
2016

ETHICS AND COMPLIANCE

PROGRAM EFFECTIVENESS REPORT



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2016 Program Effectiveness Report

Introduction

LRN's mission—"Inspiring Principled Performance"—demands a commitment to understanding what makes ethics and compliance (E&C) programs effective. The 2016 edition of our HOW Report® demonstrates that an organization's commitment to sustainable, human values, such as trust and respect, drives superior performance across its operations. Values-based organizations demonstrate better financial performance than their competitors, as well as greater innovation, stronger customer satisfaction and higher levels of employee engagement.

Employees at values-based organizations are also less likely to experience misconduct at work and more likely to report any transgressions that do occur. From our ongoing research—as well as our experience with hundreds of clients over two decades—we have learned that a values-based approach to governance, culture and leadership correlates strongly with more effective E&C programs. This edition of the Program Effectiveness Report represents our latest effort to document that linkage and provides guidance for operationalizing values in the workplace.

The findings revealed in the Path Forward section of the report will help E&C officers go beyond typical assessments to review the real effect of their programs. Rather than simply inventorying the components of E&C programs—what might be called inputs—we have created the Program Effectiveness Index (PEI), an approach to measuring outcomes. The goal is to help E&C professionals better evaluate the impact of their programs by focusing their lens on the presence or absence of ethical behavior throughout the organization and across their operations (see "Quantifying Program Effectiveness"). Only by focusing on results—and outcomes—can organizations fully understand the extent to which values are built into how they operate.

To focus on the need to measure results and behavior, we have changed the basis of our evaluation criteria from past years. As we have learned, putting values at the core of an organization's operating system is not only a requirement for the creation of a truly ethical culture, it is a catalyst and predictor of above-average performance.



Quantifying Program Effectiveness

LRN's Program Effectiveness Index (PEI) is a proprietary framework for analyzing the impact of ethics and compliance programs. Notable for its unconventional approach to program effectiveness, the PEI measures outcomes across three areas of critical workplace behavior: ethical decision-making (are the choices employees make animated by values or expediency?); organizational justice (are senior executives and high performers held to the same standards of conduct as other employees?); and freedom of expression (do employees speak up and willingly contribute and exchange ideas?). The latest report emerged from a survey of 556 ethics, compliance and legal experts around the world. It measured the incidence of key behaviors in the workplace that strongly correlate to a healthy ethical culture. Participants rated their organizations using the following criteria:

1. “High performers who violate our code of conduct or values are tolerated.”
2. “Managers in my organization sometimes act as if they are above the rules.”
3. “Our employees trust that their leaders consistently make values-based decisions.”
4. “Employees in my company feel pressured to achieve immediate objectives, even if it means acting in ways that are inconsistent with our values.”
5. “Employees in my company hesitate to speak up/out during team meetings because they worry about how their managers will react.”
6. “Employees in my company question decisions when they conflict with our values.”
7. “Employees in my company do the right thing, even if it’s not in their personal best interest.”
8. “Employees in my company are comfortable skipping levels or going to a level above their direct boss to raise ethical concerns.”

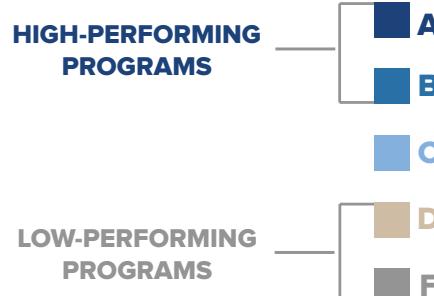
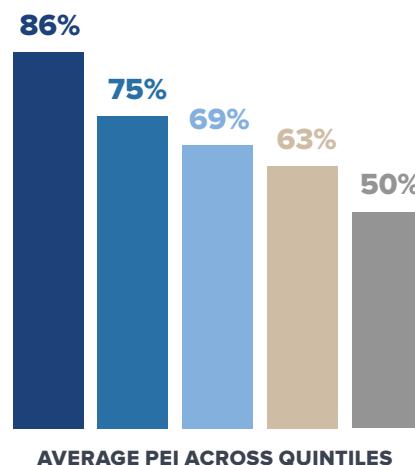
For each of the statements listed in the previous column, respondents were asked to check one response that most accurately reflected their point of view: Almost always untrue, Often untrue, Sometimes untrue/sometimes true, Often true, or Almost always true.

The “average PEI score” reported with respect to a particular behavior or attribute is the average of the individual PEI scores across respondents who reported that behavior or attribute. LRN analyzed PEI scores across quintiles using A, B, C, D and F grades to promote clarity.

Fig. A

Average PEI Across Quintiles

An “A” grade program fell within the top 20% of scores with an average grade of 86%, a “B” grade program averaged 75%, a “C” grade program averaged 69%, a “D” grade averaged 63% and an “F” grade program averaged 50%. Overall, the PEI data had a +/-1.317% margin of error, indicative of valid results.



Executive Summary

The world continues to be awash in corporate scandals and misfeasance, despite efforts by regulators and the corporate community to implement meaningful controls and prevention. It is a significant challenge. Faced with a rapidly changing business environment characterized by new emerging compliance risks and legal regulations companies must comply with all applicable laws, regulations and compliance requirements across their organization as well as grow and sustain their business. New partners and new markets are fraught with risks. If not managed effectively, compliance-related risks can derail even the best corporate strategy.

