The Conference Board of Canada
Insights You Can Count On

Briefing July 2004

Measuring the Performance of Corporate Ethics Programs

Creating an Ethics Performance Story

INTRODUCTION

The cost to an organization of a real or perceived ethical lapse is high. Recent corporate scandals in North America have led to greater scrutiny of corporate behaviour and prompted regulators to crack down on businesses that cross the line. As public concern mounts over unethical corporate behaviour, companies will want more than ever to ensure that their ethics and compliance strategies are as effective as possible.

This briefing presents one strategy for measuring the performance of corporate ethics programs. It is based on the proceedings of a recent meeting of the Corporate Ethics Management Council.[1] The strategy outlined here adapts public sector expertise in evaluating the performance of public programs to the context of corporate ethics, and it supplements this adaptation with literature on results-based non-financial performance measurement.

Recent corporate scandals have prompted a crackdown on businesses that cross the line.

THE CHALLENGE OF MEASUREMENT

Despite obvious incentives to carefully manage the performance of their ethics programs, many organizations are stymied by the puzzle of what to measure and how to do it. Unsure how to quantify a "soft" concept

Exhibit 1
Definitions

For the purpose of this briefing:

Ethics programs refer to activities carried out by an organization in order to reduce the occurrence of wrongdoing, whether illegal or otherwise, within that organization.

Compliance programs refer to activities carried out by an organization in order to reduce instances of non-compliance with the law and corporate policy.

Inputs are the resources invested in an ethics program, such as staff time and money.

Activities include everything that is done to transform inputs into outputs, such as drafting the code of conduct.

Outputs refer to the tangible things produced by an ethics program, such as a code of conduct or an ethics hotline.

Outcomes are the tangible or intangible results that follow, directly or indirectly, intentionally or unintentionally, as a result of our outputs.

Indicators are quantitative or qualitative measures that, when measured, can give us a sense of whether what we want or expect to happen (input, activity, output or outcome) is actually happening or has happened.

Source: The Conference Board of Canada.

such as ethics, many corporations neglect to measure the performance of their ethics programs. (See Exhibit 2.) Others measure only what they can easily count (numbers of employees trained, ethics pamphlets printed, amount of money spent on ethics staff, etc.) without establishing a causal link between these things and the desired outcomes of the program.

This approach is problematic for the following reasons:

First, performance measurement should focus on the things that really matter, not those that can easily be counted. There is nothing wrong with paying attention to areas that are amenable to data capture, but it is no substitute for measuring progress against the ultimate, if difficult to quantify, objectives of the program.

Second, it is a truism that "what gets measured gets done." Organizations and individuals tend to focus their energy on actions that are being monitored and upon which they will be judged. Inattention to monitoring and measuring the performance of a corporate ethics program sends a message that ethics are not a priority and encourages people to devote their attention to other tasks.

Exhibit 2
Measuring the Return on Investment of Corporate Ethics Programs

U.S. companies recently surveyed by the META Group on behalf of PricewaterhouseCoopers reported that they had significantly increased their investment in governance, risk and compliance. However, despite this increase, almost one-third of respondents reported that they do not measure the effectiveness of these investments.

Source: PricewaterhouseCoopers.

Third, inadequate performance measurement can be worse than no performance measurement. Because "what gets measured gets done," poorly thought-out performance targets can act as "perverse incentives," encouraging irrational, perhaps unethical, outcomes.

Finally, any program that is unable to convincingly justify its value to an organization is unlikely to be adequately supported for long. As one ethics professional has written, "Why should compliance [programs] be different from any other parts of the organization that need to establish their value? If we believe compliance programs have value, then we need to find ways to show it."[2]

THE LIMITATIONS OF MEASUREMENT

Before creating a performance measurement strategy for a corporate ethics program, it is important to understand the obstacles to definitively "proving" that an ethics program has reduced unethical behaviour within an organization. Some of these obstacles are outlined below.

