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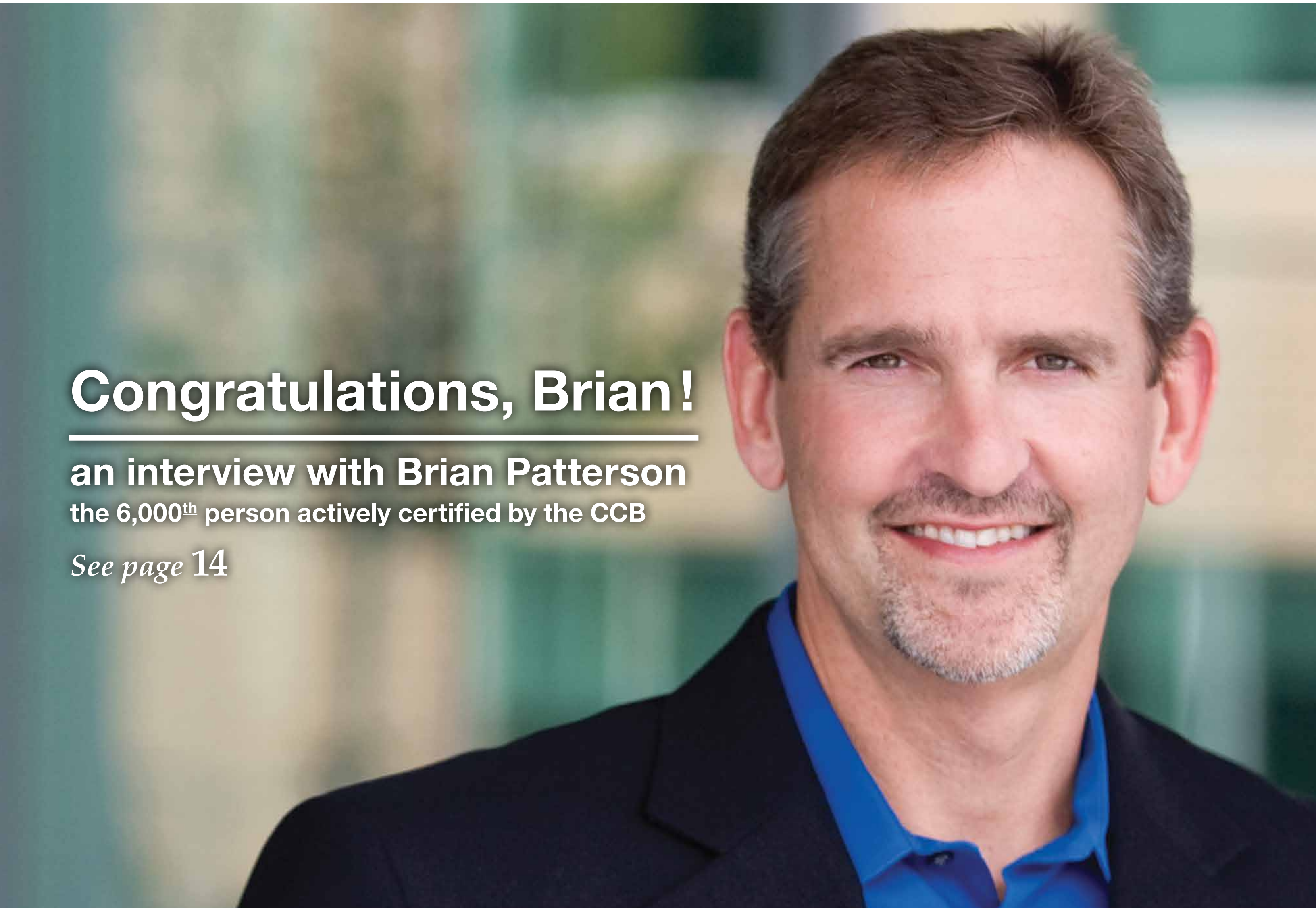

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an interview with Brian Patterson

the 6,000th person actively certified by the CCB

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by Patrik S. Florencio, Samuele Butera, and Erik Ramanathan

Compliance and business success, Part 1: The dark side of performance pressure

» Escalating financial penalties are making effective compliance increasingly vital to sustainable business success.