The central challenge for today's E&C professionals is how best to design and implement programs that operationalize values and elevate employee behavior, the optimal goal for all E&C programs. LRN's latest Program Effectiveness Report provides practical insights into the most effective ways to do both.

Currently, most E&C evaluation surveys—and many programs—focus solely on structural elements (number of policies, hotlines, training, audits, reporting lines, etc.) as the primary indicator of effectiveness. This is true despite clear and growing indications from regulators that a ‘check-the-box’ approach is not an adequate basis for judging program effectiveness. Instead, regulators are increasingly demanding that E&C programs reorient to focus more on ethical culture and behavior and less on adding more layers of rules and procedures.

LRN's latest research provides strong support for this position. The results of our survey show that values-based workplace cultures are significantly more effective at influencing employee behavior than those solely oriented toward rules or procedures. E&C programs that define their approach as values-based scored highest on LRN's new Program Effectiveness Index (PEI) and on all key outputs including level of C-suite support, cross-functional integration, middle management engagement, and code of conduct and policy accessibility.



Discussion

“More than just following the rules, workplace integrity is doing what’s right in a professional context. It encompasses the law, but also involves a top-to-bottom commitment to treating others with respect, being honest and forthright and dealing fairly with those inside and outside the organization.”

— ETHICS & COMPLIANCE INITIATIVE (ECI), GLOBAL BUSINESS ETHICS SURVEY (2016)

The 2004 U.S. Federal Sentencing Guidelines Manual outlined the need for periodic assessment of program effectiveness. Despite stressing the importance of regular evaluation, however, the Guidelines provide little insight into the meaning of “effectiveness.” And so, as part of the process of designing the Program Effectiveness Report, LRN explored what the E&C community understood it to mean.

Toward that end, we reviewed more than 15 recent surveys, an approach that allowed us to avoid well-trodden ground, fill in gaps and identify correlations that provided useful insights. These surveys grapple with a variety of questions, including:

- Whether the E&C programs make an impact and are designed to accomplish their purpose
- How to measure return on investment of E&C efforts

These are important questions, to be sure, but our analysis revealed that the criteria used to answer them center overwhelmingly on the presence or absence of specific program elements and reporting structures. The limitations inherent in evaluating program effectiveness on this basis were most memorably evident during the global financial crisis that began in 2008 and reverberates today. That crisis littered the landscape with the debris of corporate misconduct scandals that continue to occur despite an abundance of rules, policies, codes of conduct and controls. For this reason, regulators—as well as many E&C professionals—are increasingly critical of this basis for judging effectiveness.

In 2015, while addressing this disconnect, then SEC chair Mary Jo White noted that her agency expected senior management and boards of directors to “imbue the organization from top to bottom with corporate culture demanding compliance with the law and the highest ethical standards. We are not talking here about a check-the-box compliance program or nice sounding code of conduct. The goal is much deeper.”

Her remarks epitomized the shift by regulators and others towards focusing on company culture rather than checklists. The 2012 FCPA Resource Guide stated, “Compliance programs that employ a ‘check-the-box’ approach may be inefficient and, more importantly, ineffective.” Indeed, the Ethics and Compliance Initiative’s ambitious and insightful 2016 Blue Ribbon Panel Report on High Quality Ethics and Compliance Programs was highly critical of the checklist approach, noting that it can provide organizations with a false sense of security regarding their compliance measures.

This criticism recognizes that checklists do not measure or capture critical metrics that drive ethical behavior, such as the level of trust in an organization or its acceptance of those who speak up. Nor do they capture the internal patterns, relationships and mindsets that shape its culture. In short, the checklist approach to program evaluation focuses on inputs rather than outcomes. Checklists likewise provide little to no insight into the kinds of corporate culture that drive good performance, not just in the E&C area but also throughout the organization.

Notably, there was one survey in our review that did take a behavioral approach to judging program effectiveness. The 2016 Ethics & Compliance Initiative (ECI) Global Business Ethics Survey queried more than 13,000 employees of businesses, nonprofit organizations and government organizations in 13 countries to determine which factors drive good conduct or misconduct in the workplace. The ECI metrics focused on pressure to compromise organizational standards, observed misconduct, reporting of misconduct when observed and retaliation against reporters. Among this survey's many insights is that pressure to compromise organizational standards of integrity is a key predictor of misconduct.

The ECI survey is a step in the right direction, especially toward understanding the negative underlying factors that drive an organization's culture. LRN's Program Effectiveness Report, however, focuses specifically on behavioral characteristics of a healthy culture: ethical decision-making, organizational justice and freedom of expression. As we show, there is no better indicator of E&C program effectiveness than the behavior of employees. And the best way to positively affect workplace behavior is to focus on organizational character and values.