The ultimate outcomes of an ethics program do not easily lend themselves to measurement.

The difficulty of collecting meaningful data: The ultimate outcomes of an ethics program—for example, a reduction in unethical behaviour—do not easily lend themselves to measurement. How can increases or decreases in ethics or values be quantified? And, since unethical behaviour is by nature covert, how can a company be certain that its programs are actually reducing unethical behaviour, rather than merely *reported* occurrences of unethical behaviour?

Attribution: Cause–effect relationships can be difficult to establish. How can you tell whether it is your program, among a myriad of other influences, that is improving the ethical environment in the organization? Conversely, if there is no improvement, how can you determine whether this is due to flaws in the ethics program or to external factors?

Time lag: Transforming the ethical environment within an organization is a gradual and painstaking process, yet ethics and/or compliance managers need to be able to show results on a regular basis. Moreover, time lags compound the problem of attribution; the longer the lag between a program's activities and the desired outcome, the more difficult it becomes to demonstrate cause–effect relationships.[3]

CREATING AN ETHICS PERFORMANCE STORY

Measuring the performance of an ethics program is therefore not about trying to prove that the program has made the organization more ethical. Rather, it is about creating a persuasive argument or credible "performance story"[4] that:

- demonstrates that the logic of the ethics program is sound (i.e., the activities and outputs of the program might reasonably be expected to contribute to the ultimate outcomes desired);
- demonstrates that the program is being managed with the ultimate outcomes in mind; and
- provides evidence that the program is moving in the right direction.

Creating an ethics performance story is a three-step process that:

1. Establishes agreement on the ultimate outcomes of the ethics program;
2. Creates a program plan, or logic chain, that shows how those ultimate objectives are to be achieved; and
3. Creates indicators that will show, directly or indirectly, that the ethics program is on track to achieving its intended outcomes.

STEP 1: ESTABLISH AGREEMENT ON DESIRED ULTIMATE OUTCOMES

It is impossible to measure the performance of a program without knowing its purpose. Thus establishing agreement on ultimate outcomes is the necessary first step in performance measurement. There are various questions to consider in this context: is the ultimate outcome to ensure that all business practices comply with existing laws and regulations? Is it to conform with the ethical requirements of external stakeholders, such as clients or shareholders? Or is it the creation of a less compliance-driven, more values-based ethical environment within the organization?[5]

Exhibit 3
Some Possible Outcomes of a Corporate Ethics Program

High Level
Unethical or illegal behaviour is reduced or eliminated
Employees do the right thing
Employees are more committed to the organization
High-quality employees are recruited
Exposure to legal and reputational risk is reduced

Shorter Term
Employees are willing to seek advice on ethical issues
Employees are willing to report wrongdoing and "bad news" to management
External needs of stakeholders are met
Organizational values permeate the decision-making process at all levels

Source: Joshua Joseph (see Suggested Reading); Ethics Policy and Integration Centre.

The choice of ultimate outcomes belongs to your organization. The important thing from a performance measurement perspective is that there must be agreement on what those desired outcomes are: "You cannot do a good job of performance measurement in the absence of agreement on high-level outcomes. High-level outcomes drive the design of your logic model [or logic chain], which in turn drives the selection of your performance indicators."[6]

STEP 2: BUILD THE LOGIC CHAIN

Once there is agreement on the desired ultimate outcomes, an organization can proceed to build the logic chain. A logic chain is a sort of map that shows you where you want to go (your ultimate outcomes) and what you need to do to get there. Ideally, it is created by working backward from a clear set of ultimate outcomes to identify:

- the shorter-term outcomes required to support the attainment of the ultimate outcomes;
- the outputs required to support the attainment of the shorter-term outcomes; and, finally,
- the inputs and activities required to generate those outputs.

(See Exhibit 4 for a sample logic chain for a corporate ethics program.)