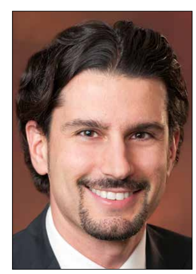
» The root cause of many compliance violations is not intentional fraud or misconduct, but the unrelenting pressure exerted by management to hit short-term financial targets.

» Culture is the output of the "noise in the system" that is heard, seen, and felt by employees.

» In high-pressure environments, a code of conduct by itself is insufficient.

» Every aspect of corporate culture must balance performance pressure with compliance pressure.


Florencio


Butera


Ramanathan

It's the oldest question in the book. How do you drive appropriate behavior? For companies and their leadership, the question has never been more financially significant. In the new era of heightened government enforcement, financial penalties for compliance violations have climbed to hundreds of millions of dollars, and in many cases even reached into the billions. In the pharmaceutical industry, a few quick examples suffice to make the point. GlaxoSmithKline recently paid $3 billion for marketing violations, topping previous record holders such as Pfizer ($2.3 billion) and Eli Lilly ($1.4 billion).

In the past decade alone, over $25 billion in fines have been paid just for marketing violations by pharmaceutical companies. The story is much the same in other highly regulated industries, such as financial services, wealth management, insurance, telecommunications, medical devices, and engineering. To name just a few examples, Goldman Sachs paid $550 million for misleading investors, AIG paid $800 million for accounting and bid rigging practices, HSBC paid $1.2 billion for failing to maintain an effective anti-money laundering program, and Siemens paid $1.3 billion for bribing foreign officials.

As the trend toward ever escalating financial penalties for compliance violations continues to rise, one business reality is becoming clear. In the future, the most successful businesses will not only be the best at generating revenue, but also the best at compliance, so they can retain their profits by avoiding mega fines and other significant compliance sanctions like plant closures and forced product withdrawals.

Finding a solution

So, what are companies doing to address this major business reality? Giving it the same degree of focus, passion, and respect as other multi-million dollar business issues? Innovating and holding cross-functional strategy meetings at the highest levels to ensure compliance and business ethics? Not quite. Most companies have a code of conduct – true, but the real impact of these codes is arguably limited. Even with periodic training and awareness campaigns, employees are far more likely to be influenced by workplace pressures and the daily behavior they see exhibited around and above them than they are on written rules and values. Codes are a foundational and essential step – no question, but alone they will do nothing to stem the tide of fines and scandals. What is needed is a solution whose innovation and depth matches the risks and size of the problem.

So what else are companies doing? The most visible change has been increased investment in corporate Compliance departments. These departments are a company's front-line defender, implementing corporate-wide controls designed to detect and fix problems in high-risk areas before they morph into serious compliance violations. But in high-pressure environments in which the imperative to hit target is overpowering, controls alone cannot prevent the multitude of violations that expose companies to major financial risk. To genuinely address compliance risk, the business world will need to confront an uncomfortable reality: The true root cause of so many ethics and compliance violations is not intentional fraud by criminal employees, but is rather the unrelenting pressure exerted by management to hit short-term financial targets and the force this can unwittingly exert on employees to hit such targets at any cost. (Compliance violations that occur unintentionally by human error or from a lack of knowledge of the rules are well understood and not are the focus of this article; these types of violations are best prevented and identified through training and controls).

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Three major forces fueling compliance violations

The first force fueling compliance violations is greed and opportunity. An opportunity to make money inappropriately presents itself and, over time, greed overpowers caution and ethics. This is the classic case of the criminal employee. For instance, an ex-Citigroup employee working in the bank's Treasury Finance department managed to transfer $22 million in company funds to his private account.[1] His ploy was to assign a fraudulent contract or deal number to the wire transfer instructions to make it look like the transfers were supported by an existing Citigroup contract. It was a crime of opportunity, because but for his employment at Citi, the particular role he played there, and the absence of adequate controls, he would never have had the opportunity to make $22 million magically appear in his own bank account.

The second force fueling compliance violations is direct pressure. This is where someone powerful, such as a boss or influential colleague, directly pressures someone else to violate the law. A classic example is what allegedly took place at WorldCom and led to a $750 million compliance penalty. Faced with rapidly declining sales, the CEO and CFO directly pressured the financial controller to report financial reserves (profit made in the past) as new profit to give the impression that the company's earnings were stable. The financial controller resisted at first, but ultimately succumbed to the power of his bosses. Absent the abuse of power, the financial controller and his team would not have deviated from past lawful practice, cooked the books, and misled investors by falsely reported earnings. Had the CEO and CFO been able to commit the violation themselves, they may have done so. However, they needed the "help" of those who generate and submit financial statements. The only way to achieve the result they desired was to exert powerful influence on others under them through direct pressure.