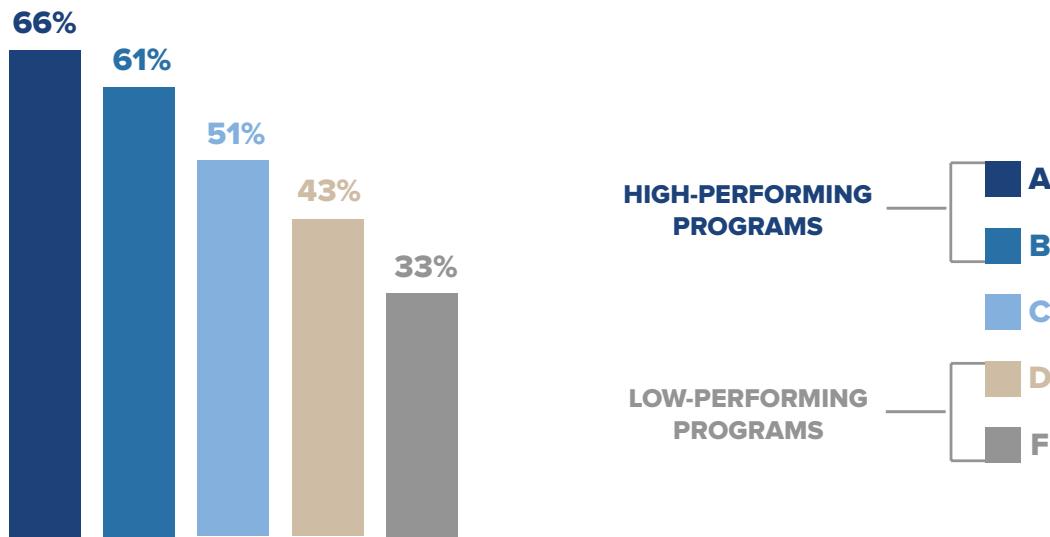


Values-based E&C Programs Excel in Impact and Effectiveness

There is a strong correlation between organizations that are values driven and organizations with high-performance E&C programs. This chart uses the quintiles described above that ranked respondents based on their answers to the PEI Index.

Fig. B

Over time, my organization's E&C program is increasingly focused on values and less on rules.



An "A" grade program fell within the top 20% of scores with an average grade of 86%, a "B" grade program averaged 75%, a "C" grade program averaged 69%, a "D" grade averaged 63% and an "F" grade program averaged 50%.

The Value of Values

“Values-based leaders communicate organizational values that tell members how to behave in order to fulfill the organization’s mission... . Because the core values represent the soul of the organization, they are likely to remain steadfast in the face of changing market trends and fads.” — THE FINANCIAL TIMES, 2016

In the 2016 edition of The HOW Report®, LRN demonstrates that distinct financial benefits accrue to companies that cultivate ethical cultures. Specifically, our research indicates that 97% of these values-based entities demonstrate better performance than their competitors in all of the 17 countries represented in the study. This compares to 80% and 30%, respectively, for more traditional command-and-control or rules-based organizations (see “A Framework For Organizational Culture”).

A Framework For Organizational Culture

LRN’s work finds that three systems influence individual and organizational behavior: governance, culture and leadership. Governance refers to formal structure, rules and policies. Culture refers to norms, traditions, habits and mindsets. Leadership refers to how managers behave, as well as the source of authority and how it is exercised. Through this “GCL” lens we have identified and described three dominant archetypes and assessed the impact of each on organizational performance:

| Blind Obedience | Informed Acquiescence | Self-Governance |
|---|--|---|
| Power-based, task-driven organizations that operate through command-and-control-based principles and policing, and which place little emphasis on building enduring relationships among colleagues, with customers, or within society. Employees are coerced to do as they are told under the threat of punishment or adverse consequences. Such organizations focus on short-term goals. | Rules-based, process-driven organizations that operate through hierarchy, policy and 20 th -century “good management” practices. Employees are motivated by performance-based rewards and expected to fulfill the expectations of their roles. Long-term goals are identified but are often set aside in favor of short-term success. | Purpose-inspired, values-based organizations that are led with moral authority and operate with a set of core principles and social imperatives. Employees are inspired by a desire for significance and encouraged to act as leaders regardless of role. Such organizations are focused on long-term legacy and sustainable performance. |



The HOW Report® provides metrics that demonstrate the real and significant return on investment of E&C programs shaped by mission and values. Instead of using number of employees trained or similar inputs to “prove” program efficacy, The HOW Report® documents the transformative effect of democratic, transparent and values-driven corporate governance. Moreover, the global study provides compelling evidence that this model of governance significantly drives down the incidence of misconduct. By focusing on values rather than “a rule for every occasion,” the HOW framework points the way to ethics as a transformative ingredient in all aspects of an organization’s success.

Additionally, organizations that are values-based are eight times more animated by long-term goals, six times more resilient and eight times more efficient at making expedient, effective and values-based decisions.

Given this overall outperformance, it is not surprising that E&C programs centered on values are more effective than ones that aren't. A values-based approach toward shaping culture emphasizes and sets expectations, not just about what can and cannot be done according to rules, but rather what should and should not be done

in alignment with core beliefs. In rules-based environments, that is, everyone's job is to do the next thing right—to act correctly. In values-based environments, in contrast, everyone's job is to do the next right thing—to act morally. This is a particularly important distinction for this age of hyper-transparency in which actions that are technically legal can be perceived as "wrong" under the glare of public scrutiny. Values-based organizations enable employees to deliver on their fullest potential not only in the results of their projects, but also in their commitment to responsible business practices.