The components of a logic chain (inputs, activities, outputs and outcomes) are linked by logical assumptions. Many of these logical assumptions will be fairly obvious. For example, the inputs of staff time and resources devoted to creating a code of ethics can reasonably be expected to result in the creation of an actual document (output). Moreover, it is easy to measure whether this has happened. However, the further you move up the logic chain toward the ultimate outcomes—the things that really matter—the more difficult it becomes to demonstrate a causal link between your program and those results, and the more critical it becomes that your assumptions are well reasoned.

For example, Exhibit 4 contains an assumption that a code of ethics (output) will help increase the capacity of staff to deal with ethical dilemmas (shorter-term outcome). This assumption seems reasonable, but it is difficult to prove, at least directly. The problem is magnified as you approach the ultimate outcomes. The assumptions of the logic chain notwithstanding, it is virtually impossible to definitively demonstrate a causal link between (a) the creation of a code of ethics and (b) the ultimate objective of a reduction in unethical behaviour within the organization.

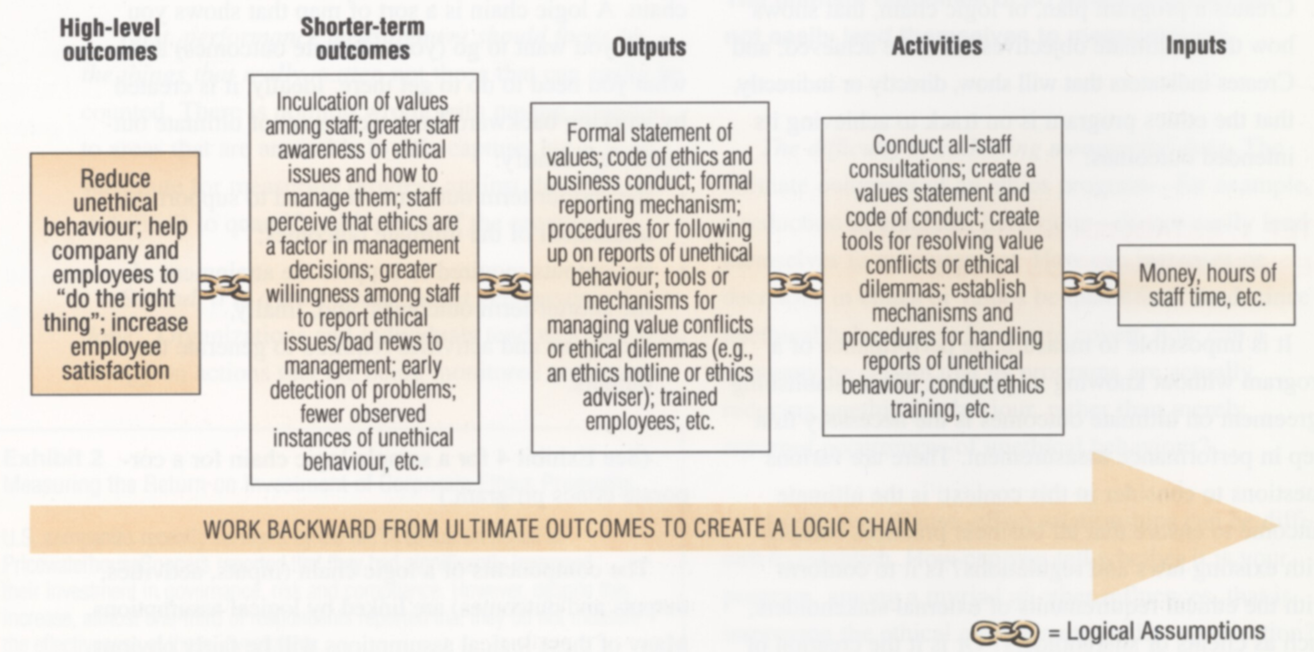
The logical robustness of each assumption in the logic chain is therefore of paramount importance. You can rely on measurement to tell you that outputs are being generated and, to an extent, that shorter-term outcomes are being achieved. But the further you move up the logic chain toward the ultimate outcomes, the more difficult measurement and causal attribution become and the more you need to rely on the assumptions of the logic chain. The performance measurement strategy, and indeed the performance of the ethics program, is only as strong as the weakest logical "link," or assumption, in the chain.