Had the CEO and CFO been able to commit the violation themselves, they may have done so. However, they needed the "help" of those who generate and submit financial statements.

The last major force fueling compliance violations, and the focus of this article, is unbalanced performance pressure. This exists in companies where the balance has tipped so decisively toward short-term financial performance that the culture is easily interpreted by the workforce as "performance at any cost and by any means necessary." This is arguably the least controlled and admitted force that fuels violations. Ironically, it may also be the most widespread and accountable force, because although the first two forces arise only sporadically when the opportunity presents itself, this force acts upon the workforce every day.

Also unlike the first two forces, this force is "indirect" because, although it is powerfully perceived, no one has directly told or pressured any employee to violate the law. Quite the contrary, senior leadership may have voiced its commitment to doing things right. However, the corporate culture and environment created actually pushes employees to commit violations by pressuring them to hit targets at any cost. This is a reality that can no longer be ignored by senior leaders and their management, because the prevention of mega-fines coupled with plant closures, forced product withdrawals, and other significant compliance sanctions will only be possible once this major root cause of violations has been understood and acknowledged by business leaders, and then properly and candidly addressed.

Unbalanced performance pressure

Imagine that a chocolate company makes two kinds of round chocolate eggs, one pure chocolate and the other with a peanut center. Part of the manufacturing process requires the chocolates to first be compressed into little balls, and then be coated with a crunchy sugar outer layer. The two processes of compression and coating are accomplished by two separate machines, which means the compressed chocolates need to be captured and then transferred to the coating machine. This is accomplished via sterile bags to ensure the chocolates are not contaminated with foreign agents during the transfer.

But imagine that a system failure has caused the manufacturing plant to run out of sterile bags. A decision-maker within the manufacturing team (let's call him Jim) is now facing a fork in the road. Does he stop production until a fresh supply of sterile bags has been acquired, or does he come up with a creative solution to keep production moving, even if that "solution" is inconsistent with manufacturing regulations and hence crosses the line?

Neither Jim's boss nor anyone else is aware of the issue or has told him to keep production moving at any cost, so there is no direct pressure acting upon him. Nor is there any personal financial windfall to Jim in crossing the line, so greed and opportunity are not in play. Absent any other force, Jim would likely do the right thing and await a fresh supply of sterile bags. But there is a force acting upon him. It comes from the corporate culture created by his senior leadership and is powerfully experienced by him as "performance pressure." At this critical moment in time, Jim's decision is much more likely to be determined by that corporate culture than by controls and deterrents.

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From a control perspective, there may be a policy that requires the use of sterile bags, and Jim may have been properly trained on that policy. Additionally, monitoring, auditing, and other methods of oversight may eventually detect any deviation made by Jim from the approved procedure, thereby limiting the damage. But by that time, the deviation will already have occurred.

To really have a shot at reducing the risk of fines and penalties for these types of compliance violations, the real question is: What thoughts are running through Jim's mind at the moment he is pondering what to do? His thoughts may run something like this: If I stop production to wait for sterile bags, I will miss my weekly/monthly production quota. What will happen to me if I miss that quota? Will I be faulted for not meeting my objective? Will my bonus be impacted? Will my job be at risk? What would my boss want me to do? Will he support me when it comes time to explain to upper management why quotas were not met? Should I raise this issue with him or avoid that conversation by coming up with a solution myself? I could re-use old bags and no one would ever know. If my boss and management did find out, what would their reaction be? Am I better off missing my production quota, or deviating from standard procedure and risking detection?'

The answers to these worried concerns, weighed and balanced in Jim's mind, will dictate the ultimate choice made. And to find those answers, Jim will look to corporate culture; to what others do and say around and, especially, above him (whether or not that is consistent with the code of conduct); to what the company actually values, rewards, and punishes. He will easily distinguish between what is said out of political correctness and what is real. All of the cues around him, embedded in the fabric of his company's culture, will answer what is truly valued the most: *how much* product is made (sales), or *in what way* that product is made (quality/safety). Stated differently, Jim will look to the balance between performance pressure and compliance pressure within the company's culture. Ironically, if Jim's senior leadership was aware of the situation and could reach down into the plant and speak to Jim directly, they might say "Do the right thing." But is this clear to Jim? Does it jive with his reality?