Detailed Findings

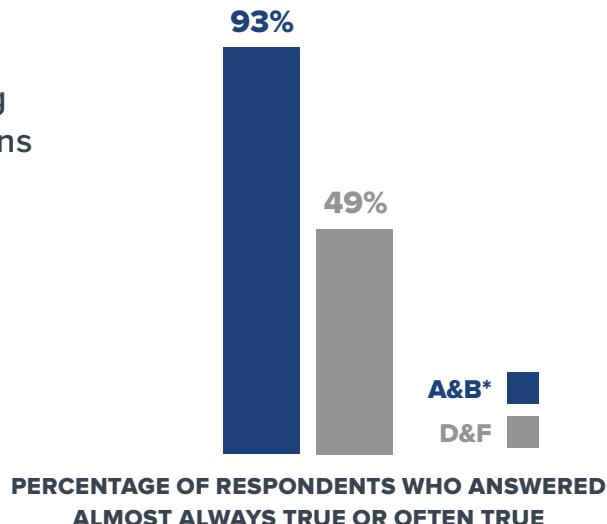
The basis for LRN's approach to evaluating E&C program efficacy—that measuring outcomes is more revealing than inventorying inputs—is found throughout the Program Effectiveness Report's results. These insights are not only enlightening but also actionable. Here are four examples:

1 | The most effective E&C programs are embedded in business operations.

For example, organizations with high-performing programs view their strong values orientation as an element of brand appeal.

Fig. 1.1

Our organization
recognizes that living
our values strengthens
our brand appeal.



* For clarity of takeaway, the following charts reflect organizational behavior at the extremes. A&B responses represent those organizations with the highest scores, while D&F responses represent those with the lowest.

Further, their C-suite is actively engaged in operationalizing the organization's values in concrete ways, including through management, communications, decision-making and incentives.

Fig. 1.2

Which of the following behaviors does your C-Suite demonstrate?

| | Holds leaders accountable for ethical behavior | Promotes ethics without prompting | Models values-based behavior | Engages the Chief E&C Officer while making strategic decisions | Considers managers' ethical behavior for performance reviews and as a prerequisite for promotion | Holds leaders accountable for owning E&C in their business areas |
|-----|--|-----------------------------------|------------------------------|--|--|--|
| A&B | 85% | 67% | 73% | 58% | 51% | 62% |
| D&F | 53% | 40% | 61% | 43% | 42% | 49% |

Similarly, middle manager engagement in E&C programs correlates to high performance. Though tone at the top is important, other managers must be involved in ensuring alignment on key values and behaviors.

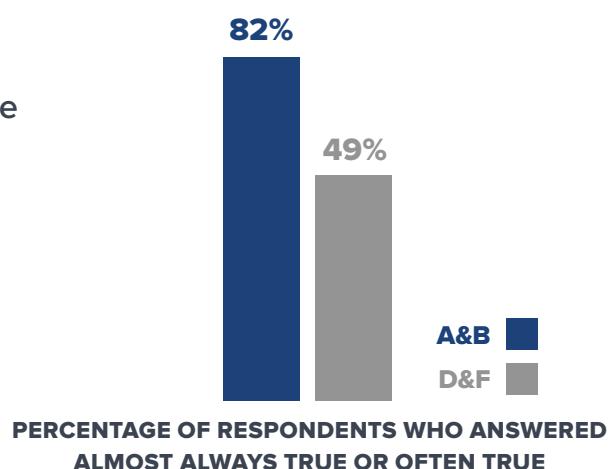
Fig. 1.3

Our middle managers clearly know they are accountable for...

| | Assessing E&C risk for their business and teams | Actively supporting the E&C program | Modeling values-based behavior | Dealing effectively with E&C concerns raised by their teams |
|-----|---|-------------------------------------|--------------------------------|---|
| A&B | 74% | 83% | 73% | 61% |
| D&F | 48% | 63% | 61% | 54% |

Fig. 1.4

Our organization develops and/or coaches middle managers to enable them to promote our E&C program.



2 | The most successful E&C programs use a variety of channels to convert guidance into practice.

Rather than rely on a “one and done” approach to ethics and compliance, high-performing programs communicate guidance and values through many channels on an ongoing basis.

Fig. 2.1

Rate the degree to which your code of conduct meets the following goals:

| | | | |
|---|--|--|---|
| Helps align values-based behaviors with achievement of business goals | Integrates organizational core values by expressing them in behavioral terms | Connects people with a clear sense of the organization’s purpose | Inspires commitment to ethical behavior |
| A&B | 92% | 91% | 90% |
| D&F | 68% | 73% | 74% |

Fig. 2.2

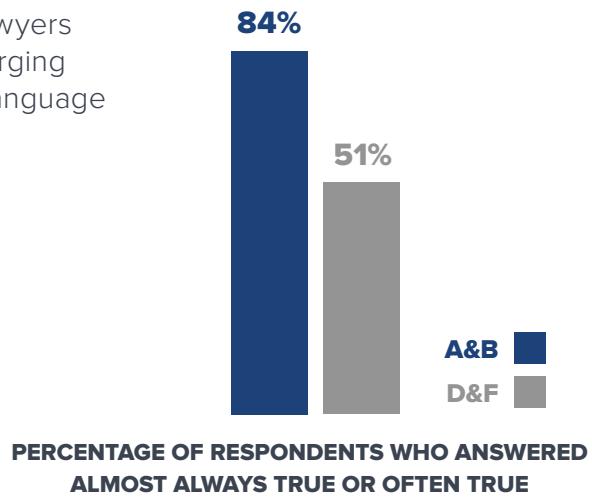
Which of the following strategies do you currently use to embed your code of conduct?

