders in a narrow sense but extended to society in the broadest terms. Shareholders forgot to allocate a premium to the social benefits of companies that worried about the how, and not only about the what to do, and we have been forced instead to allocate a cost to the social harm that resulted from the non-adherence of industry players to basic principles such as accountability, prudence, and duty of care. Business leaders failed to recognise their firms as nexus of contracts that went beyond the firm, and the ravenous nature of a classical p-firm have become apparent to society as a whole, forcing us to look at a deep transformation of business.

4 Change management

Change management, culture, and compliance never trail too far behind, and tight financial times are likely to force mergers and strategic alliances that would never be considered under normal circumstances, making these areas of expertise truly relevant for the modern strategic groups and executive teams. Corporate governance is not practical unless the ethical contract including the "highest need" and "highest good" are agreed upon at the top levels of the organisation. The better defined and enforced this corporate social contract is the more effective a governance framework, whatever its size and scope is likely to be.

The surge of the "ethical consumer" and its supplier match the "ethical firm" that has prompted much debate on what the term "ethical" actually means in a business world. It is interesting to note that the main driver of the ethical movement has been more apparent from the consumer perspective. According to the Stanford Open Encyclopaedia of Philosophy, the term ethics is "derived from the Greek word 'ethos', which means 'way of living' [...] " - ethics is a branch of philosophy that is concerned with human conduct, more specifically the behaviour of individuals in society. Ethics examines the rational justification for our moral judgments; it studies what is morally right or wrong, just or unjust. Szasz (1960) correctly pointed out that:

[...] anything that people do - in contrast to things that happen to them - takes place in a context of value. In this broad sense, no human activity is devoid of ethical implications.

If we apply this concept to business ethics, we can say that these consist of a set of principles that explain human behaviour when an individual or a group of people are engaged in an economic activity. Whether these principles are truly ethical or not depends much more on the consistency of the behaviour with the principle, the individual upholds than the coincidence of principles and values from individual to individual. Aristotle had argued that conflicts arise not from a difference of opinions of what is good but what is the "highest good". This difference in priorities, the subordination of other values that can also be described as "good", create what Kant described as a moral dilemma. Complex ethical decisions are seldom made against the backdrop of a "good" versus "bad" principle, but rather following a discussion of which is the "better" principle to apply. Firms experience these shifting needs on a much more frequent basis due to the rapidly changing environments in which they operate. Shareholders, regulators, and customers will struggle to follow the evolution of these changes due to the speed at which these occur. Understanding these drivers means undertaking a deep study of society and industry, going from behaviour to motivator. If the motivator is a principle, then we are entering into the world of ethics.

5 Ethical principles

Individual ethics are shaped by convention to a certain extent, but every gap is filled by individual conviction. [17] Rossi (2008) positioned the "value regions" of Haire, Guiselli, and Porter ([4] Chryssides and Kaler, 1996, p. 163) as proof of the power of external convention. To explain individual behaviour, we must look at the pressures exerted on the individual who under the Kantian philosophy we assume to be ultimately free to make ethical decisions. There is of course, a counter argument that will not be discussed here which is that the freedom of the individual on which so much environmental pressure is exercised may not be free or as free as Kant would like him to be. There are a number of theories that rationalise the behaviour of the people while participating in business, and a summary of their main theme, originators, and supporters appears below.

Coincidence theory

This theory states that good ethics and good business coincide. It therefore makes good business sense to follow an ethical behaviour. Profits and ethics coincide. [4] Chryssides and Kaler (1996) criticise this theory due to a lack of supporting evidence and the problem that it does not hold true in all cases. As a matter of fact, there is an evidence to support that it is more costly in the short-term and that the immediate effect of adopting a code of ethics is a dip in the stock value which is natural, given the fact that more managerial constraints could result in a drop in performance.

No difference theory

This theory states that individuals should uphold the same standard of behaviour in their business life than in their personal life. The problem with this theory is that individuals can have a diverse or even conflicting set of values driving their behaviour - irreconcilable differences can arise.