STEP 3: DERIVE INDICATORS FROM THE LOGIC CHAIN

The logic chain fulfills three important functions. First, it is a road map: it describes the steps planned in order to implement an ethics program (A leads to B leads to C…). Second, a logic chain provides a rationale for the ethics program—an argument for why what you are doing makes sense. Third, by laying out the steps from where you are to where you want to go, the logic chain tells you what you want to measure.

If a logic chain clarifies what you want to achieve and how you plan to achieve it, an indicator is the expression of how you will know if you are on track. An indicator should answer the question: "Has what I expected to happen as a result of my activities (the assumptions of the logic chain) actually happened?"

Exhibit 4
Sample Logic Chain for a Corporate Ethics Program



Source: The Conference Board of Canada.

The indicators selected will vary depending on the orientation of individual ethics programs (compliance-oriented, values-based, etc.) and the ethical and compliance issues unique to particular sectors and organizations. However, there are some basic rules of thumb that can be used to determine indicators.

Proxy indicators are never perfect, but if well thought out, they can provide an adequate indication of how an ethics program is doing.

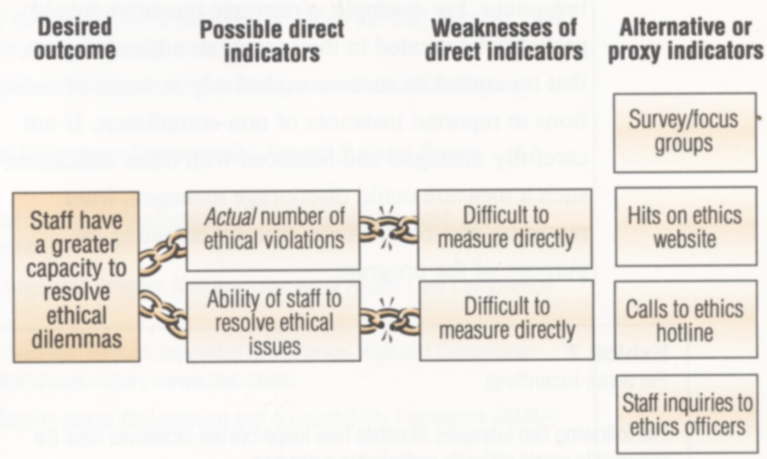
First, be aware of what can and cannot be measured directly. Use proxy indicators for outcomes that are difficult to measure directly. Solid ethics performance measurement strategies incorporate a mix of direct and indirect indicators. Inputs, activities and outputs can generally be measured directly. Shorter-term and ultimate outcomes will need to be measured using a combination of direct and indirect, or proxy, indicators.

For example, the capacity of staff to deal with ethical dilemmas is difficult to measure directly. However, it can be logically surmised that the number of hits on the website and calls to the hotline indicate that employees are using these tools to help them resolve dilemmas. Therefore, hits on the website and calls to the hotline can be proxy indicators for increased capacity.

Proxy indicators are never perfect, but if well thought through, they can provide an adequate indication of how an ethics program is doing relative to its core objectives. For example, an indicator such as "employee perceptions of whether ethical considerations are a factor in management decisions" would, at first blush, seem to be a highly imperfect proxy for the "real" level to which ethical decision-making has taken root within the organization. However, research has shown that instances of observed unethical behaviour decline when employees perceive that ethics are taken into account in decision-making and that there is a commitment by senior executives to ethical leadership.[7] A seemingly "soft" proxy measurement such as employee perceptions can then be seen as a highly relevant, if imperfect, indicator of the overall ethical environment within the organization.