| | | | | |
|------------------------|------------------|------------------|-----------------------|---------------------------|
| Discussions Led by E&C | E-mail Campaigns | Online Education | Internal Social Media | Classroom Style Education |
| A&B | 73% | 59% | 83% | 35% |
| D&F | 57% | 45% | 73% | 28% |

Simplifying E&C policies, many of which are written by lawyers with regulators rather than employees in mind, is an emerging best practice. Making policies accessible through clear language helps employees internalize guidance.

Fig. 2.3

Our policies effectively communicate the organization's expectations of behavior in a clear and concise manner.



Similarly, E&C training has moved away from long repetitive modules with layers of rules and prohibitions to formats that engage rather than lecture employees.

Fig. 2.4

Indicate how likely it is that your organization will use one of the following techniques to improve your E&C training programs:

| | | | | |
|---|----------------|------------|-----------------------|------------|
| Shorter, More Frequent Training Modules | A&B | 84% | Facilitated Workshops | 79% |
| | D&F | 66% | | 65% |

3 | High-performing programs proactively convert regulatory guidance into practice.

One challenge for E&C professionals is responding to “informal” guidance from regulators, which has become increasingly prevalent. The most effective programs internalize such guidance and continuously improve.

Fig. 3.1

Indicate the extent to which your organization has implemented each of the following ongoing guidance from the U.S. government on what makes an effective program:

| | | | |
|--|--|---|--|
| Cross-functional commitment and cooperation by HR, Audit, Finance and Sales to E&C | Assuring internal controls are sufficient for magnitude of organizational risk | Compliance policies that are clear and easily understood by employees | Root-cause analysis of executive/employee accountability when violations occur |
| A&B | 76% | 74% | 80% |
| D&F | 51% | 54% | 61% |

4 | High-performing programs spread their impact broadly, recognizing that it is the whole organization that needs to be engaged in ethics.

Consistent with moving away from the “silo-based” approach to ethics and compliance, high-performing programs involve other corporate departments actively in their efforts.

Fig. 4.1

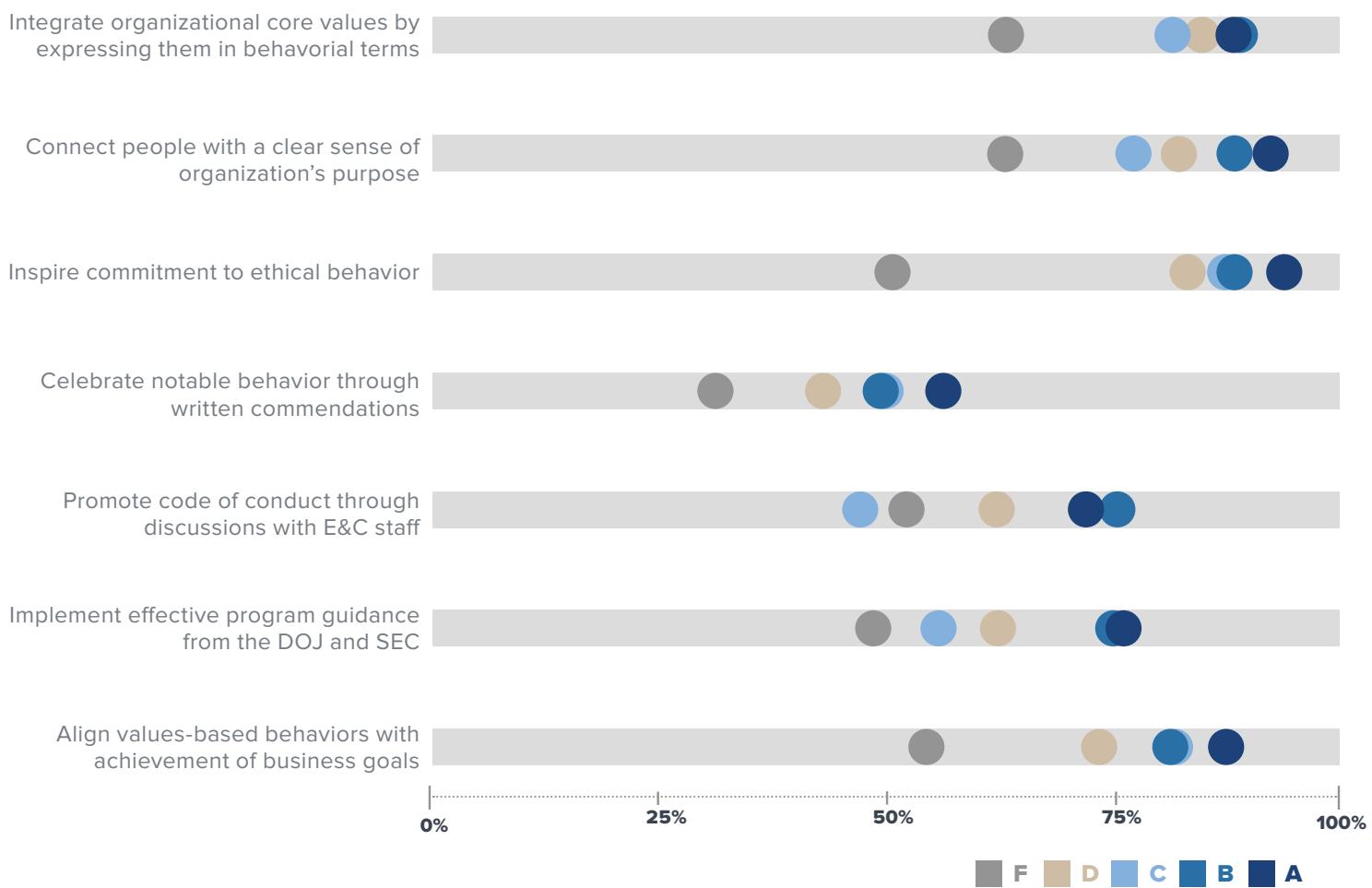
Indicate how effective each of the following are at being catalysts for your company’s values and their application in the workplace:

| | C-Suite | Human Resources | Internal Audit Department | Legal Department | Sales/Marketing | Finance/Accounting |
|----------------|------------|-----------------|---------------------------|------------------|-----------------|--------------------|
| A&B | 85% | 80% | 74% | 87% | 56% | 69% |
| D&F | 52% | 54% | 51% | 64% | 39% | 55% |

The Path Forward

The unavoidable takeaway of this edition of the Performance Effectiveness Report is that the best course for E&C leaders is to use values as the basis for promoting a more ethical ecosystem. Instead of an emphasis on inputs and more and more layers of rules, it is a focus on culture and behavior that will make the difference. That's why much of our work at LRN is now geared toward both helping companies see the need for this reorientation and providing them with the means to achieve it. As the results of this report demonstrate (see Fig. C), creating a truly ethical organization involves a multi-front approach to an implementation that embeds values in the DNA of an organization.

Fig. C
How Ethical Organizations Get There



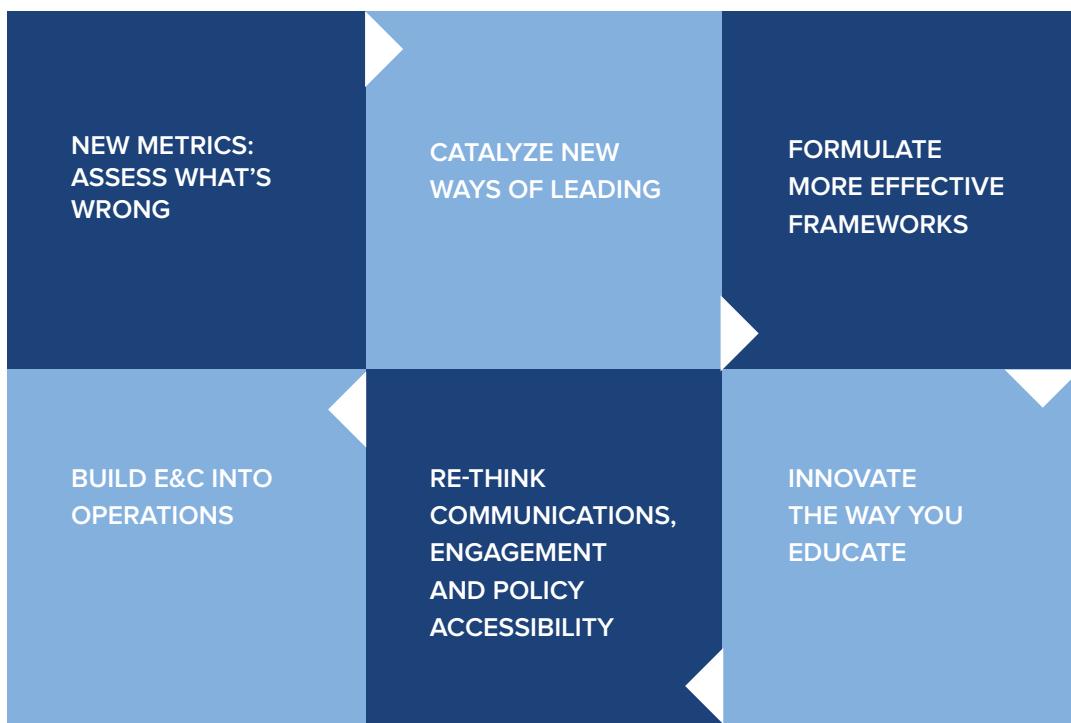
A Snapshot of Best Practices

This process is a journey, involving far more than an off-the-shelf product, and it is certainly more than a matter of running through a checklist. It requires patience, a willingness to look at problems candidly and the courage to tackle them. But as demonstrated in the 2016 edition of The HOW Report®, the journey pays significant dividends, not only in more ethical employee behavior but also in almost every category of aspirational business outcomes.