Utilitarian theory

This is the theory that fits the neo classical definition of the firm best. This definition implies that the firm and, by implication, the individuals who work for it have but one single driver and goal: long-term profits for the shareholders. This is equivalent to the "business is business" utilitarian category described by [17] Rossi (2008). If we subscribe to this theory, we are likely to believe that all firms are profit-maximising p-firms; however, principal-agent costs, entrepreneurial rents, x-inefficiency, and short-termism are characteristics of how management operates in our society and is underestimated in the p-firm. The assumption that all people employed by the firm are united by a single driver is too minimalist and does not take into account individual motivators. The assertion that this main driver is the creation of long-term profits for the shareholder does not stand scrutiny. However, given the realities and pressures of the modern firm, and with the above caveats in mind, this is the definition with which the majority of business leaders identify the most. Social contract theory, for example, advocates the power of the collegiate versus the strength of individual inclination. Experts in organisational behaviour are likely to subscribe to this theory and apply it in a business context.

6 Kantian ethics and law

Consider the following statement: what is legal is ethical. Approaching business ethics from this point of view might appear, at first glance, safe and correct. Such an approach would imply that the firm is generally regarded quite low in terms of its ethical inclinations, and therefore the legal framework provides the limit for the behaviour of the human components. This legalistic approach has the intrinsic problem that with the fierce pace of innovation and developments in globalisation and markets, the legal cycle cannot catch up with the business practice proactively, but only after a certain time when regulators and lawmakers finally digest and understand what is happening, and many times, social damage has already taken place. This is the approach that the leadership of the banking industry took. Devoid of a true understanding of the ethical culture they were nurturing, it proved of little value to them or their shareholders.

If we were to examine a random number of corporate mission statements from a variety of industries, we are likely to conclude twenty first century firms subscribe to a utilitarian approach to ethics. If we assume that individuals have a greater understanding of Kantian morality, it is not difficult to see tensions and conflicts between the convention in a firm and an individual will arise. The more utilitarianism dominates in a country, region, market, or industry, the less room there is for Kantian morality to operate. This is critical as inevitably; the most rewarded managers are those who can present short-term profits to shareholders. Demanding a Kantian ethical stance from a utilitarian leadership is a conflicting message that shareholders today are sending to the markets and to the firms.

Shareholders cannot be assumed to be morally neutral to the cash flows on which they have invested and depend. Until shareholders exhibit a less utilitarian influence on management, they will prefer and retain those managers who deliver the highest benefits without much regard to their individual actions. The disconnect between ownership and control makes selling a stock a less emotional choice than selling a company one has founded. We can see that there are degrees of ownership, and there is a tipping point where the individual is invested enough in a firm to behave like a rational owner who takes an active interest in the long-term of the firm. It is also true that there are cases where employees have invested their whole careers in the long-term existence of the firm and therefore could behave more like owners with the best interests of the company aligned to their own. The relative commitment of each will determine the drivers who are capable of influencing their decisions.

If we accept that ethics need to be applied in very utilitarian environments and affected by short-termism, then we must accept that the results of its application will differ substantially from the results that would emerge from applying purely Kantian principles to similar situations. This reference to short-termism is inevitable, as most of the minority shareholders expect to receive steady cash flows from their investment. We also assume that most managers are looking for entrepreneurial rents with a finite period of service in mind depending on their career ambitions.

When in this paper we refer to the rational shareholder, it is the majority shareholder, that shareholder who has invested sufficiently in the company to depend on its growth rather than its cash flows to meet its objectives. If managers trained and worked under leadership that subscribes to a utilitarian approach to ethics, operate without clear limits, in their minds, their behaviour can justify many actions in the quest for profits. When profits become the principle, then the only real duty of managers becomes a very narrow profit delivery goal and governance will be seen as a limitation rather than as an opportunity to include all stakeholders in the day-to-day decisions of the company.

To avoid misunderstandings, there must be an ethical contract among all stakeholders. Shareholders must behave in a such a way as to make it perfectly clear to the senior management such convention and synergy is what they expect. Regulators and governments must assist with some pecuniary benefits to those shareholders who invest in companies that apply the higher standards they want to embed. If they consistently reward profit versus growth, short-term versus long-term, and results without regard to method, they also share in the creation of the corporate culture, its strengths, shortcoming, and behaviours. They are co-responsible because