Second, where causal attribution is difficult to demonstrate, rely on existing external research: You may be able to use existing research to support an assumption that cannot be backed up by measurement. For example, the sample logic chain in Exhibit 4 proposes the creation of procedures for following up on reports of unethical behaviour. It seems logical that the existence of procedures (output) would make employees more likely to report violations (shorter-term outcome), but it is difficult to demonstrate directly since we can never know what proportion of ethical issues is actually being reported. However, we can support our logic chain and create a more compelling performance story by referring to research that suggests a positive correlation between following up on reports and employee willingness to report violations.[8] Therefore, if an organization can demonstrate that reports of unethical behaviour are acted on, there is a robust argument that the creation and implementation of the follow-up procedures has made a contribution to attaining the overall objectives of the program.

Exhibit 5
Using "Proxy" Indicators Where Direct Measurement Is Difficult or Not Practical



Source: The Conference Board of Canada.

Third, keep indicators to a minimum and keep them simple: Having too many indicators, or indicators that are unnecessarily complicated, can make performance measurement unduly expensive and onerous. In the words of one ethics professional, "You don't want to give people an excuse not to [collect the data needed to measure performance]."[9]

Fourth, be sure to tap employee perceptions: Employee surveys and focus groups are an often-recommended tool for measuring the performance of a corporate ethics program. Surveys provide quantitative information that, over time, can be used to measure progress and that, if a standardized survey is used, can be used to benchmark across industries. Moreover, surveys can reveal ethical issues at the line employee level that managers and executives might not otherwise be aware of.[10]

Exhibit 6
Employee Perceptions

Think your ethics program is helping to inculcate an ethical environment in your company? Better check with the front-line staff. A recent study by Walker Information in Indianapolis found that line employees were only half as likely as executives (32 per cent to 60 per cent) to believe that staff are comfortable reporting ethical violations to management.

Source: Walker Information.

Fifth, be aware of the risk of creating perverse incentives: An indicator can be a dangerous thing if it provides incentives for unethical or counterproductive behaviour. For example, a perverse incentive would probably bè created in the case of an ethics program that measured its success exclusively in terms of reductions in reported instances of non-compliance. If not carefully managed and balanced with other indicators, such a measure could discourage managers from reporting non-compliance, thereby defeating the purpose of the program.

Exhibit 7
Perverse Incentives

The following two examples illustrate how inappropriate incentives have the potential to create ethically undesirable outcomes.

In the United States, the Securities and Exchange Commission is reportedly investigating whether linking incentives to the discovery of new oil and gas deposits may have encouraged managers and executives at a major multinational to overstate its proven energy reserves.

Recent research from the United States suggests that hospital "report cards" can discourage doctors from undertaking difficult surgical procedures that might drag down their performance scores.

Source: *Wall Street Journal* [on-line] (March 11, 2004) [cited June 7, 2004] <http//:online.wsj.com>; Mark Schacter (2003) (see Suggested Reading).

CONCLUSIONS

In a context of declining public trust in the private sector and an increasingly rigorous regulatory environment, Canadian corporations will want to ensure that they are managing their ethics and compliance programs for results. Having a robust performance measurement strategy helps to deliver results by communicating to employees that integrity is a priority, ensuring that program activities are aligned with long-term objectives, and identifying weaknesses and areas for improvement within the ethics program.

Every performance measurement strategy involves trade-offs—between clearly demonstrating results and the effort required to measure performance, between the time needed to effect real change and the need to demonstrate results relatively quickly, and between measuring progress toward desired outcomes and what the program can realistically be held accountable for.

Meaningfully measuring the performance of a corporate ethics program entails the creation of an ethics performance story. This story should contain:

- clear high-level objectives for the ethics program; and
- a rigorous logic chain describing the planned activities and how they will lead to the desired outcomes.