Of course, while every organization's starting place and circumstances are unique, some steps are common to all of them once they embark on the journey (see Fig. D). The first step is using new metrics focused on behavior to assess effectiveness in the workplace. The others are focused on building effective frameworks to operationalize values throughout the organization, using the E&C program as a catalyst. LRN's Advisory Services practice has substantial experience in this process and has developed qualitative and quantitative tools to assist those who want to undertake it. Using our platform of E&C education solutions and policy simplification practice, we can help your organization improve culture, behavior and, ultimately, business outcomes.

Fig. D

Steps on the Journey to Values-Based Organizations



Appendices

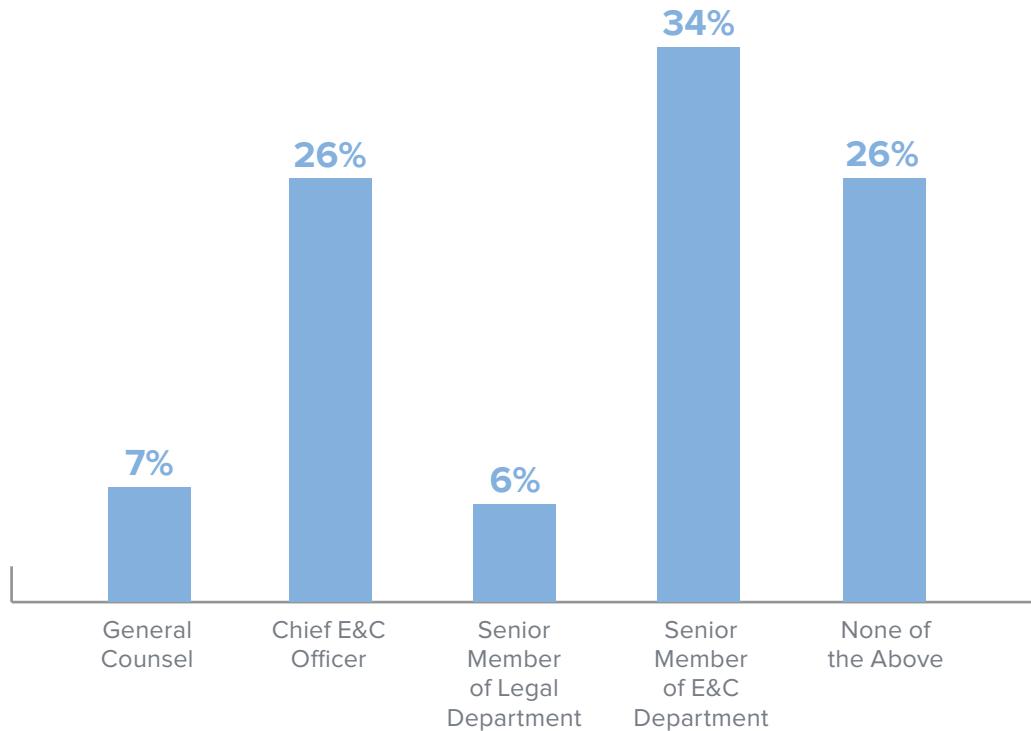
Appendix A: Surveys Reviewed

Ethics & Compliance Initiative (ECI) Research Center's National Business Ethics Survey (2013); ECI's Global Business Ethics Survey (2016) and Blue Ribbon Principles and Practices of High Quality Ethics and Compliance Programs (2016); SAI Global with Baker & McKenzie Compliance and Ethics Benchmarking Survey (2013); Society of Corporate Compliance and Ethics and the Health Care Compliance Association's Compliance and Ethics Report (2014); Deloitte and Compliance Week's Compliance Trends Survey (2015); Ethisphere and Convergent's Compliance Strategy and Performance Report (2015); Ethisphere's Actionable Insights from the World's Most Ethical Companies (2015); NYSE Board of Director's Compliance and Ethics Survey (2015); Organization for Economic Co-operation and Development's Corporate Governance and Integrity Report (2015); PricewaterHouseCoopers' State of Compliance Survey (2015); Charter Global Management Accountant's Managing Responsible Business (2016); Kroll and Ethisphere's Anti-Bribery and Corruption Benchmarking Report (2016); NAVEX Global's Ethics and Compliance Training Benchmark Report (2015 and 2016); NAVEX Global's Ethics & Compliance Policy Management Benchmark Report (2016); Society of Corporate Compliance and Ethics and the Health Care Compliance Association's Compliance and Ethics Program Objectives Survey (2016); and Thomson Reuter's Cost of Compliance Report (2016).