they allow a certain fixation of corporate values that lead to society's harm in the long run.
[2] Bruner and Goodman (1947) first commented that "if a given perceptual hypothesis is rewarded by leading to food, water, love, fame, or what not, it will become fixated" - and the experimental literature, notably the work of [8] Ellson (1941) and [13] Leeper (1935), indicate that the fixation of "sensory conditioning" is very resistant to extinction. As fixation takes place, the perceptual hypothesis grows stronger not only in the sense of growing more frequent in the presence of certain types of stimulation but also more perceptually accentuated. Perceptual objects which are habitually selected become more vivid, have greater clarity or greater brightness, or have greater apparent size.
Shareholders can and should be incentivised to monitor the ethical approach of the firms they invest in, according to their own understanding of ethics, and also in line with government's understanding of "common good". The ideal situation is that the individual "highest good" must also, if the government is reading the social needs correctly, match in the majority of situations, "common good". If portfolio shares can be measured in terms of the aggregate social utility of the shares that make it up, and tax advantages given to the highest indexes, we might see that the idea of harm, ethics, rights, and duties really goes into the very fibre of the firm and is at the core of competition to compensate for its cost.

Regulating for the common good in a utilitarian society

Regulators play a part in extreme utilitarian environments, because there is no social penalty for holding shares of companies that dedicate themselves to activities that contribute to social harm (for example, suppliers of weapons or pornography), and although there is perhaps some social guilt now attached to the same, until individual share portfolios are rated with a social benefit index and perhaps taxed differently, there is no real incentive for the shareholders to differentiate companies on this basis. If all shareholders were truly rational, investments would naturally shift away from these types of firms, but the evidence suggests that these firms are well capitalised and never short of investors.
Society has assigned the task of codifying behaviour to regulators, and these regulators in turn create the regulatory environment where the firm lives, depending on the individual perceptions of the society and the individuals who make it up. The regulatory bodies who create the regulatory rules and processes must be able to encourage certain behaviours and discourage others, but firms should not forget that these bodies are affected by market forces and politics, and the more globalised commerce and politics become, the more stressed this environment becomes: the result is an apparent calm, where everything seems to tie in nicely, but where ultimately, there is a constant movement and mismatch, turmoil rather than peace, and dynamic creation of rules that can never be fully reflected on the formal framework investors and shareholders so blindly trust.
The more turbulent the environment, the more crucial corporate strategy becomes. Many companies - financial services, in particular - and also construction and the pharmaceutical companies, have appointed a separate business function to look after the firm's compliance needs. They are a supporting function that is not called to assume overall visible business leadership often. Yet, if as Grant suggests, strategy is the "link between the firm and its external environment", and the external environment is defined by a legal framework that expands or narrows sometimes very slowly, as in the case of many European Directives which debate happens long before implementation, others quite dramatically due to an immediate need or social outcry, such as the anti-foreclosure legislation in the USA, businesses ignore the capabilities they have built, even if reluctantly or only forced by the increasing amount of laws and the seemingly never-ending maze of legislation that surrounds them, at their peril.

7 Why compliance?

In a complex business environment, a strong compliance department is essential and perhaps more importantly rare. The first reason is perhaps that the forced fit between the traditional legal profession and the modern, dynamic, and changing management environment is not easy to achieve.
The second reason is that the value of the compliance analysis when it occurs post-facto to implementation of

rules and regulations is limited. It serves to answer business questions, but it seldom shapes corporate strategy. The third reason is that building this strength is costly and time consuming. When resources are limited, it is not always possible to feed the expensive needs of a strong compliance department. No wonder it is, many times, seen as a burden, a necessary evil of doing business. Finally, compliance departments, not unlike industry regulators, concentrate too much on the formal framework of governance of the firm, leaving the cultural and ethical aspects to the HR department who may, in turn, see this as a compliance responsibility.

But, if the world of compliance is essentially the world of norms, compliance leaders must become observers of the behaviours prevalent in their firms to have long-term success. Compliance leaders who subscribe to the views expressed by Kant in his *Groundwork of the Metaphysics of Morals* will admit that the most serious breaches of the law are breaches not of technicality but of morality and are penalised in precisely this manner by society through regulators and the judiciary alike. Compliance departments can achieve much by leaving their scribe and archivist roles and becoming much more active in re-defining their function as both an ethical catalyst and a compass of the leadership team. They have a duty to be able to explain and test the decisions of the firms with strong categorical imperatives, rather than simplistic though highly technical references to the law. They need to clarify what principles are at the core not only of the mission but also of the survival of the firm, and they need to be able to voice the opinion of the stakeholders at the highest levels of the organisation. The ability to be ethically impeccable and capable should make or break decisions and careers. And compliance leaders should make sure that the right behaviours are highlighted, rewarded, and embedded within their organisations. Rigid governance and tight procedures are much needed if the culture is weak, but there is a scientific way to justify a simplification of processes and the empowerment of the workforce when the right culture is in place. Less complex processes produce efficiency, flexibility, certainty, leadership, and speed, all attributes that are highly priced business skills that in themselves create value and competitive advantages. Universal principles have always existed and may look obvious, but the ability to verbalise an ethical imperative is not as easy to find and could solve much of the stakeholder conflicts in the turbulent environments of the twenty first century.