The performance story is bolstered by:

- ensuring that progress is measured against the desired ultimate outcomes, not just on what can be measured easily;
- selecting a combination of direct and proxy measures;
- selecting a few simple, logically robust indicators, carefully vetted for the risk of creating perverse incentives;
- using existing external research and proxy indicators where direct measurement is not possible.

1 The Corporate Ethics Management Council is a network of senior executives responsible for, in a variety of capacities, all facets of ethics and compliance management in major Canadian public and private sector organizations. It is facilitated by The Conference Board of Canada.

2 Vickie McCormick, "Justifying the Compliance Program Budget Through Compliance Program Metrics," *Journal of Health Care Compliance* (September–October 2001), p. 27.

3 See Mark Schacter, *What Will Be Will Be. The Challenge of Applying Results-based Thinking to Policy* [on-line] (Ottawa: Institute On Governance, 2002) [cited Dec. 7, 2003]. Available from Mark Schacter Consulting <www.schacterconsulting.com>.

4 See Mark Schacter, *Not a "Tool Kit": Practitioner's Guide to Measuring the Performance of Public Programs* [on-line] (Ottawa: Institute On Governance, 2002) [cited April 1, 2003]. Available from Mark Schacter Consulting <www.schacterconsulting.com>.

5 For interesting research on the relative merits of compliance, values and external stakeholder-based ethics programs, see Linda Treviño et al., "Managing Ethics and Legal Compliance: What Works and What Hurts," *California Management Review* 41, 2 (Winter 1999), pp. 131–151 (136–138).

6 Schacter, *Not a "Tool Kit,"* 2002, pp. 13–14.

7 Treviño, "Managing Ethics," 1999, pp. 136–137 and 141–143.

8 Ibid., pp. 137 and 141.

9 Galib Amlani, "Results-based Management and Accountability Framework for PWGSC's Ethics Program" [on-line], Presentation to the Corporate Ethics Management Council, Sept. 16, 2003 [cited Dec. 7, 2003]. Available from The Conference Board of Canada <www.conferenceboard.ca>.

10 Treviño, "Managing Ethics," 1999, p. 145. See also Walker Information, "A National Benchmark Study on Business Ethics" (Indianapolis: Walker Information, 1998).

Suggested Reading

Amlani, Galib. "Results-based Management and Accountability Framework for PWGSC's Ethics Program" [on-line]. Presentation to the Corporate Ethics Management Council. Sept. 16, 2003 [cited Dec. 7, 2003]. Available from The Conference Board of Canada <www.conferenceboard.ca>.

Boucher, Priscilla. "Evolution of a Values-based System to Measure and Improve Performance" [on-line]. Presentation to the Corporate Ethics Management Council. Sept. 16, 2003 [cited Dec. 7, 2003]. Available from The Conference Board of Canada <www.conferencboard.ca>.

Brown, David A.H., and Brown, Debra L. *Beginning at the Top: The Board and Performance Measurement.* Ottawa: The Conference Board of Canada, 2001.

Choquette, Mary. *From Instinct to Indicators: Demystifying Ethics Performance Measurement.* Ottawa: The Conference Board of Canada, 1998.

Ethics Policy and Integration Centre. *Measuring Organizational Integrity and the Bottom Line Results One Can Expect* [on-line]. Sept. 30, 1999 [cited April 30, 2004]. Available from the Ethics and Policy Integration Centre <www.ethicaledge.com>.

Farquhar, Carolyn R. *Governments Get Focused on Results: Integrating Performance Measurement into Management Decision Making.* Ottawa: The Conference Board of Canada, 2000.

Ittner, Christopher D., and Larcker, David. "Coming Up Short on Nonfinancial Performance Measurement." *Harvard Business Review* (November 2003), pp. 88–95.

Joseph, Joshua. "Integrating Ethics and Compliance Programs: Next Steps for Successful Implementation and Change" [on-line]. 2001 [cited April 30, 2004]. Available from the Ethics Resource Centre <www.ethics.org>.