What if Jim works in a culture in which the values messaged by the C-suite are inconsistent with how the business actually operates? What if Jim perceives a culture of fear in which there is little room for otherwise competent employees to make honest mistakes and grow, a culture in which performance pressure overpowers any existing compliance pressure?

If Jim hears little else but the imperative to meet production quotas from his boss and production management, he will assume *how much* matters more than *in what way*. If he and those around him are only rewarded in bonuses, promotions, and awards for *how much*, his assumption will be reinforced. If quotas are set without room for errors or delays, or are insufficiently resourced to be accomplished in the right way, his assumption will be further strengthened. If he and those around him are blamed, de-valued, or terminated for missing quotas (even when competent, best-efforts are applied), his assumption will be solidified and he will likely come up with a creative solution, like re-using old bags, even if this is a breach of manufacturing regulations. The result of this breach could be product contaminations and a mix-up between the peanut and pure chocolate products, both of which could compromise consumer safety (and even be deadly for peanut allergic consumers).

And if Jim is feeling this way about his corporate culture, how many others at his company are feeling the same? How many decisions are being pushed by unbalanced performance pressure in the wrong direction each day in every department at every facility owned by Jim's company?

If Jim was in research and development, he would look to culture to determine whether his company cares more about *how many* new products he develops (sales), or *in what way* he develops them (quality/data integrity). If he was in finance, he would look to the culture to determine whether his company cares more about *how much* profit and loss is reported to senior leadership, the Street, and/or shareholders (perceived financial strength of the company), or *in what way* that profit and loss is classified and reported (actual financial strength of the company). If he was in sales and marketing, he would look to culture to determine whether his company cares more about *how much* he sells (sales), or *in what way* he sells (in compliance with promotional laws).

Absent a comprehensive counter-balancing force embedded throughout the company's culture to address performance pressure, it can be experienced so acutely that it becomes easier to engage in non-compliant behavior to achieve a target than to face the consequences of failing to hit it. And it doesn't matter if a company makes chocolates or other food products, medicine or medical devices, or creates complex financial products—the same pressure exists in every industry.

The big disconnect

One of the reasons for so many compliance violations at companies, and for the surprise and disappointment of executive management upon discovering them, is the sometimes big disconnect between what is messaged by the C-suite (e.g., code of conduct, executive blogs, and periodic communications) on the one hand, and the culture it actually creates, however unknowingly and unintentionally, on the other. From a leadership perspective, if you are not defining and taking the steps necessary to develop and maintain the culture you want, you will end up with a culture you never intended which may threaten your long-term success and sustainability. And while some companies do proactively attempt to shape their culture, they usually do so through the same one-sided performance-driven lens they apply to everything else, which only serves to further strengthen the assumption of employees that *how much* matters more than *in what way*.

A "winning culture" that attracts and retains the best people, provides the drive to win, and increases productivity is vital to the success of business, but so too is a "compliant culture" that fosters the respect, trust, and goodwill of employees, avoids fines and penalties, and ensures a company's long-term sustainability. Both of these essential goals can be achieved through a balanced culture.

But at many companies, this is not what exists today. To truly have a shot at minimizing corporate risk in this age of unprecedented government enforcement, companies will need to recognize and admit that performance pressure is a significant root cause of many of their compliance violations, and that their current culture does not adequately balance the emphasis placed on performance and compliance in terms of time, activity, and perception.

Conclusion

At many companies, the current noise in the system that is heard, seen, and felt by employees has tipped the balance so decisively toward short-term financial performance that it is often interpreted as performance at any cost and by any means necessary. The existing culture-balancing tools of a code of conduct, periodic executive blog/communications, and yearly code training by the Compliance department lack the power to appropriately guide and balance that daily performance pressure. ✳

In Part 2 of this article, we will present a concrete set of practices designed to visibly, consistently, and measurably counter-balance the performance pressure that so often leads to costly compliance failures.

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1. Mitchell Maddux: "Ex-Citigroup Exec Pleads Guilty to Embezzling $22M." *New York Post*, Sept 6, 2011. Available at http://bit.ly/1cIqp9Z