

Ethical Business Practice and Regulation

A Behavioural and Values-Based Approach to Compliance and Enforcement

Christopher Hodges

Professor of Justice Systems, and Fellow of Wolfson College, University of Oxford

Head of the Swiss Re/CMS Research Programme on Civil Justice Systems,
Centre for Socio-Legal Studies, Oxford.

Ruth Steinholtz

Founder and Principal
AretéWork LLP

Former General Counsel and Group Security Coordinator,
Head of Ethics, Borealis AG



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PREFACE

What is Ethical Business Practice and Regulation?

This book explains why any organisation of human beings is more likely to succeed in its objectives if all the people involved aim to, and do, behave *ethically*. There is a considerable amount of solid scientific evidence that supports the idea that joint human endeavours will flourish when people do so. It is now accepted in business management that companies perform best if they have clear ethical values and behave in accordance with those values, involving all stakeholders.

We apply these lessons to the *regulatory relationship* between public authorities and businesses. We propose a model of an ideal regulatory relationship between authorities and businesses: *Ethical Business Regulation* (EBR). Adopting EBR will maximise good outputs for both business and regulators, and their respective stakeholders—society, staff, customers, suppliers and investors. To achieve EBR, both regulators and businesses need to adopt ethical practice. On the business side, we call this *Ethical Business Practice* (EBP).

The Essence of Ethical Business Practice

An organisation in which the leaders consciously and consistently strive to create an effective ethical culture where employees do the right thing, based upon ethical values and supported by cultural norms and formal institutions. EBP requires people who can recognise ethical dilemmas, challenge constructively, speak up if they know or suspect unethical behaviour, and who use mistakes and wrongdoing as an opportunity to learn and improve. Engagement with EBR then requires the organisation to be open with its regulators and provide evidence of EBP.

Ethical Business Regulation

A relationship between a business, or a group of businesses, and a regulator, or group of regulators, in which the business produces evidence of its ongoing commitment to EBP and the regulator recognises and encourages that commitment.

The Need for a New Approach to Regulation

The basic idea is that it makes sense to operate systems that are designed around how human beings actually behave rather than on theories on how they behave. This needs an evidence-based approach relying on good science instead of theoretical assertion. Decisions are made by people rather than by organisations, although the structures, systems, objectives, culture and incentives that operate within organisations can affect the decisions made by the people who work in them. The focus of achieving compliance with laws should therefore be on affecting both the behaviour of individuals and the organisational environment.

Most people want to 'do the right thing' and only a few do not. It is therefore logical to use an approach that is geared towards the majority of 'good' people who want to do the right thing but may go astray in the wrong context. Too much traditional enforcement thinking is based on the minority of people who deliberately break the rules. We need to adopt a fundamentally distinct approach that differentiates between those who try to behave ethically and those who intend not to. Of course, we will make provision for bad and unethical actors, but the entire system should not be built around them. Paradoxically, at present, too many regulatory systems are built around the idea that anyone who breaks a rule is bad and that breaking rules needs to be deterred by strong punishment. This approach, however, is preventing ethical behaviour rather than increasing it.

It is important to focus on values, culture and ethical behaviour rather than on compliance with rules. We think that the current regulatory approach perversely incentivises organisations to prefer 'tick-box' compliance models over efforts to develop and reinforce a strong ethical culture. Unless regulators and businesses can carve out a cooperative approach aimed at continuous improvement based upon fairness, ethical values and open culture, they will continue to focus on compliance, with the predictable results of non-compliance such as we have seen repeatedly. Focusing solely on rules and responding to breaches of rules by deterrence and punishment simply does not work, as we will demonstrate in this book.

Public authorities generally assume that they behave ethically and treat business fairly. After all, they represent the public interest and have power delegated from the legislature. But in fact, sometimes their behaviour may act as a barrier to businesses acting ethically, albeit unintentionally. Even an individual or business that wants to do the right thing may be deterred by the likely attitude of a regulator. Fear that the response to acknowledging a problem will be to impose blame and take strong enforcement action, especially when the business was trying to put things right, will not support a relationship of honest and open communication between business and regulator. If an enforcer's response to a company that shares full information that it has discovered wrongdoing by some of its staff is to impose a large fine on the business, adversely affecting innocent staff, managers and stakeholders, will that be seen as fair? Should the primary focus rather be on jointly identifying the root cause of the problem, then making sure that the risk of

reoccurrence is reduced, repairing any damage and seeing whether any individuals have deliberately acted unethically?

An important barometer of a regulatory system is how it reacts when things go wrong. There is now clear science and experience that we only learn from mistakes if we can share openly information on why the mistake happened and identify the root cause. The civil aviation industry and others have shown with outstanding success that this sharing must be in an open trusting relationship that does *not blame* people simply for making a mistake. If we focus solely on blame every time something goes wrong, people become defensive and we will never learn, we will never fix problems and we will destroy the relationships that would allow us to learn and improve.