The compliance leader of today must be able to give unequivocal guidance as to what constitutes the duty of the firm, must be able to understand and explain when the conduct of the members of the firm is causing harm, where restitution obligations may arise ahead of their materialisation, and must never allow that the concept of utility, profit, and cost is used as the sole or main element of decisions that involve human beings whose dignity Kant so adamantly defended. Ultimately, the toughest decisions a firm will face will involve this kind of vision and confidence, and stakeholders are awaking to the convenience of nurturing precisely this kind of firm while leaving other less ethically evolved firms behind. It is not easy to prove the firm has chosen to build and nurture this environment, but once built, good compliance abilities and an ethical culture should be part of the overall objective appraisal of resources. This is why we insist on a global metric that is acceptable beyond the boundaries of the firm.

We go further and say that if the compliance leadership and its expertise are a source of competitive advantage to the firm, and the environment in which the firm moves is highly regulated, this is a function that should seriously be considered as having the skills set to lead the future of the firm. This is very true of the financial services industry, or the aviation industry, for example. The reason why these industries are highly regulated is because the social cost of allowing competition to take its course and organise itself is simply too high for the community to pay. Therefore, the rules surrounding them are growing in number and intensity every year. Companies already in the market seldom welcome increases in legislation, but every knot in the legislative rope also acts as a deterrent for new entrants.

Business strategy should put the legislative changes in context when they allocate a cost to the new rules, because they also have a value to the business from this point of view. A strong compliance department should feature in the corporate strategy as a plus, as an opportunity to be exploited, and as a unique source of competitive advantage for a firm. Marketing should look at it as a key pillar of the brand identity and investment. The business intelligence that flows from this department must nurture and strengthen the business, and if strong, it should have the ability to act as a compass and an opportunity scout, a public relations relationship builder, and even as creator of the framework where it has evolved. If it has the credibility and the resources, it can work with the government in bringing about transformation of the local and wider environment that can benefit the firm enormously while also limiting competition.

Compliance innovators are in a position to do this, while compliance laggards, to use a marketing analogy, run the risk of being the limited competition. In a blow of this nature, the results can be swift and deadly, as a change in legislation can make a business too expensive or a business model just not viable. In short, the more turbulent the external environment, the less planning that can be made around the same and the more important a business strategy to cope with the changes becomes. There is no doubt emergent legislation has spanned a whole industry of consultants that offer analysis and solutions businesses. While their value is undeniable, particularly in the face of total absence of compliance analysis and recommendations, the value of in-house compliance strengths that view compliance intelligence as competitive advantage must be protected from prying eyes, and the problem with using a consultant is that typically the next client benefits from the experience of all others and makes a compliance strategy somewhat redundant.

8 Compliance: structure follows strategy

It has been argued that if a company possesses the abilities and particularly if the industry is highly regulated, and if regulations shape the main relationships with customers, suppliers, and competitors, not taking feedback and even leadership from the compliance department can be the most serious flaw in the corporate strategy. The strategic fit of the company with its environment will not be as good as it could be given the resources, at best, or fatally deficient, at worst.

In this case, should the compliance structure also follow corporate strategy? It depends. [9] Grant (2004, p. 397) commented that "managing vertically related business that are strategically very different is complex" - sometimes, what is beneficial to one group of businesses can be detrimental to others. Assuming the existence of a compliance function, and that this business unit has a strategy that has been formally recognised as having captured the overall firm strategy on same, we now need to focus on the placement of this business unit, that is whether the compliance function should be centralised or decentralised.[17] Rossi (2008)

[17] Rossi (2008) concluded that the compliance function should ideally not be decentralised, at least on initial inception, regardless of the business model of the firm, because local businesses can make substantial cost savings from a centralised function that will have to provide guidance on what it is that it considers important to monitor, and there will also be duplication if a businesses needs to undertake a benchmarking analysis of all legislation, at the same time as this analysis is made by all others, under different assumptions and standards. For head office, there is no saving of time or effort as it cannot claim ignorance in case of a compliance or regulatory breach.