McCormick, Vickie. "Justifying the Compliance Program Budget Through Compliance Program Metrics." *Journal of Health Care Compliance* (September–October 2001), p. 27.

PricewaterhouseCoopers. "Integrity-driven Performance: A New Strategy for Success Through Integrated Governance, Risk and Compliance Management" [on-line]. 2004 [cited April 29, 2004]. Available from PricewaterhouseCoopers <www.pwc.com>.

Public Works and Government Services Canada. Audit and Ethics Branch. *Results-based Management and Accountability Framework (RMAF) for the PWGSC Ethics Program.* Ottawa: Government of Canada, 2003.

Schacter, Mark. "Means, Ends, Indicators: Basics of Performance Measurement" [on-line]. Presentation to the Corporate Ethics Management Council. Sept. 16, 2003 [cited April 1, 2004]. Available from Mark Schacter Consulting <www.schacterconsulting.com>.

Schacter, Mark. *Not a "Tool Kit": Practitioner's Guide to Measuring the Performance of Public Programs* [on-line]. Ottawa: Institute On Governance, 2002 [cited April 1, 2004]. Available from Mark Schacter Consulting <www.schacterconsulting.com>.

Schacter, Mark. *What Will Be Will Be. The Challenge of Applying Results-based Thinking to Policy* [on-line]. Ottawa: Institute On Governance, 2002 [cited Dec. 7, 2003]. Available from Mark Schacter Consulting <www.schacterconsulting.com>.

Treviño, Linda, et al. "Managing Ethics and Legal Compliance: What Works and What Hurts." *California Management Review* 41, 2 (Winter 1999), pp. 131–151.

Walker Information. "A National Benchmark Study on Business Ethics." Indianapolis: Walker Information, 1998.

Measuring the Performance of Corporate Ethics Programs: Creating an Ethics Performance Story
by *Zachariah Ezekiel* and *Mark Schacter*

About The Conference Board of Canada

We are:

- A not-for-profit Canadian organization that competes for business like any other.
- Objective and non-partisan. We do not lobby for specific interests.
- Funded exclusively through the fees we charge for services to the private and public sectors.
- Experts in running conferences but also at conducting, publishing and disseminating research, helping people network, developing individual leadership skills and building organizational capacity.
- Specialists in economic trends, as well as organizational performance and public policy issues.
- Not a government department or agency, although we are often hired to provide services for all levels of government.
- Independent from, but affiliated with, The Conference Board, Inc. of New York, which serves some 2,500 companies in 60 nations and has offices in Brussels and Hong Kong.

Publication 609-04 • Printed copy: $185
E-copy: $135

The Conference Board of Canada
Insights You Can Count On

255 Smyth Road, Ottawa, ON K1H 8M7 Canada
Tel. (613) 526-3280 • *Fax* (613) 526-4857 • *Inquiries* 1-866-711-2262

The Conference Board, Inc. 845 Third Avenue, New York, N.Y., 10022-6679 U.S.A. *Tel.* (212) 759-0900 • *Fax* (212) 980-7014 • www.conference-board.org
The Conference Board Europe Chaussée de La Hulpe 130, Box 11, B-1000 Brussels, Belgium *Tel.* (32) 2.675 54 05 • *Fax* (32) 2.675 03 95
The Conference Board Asia–Pacific 2802 Admiralty Centre, Tower 1, 18 Harcourt Road, Admiralty Hong Kong SAR *Tel.* (011) 852 2511 1630 • *Fax* (011) 852 2869 1403

ISSN 1205-1675 • ISBN 0-88763-645-4 • Agreement No. 40063028
*Incorporated as AERIC Inc.

For more information about this Briefing, please contact us at the numbers listed above.
Briefings summarize the key findings of Conference Board research and outline the implications for member organizations.

www.conferenceboard.ca