Appendix B: 2016 PEI Survey Respondent Data

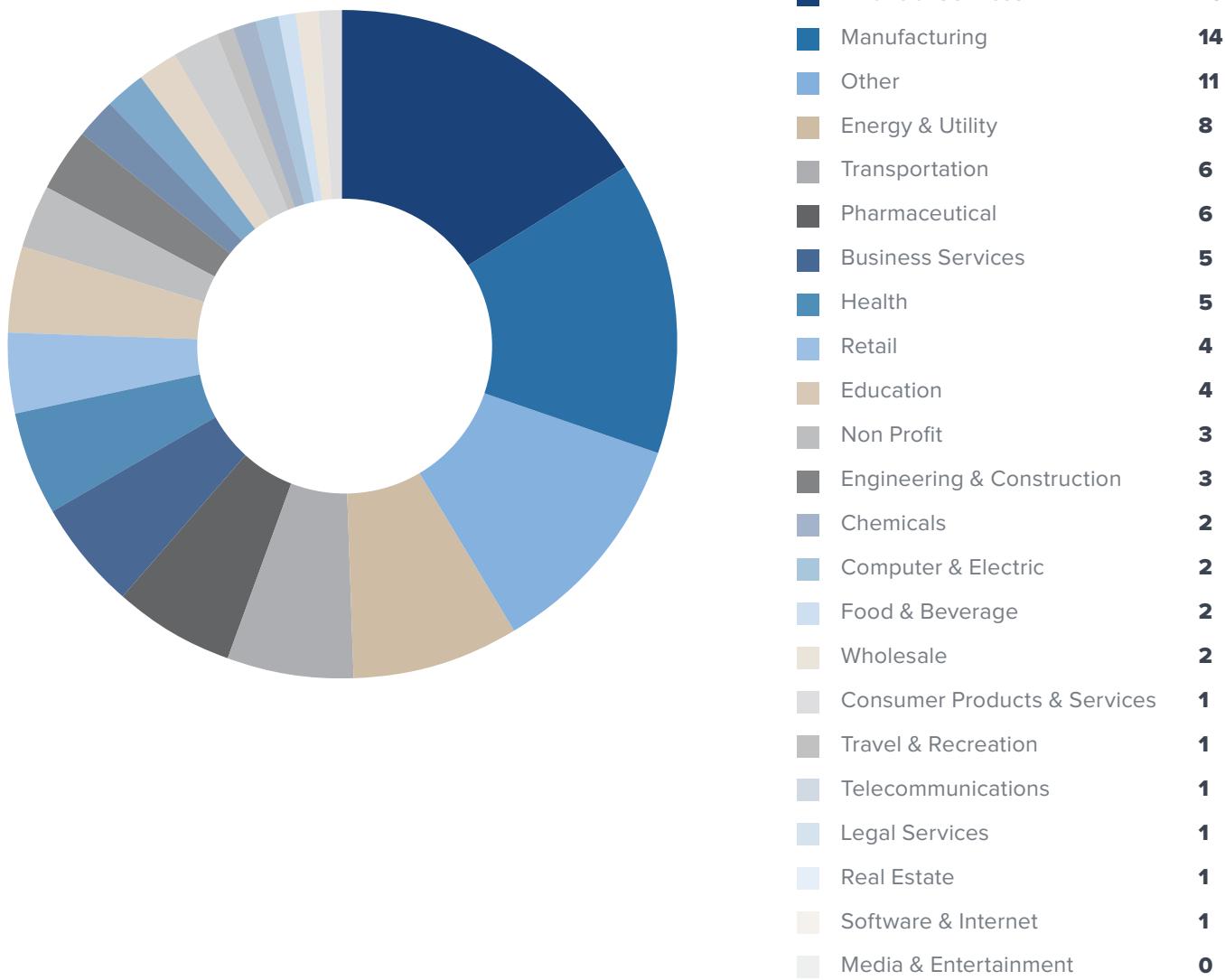
Which of the following most accurately describes your current role?

Percentage of Respondents Based on Job Title



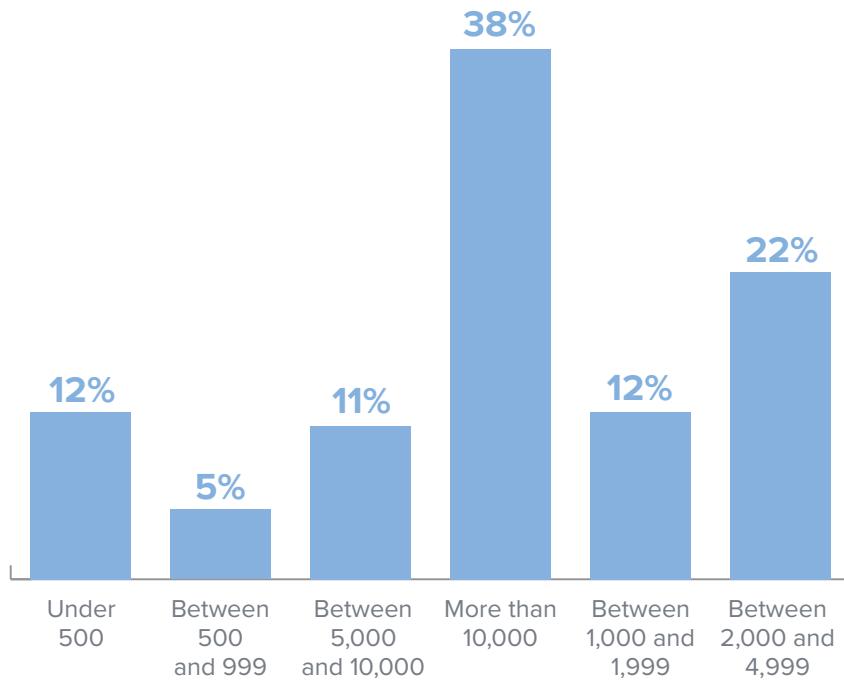
What is your company's primary industry?

Respondents by Industry



How many full-time employees does your company have?

Organization Size of Respondents



Where is your company's primary headquarters?

Respondents by Organization Headquarters