The compliance function has a role identifying rules and regulations that need to be complied with, and also testing and reporting deviations, but it cannot implement compliance behaviour on its own, nor can it be held accountable for non-compliant behaviours of business units. It is a knowledge-intense, information-dependent function. It is more akin to the intelligence section of the general staff and must be able to have direct access to the ultimate holders of corporate responsibility if it is to be truly respected. This is an area where information asymmetry can prove deadly for corporate careers, and it is the ultimate test of control for a CEO and the board.

The local intelligence should flow to the centre in its undigested form, and the centre should then be able to see the differences across its different units to determine what it can become a global process due to its commonality, and what could be the source of threat or competitive advantage, by region or by country, depending on the differences.

This intelligence makes up the feedback needed by the corporate strategists to investigate external factors further. When the portfolio mix of the multinational firm involves a couple of businesses that are not part of its core knowledge, it should not be afraid to delegate part of its function to a recognised centre of excellence that answers to head office in its performance. The first step, of course, is to own the function, as no manager can delegate a responsibility he/she himself does not hold. This is evident only where local compliance officers or local counsel, for example, report directly to the head of legal or head of compliance in the multinational environment.

Taking cultural value regions and structure into consideration, [17] Rossi (2008) suggests that the effects of embedding compliance functions in different structures would be as follows.

If the compliance model is centralised

European Decentralised Federation . A strong compliance department in this model brings a nice balance to the local relationships and the mere existence of such a structure discourages unethical behaviour or deliberate non-compliance.

The Americans: coordinated federation . In this case, the local efforts of a centralised compliance function are likely to succeed, as subsidiaries report to a strong centre anyway.

The Japanese, centralised hubs . This is where the most difficult clashes in case of divergence can arise, because both centre and compliance functions are likely to be privy to the same information and are used to full control of the local teams. Conflicts and compliance are likely to be defined and solved in head office, but local management might come to feel very threatened by the presence of compliance officers that report independently to a strong leadership group that does not coincide name by name with their own.

If the compliance model is decentralised

European Decentralised Federation . In this case, a decentralised compliance model brings too much conflict at the local level while the centre is living an easy life, unaware of the conflicts that arise and unable to prepare for potential governance storms. Also, the centre should not be weak to be an arbiter in case of conflict.

The Americans: coordinated federation . Decentralised compliance structures in a federation are likely to result in resistance to compliance initiatives by the centre itself, who is pulled in different directions by strong local compliance departments, but also resistance by the compliance department to centre initiatives, and ultimately rebellious management teams might decide to ignore both.

The Japanese, centralised hubs . This is a model that can stifle innovation and dilute the direction of a strong centre.

There is no compliance model that will fit the typical business cultures perfectly, and for that reason, the centre should select the complementary compliance strategy, expanding the strength of the compliance department when it has chosen to be a coordinator, and limiting its influence when it has chosen to be a controller. It is clear that when local empowerment is excessive and centre's scope of control more limited, the compliance department can justifiably be deployed to bring a sobering element of control. Where the subsidiary is weaker, a centralised compliance department allows for clear, consistent messages that do not intimidate the management team. The centre can also choose to moderate an excessively strong compliance officer or act as support for one that is too weak.

9 Conclusions

Is there a logical thought process that allows for a compliance strategy to emerge in a multinational environment? [17] Rossi (2008) had argued that if the compliance business unit exists and it could become a source of competitive advantage for the firm, and if the industry where the firm manoeuvres is very attractive, the centre should build it up. Once the competitive advantage starts to diminish, it should aim to harvest the same. The more turbulent and competitive the environment, the stronger the justification for a compliance environment that ensures the people at the top of the business remain loyal, engaged, and unified with the centre.

Adaptability and flexibility may be elements of national differentiation, but in terms of local laws and regulations, once these have been identified, there can be no negotiation in terms of respecting the rules of the game to win it in the long-term. Moreover, globalisation and regional development have allowed a basic harmonisation to emerge. The compliance strategy of a multinational must be a universal one: to ensure all stakeholders agree, know and accept the common set of corporate, national, and global rules of engagement. Perhaps, the second element, arguably, is to keep it simple. There should be, after all, only a few real compliance risks that could prove detrimental to a business. The company must comply with all elements of substance. Compliance with the formal elements gives an indication of knowledge of the rules, but not of an embedded compliance culture, and therefore, it is a misleading benchmark. A few key areas that are absolutely militarised the compliance "red zones" have to be established and communicated. In addition, the compliance department should be providing the business with useful and creative information that can help the business gain a competitive advantage.
This function navigates the maze of international rules with ease and can point towards the right path, but only operations can acknowledge the path and walk it. Giving the compliance department the impossible mission of aiming for a compliant organisation, which can only be achieved through reporting non-compliance and demanding more expertise in this area from every level of management, while at the same time benchmarking its performance for how clean the reporting slate looks, is akin to destroying it, because its credibility and motivation will decrease in direct proportion to its success reporting deviations.
The centre must be careful in establishing that accountability for behaviour rests with the business, which should grow in direct proportion to the level of specialisation and experience expected from the role, experience, and tenure of each company member. Experience in the business is essential to identify and report adequately; therefore, compliance officers or risk managers must have the personality and credentials to command respect at all levels, and even at that, their job is far from easy and, to some degree, their performance will always be slightly short of the mark, because the level of control demanded from him/her depends largely on the resources and support given by the very people they are expected to scrutinise and test against high ethical and legal standards.
Generally in a world of specialists, there will always be an element of bounded rationality in their analysis, but their ability to ask tough questions and to develop valuable business insights from them cannot be underestimated. Alternatively, we ask: how could this knowledge impact on the practical application of a compliance strategy in a multinational group? The ethical maturity index of an organisation is the mapping of its aggregate corporate assets along a progression line ([7] Demidenko and McNutt, 2010). It is based on a set of questions that when asked of a sufficient number of subjects produce results that are statistically significant and correlate to the ethical evolution of the firm. These results can track linear progress of the firm over time and also assist stakeholders to benchmark it against the competition. It is also a risk indicator that can assist to explain volatile stock prices, long-term value trends, and leadership success.
If we can pinpoint the ethical maturity of the highest layer of control in a corporation, and there is adequate knowledge and operation expertise in the industry, it is safe to expect this management team to reward like-minded managers. We must ensure that the brain, heart, and soul of the firm also have strong limbs to carry out the necessary work. There is a stronger argument for more ethically mature groups to be, at least considered for a decentralised compliance policy, but the least mature will need to be nurtured, and if in the aggregate, the median maturity index falls below a certain measure, then the argument for centralisation becomes much stronger.
This will be very difficult to achieve in a decentralised business model unless all group compliance officers are in certain ways, isolated for independence from the firms they monitor, and the way to centralise this function is to delegate the full control of these compliance officer to the centre, local compliance intelligence flowing to the centre will allow the centre to evaluate the ethical progress of the company, while the technical progress of the regulations can and should be kept at local level.

Regardless of the business model a multinational chooses, the safest compliance strategy is to centralise, which is the only way accountability as custodian, arbitrator, and disciplinarian can be given to the centre. High-profile corporate scandals have occurred on decentralised structures, such is the case of Nick Leeson in Singapore (Barings Bank).

For this reason, decentralised strategies must be justified and founded on close examination of the ethical maturity of the leadership of the firm before it can be considered as a serious substitute for this function that is one of the most important ones the centre can exercise. When accountability resides with the centre, then it is possible to allow partial or full delegation of certain areas is possible, on a temporary or semi-permanent basis, provided there are centres of excellence that have both an ethical maturity equal to or above that of the centre, and that the technical business expertise resides there. The problem of regulated entities, where the primary regulator of a firm is a local one and the secondary regulator is the centre's regulator, should be easily solved by using the highest standard of the two to benchmark compliance. It may be more expensive for the local entity if held to the lower standard but the centre can then contribute to the cost on that basis. If the centre is the one with the lower standard, then this is an opportune moment for "ethical learning" that can benefit all other entities under the supervision of the centre through time.

In conclusion, for a centralised or decentralised group compliance strategy to be justified, there will be certain areas that warrant understanding and scrutiny - ethical maturity within the company, level of technical knowledge, and operational expertise at board level, a careful scrutiny of the recruitment, and the selection and performance process to ensure that the ethical legacy or code of ethics permeates the organisation and is implemented by the next generation of management and employees.

The views are personal. The usual disclaimer applies.

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Appendix

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