Every time there is a major scandal, there is a call for more regulation, in the hope that this will solve the problem. However, it has been shown that more rules and hard enforcement just do not work. Deterrence does not work without highly visible and all-pervasive enforcement, something that government cannot afford and which would be democratically unacceptable. An increase in monitoring, reporting and compliance in general can inadvertently *increase* unethical behaviour, as people feel they are not trusted. Companies can spend large amounts of energy on compliance and have little left over for ethics. Focusing on rules crowds out objective thought on whether behaviour is ethical. Focusing on compliance can engender cynicism and disengagement, as the implicit message is ‘we are only doing this because it is the law’ and ‘we don’t trust you’. Disengagement clearly feeds unethical behaviour directly and indirectly as disengaged employees are less likely to speak up and report issues.

The purpose of regulation is to ensure that business performs in the best interests of society. We are convinced that the traditional approach to compliance and regulation is failing and that there is a better way for regulators to support organisations to behave ethically and for organisations to strive to do so. Fundamentally, a focus on compliance will not necessarily result in ‘doing the right thing’. Conversely, when the focus is on values-driven ethical behaviour, we believe that compliance with just rules will result.

When one starts to look more closely, there are, in fact, many examples of successful ethical and open cooperation in the UK, such as in the areas of safety (civil aviation, workplace health and safety), general business trading (the Primary Authority scheme, data protection, equality and human rights) and regulated sectors (gambling, medicines, medical technology, water and energy). Profound cultural transformation is needed, but has already been shown to be possible. In 2017, the UK government has proposed a general shift across all sectors towards regulatory self-assurance and earned recognition. We believe that these structures can only work if they are based on a further explicit policy of adopting ethical values—as the Scottish government has explicitly done.

We think that the evidence is now clear, consistent and compelling, and that the time is right for a step change in much regulatory practice. But the same is also true of much business practice. Before we look at that, however, we need to look more widely at society.

The Collapse of Mutual Trust in Contemporary Society

Businesses and regulators are made up of individuals, and those individuals generally possess ethical values and the intention to do the right thing in their lives. But it is not enough for an individual to have strong ethical values and good intentions. Forces such as the context, situation and institution or society within which an individual operates can derail the individual. That is why we must focus on the culture of the organisations and societies within which people inter-relate to ensure that ethical behaviour is supported—and not deterred—and that incentives for unethical behaviour are eliminated. As Richard Barrett says:

If you want to succeed in business in the era we are now entering, your values must be evidenced in every decision you make and every action you take. Furthermore, your behaviours must align with your values—you must be seen to be walking the talk and operating with integrity. This is important; not just for building societal goodwill, it is also important for building the resilience of your organization and finding economic success.¹

Humans are basically social creatures: we depend on each other for our collective survival, progress and success. We all belong to multiple, overlapping groups (family, work, club, social, nation, religion and sub-groups within all the above). The problem is that there is currently unmistakable evidence of fractures in and between various societal groupings. This lack of cohesion threatens our social stability and security as well as our ability to prosper economically.

In 2016, trust in business was higher than trust in government and was *increasing*.² However, in 2017, trust was ‘in crisis around the world’.³ The Edelman 2017 trust barometer concluded:

The general population’s trust in all four key institutions—business, government, NGOs, and media—has declined broadly, a phenomenon not reported since Edelman began tracking trust among this segment in 2012.

With the fall of trust, the majority of respondents now lack full belief that the overall system is working for them. In this climate, people’s societal and economic concerns, including globalization, the pace of innovation and eroding social values, turn into fears, spurring the rise of populist actions now playing out in several Western-style democracies.

To rebuild trust and restore faith in the system, institutions must step outside of their traditional roles and work toward a new, more integrated operating model that puts people—and the addressing of their fears—at the center of everything they do ...

¹ R Barrett, *The Values-Driven Organization: Cultural Health and Employee Well-Being as a Pathway to Sustainable Performance*, 2nd edn (Routledge 2017) xxii.

² The Edelman Trust Barometer 2016, www.edelman.com/trust2016.

³ The Edelman Trust Barometer 2017, www.edelman.com/trust2017.

We have moved beyond the point of trust being simply a key factor in product purchase or selection of employment opportunity; it is now the deciding factor in whether a society can function. As trust in institutions erodes, the basic assumptions of fairness, shared values and equal opportunity traditionally upheld by ‘the system’ are no longer taken for granted. We observe deep disillusion on both the left and the right, who share opposition to globalization, innovation, deregulation, and multinational institutions. There is growing despair about the future, a lack of confidence in the possibility of a better life for one’s family ... only 15 percent of the general population believe the present system is working, while 53 percent do not and 32 percent are uncertain.

This evidence of fracture is visible in many areas of life. We focus on the effects of a series of major incidents of individuals and organisations failing to operate ethically, which has resulted in the collapse of public trust in business. You only need to think of the financial crisis of 2008 and the low esteem in which banks are held by society, the fraudulent behaviour of Volkswagen in ‘dieselgate’ and bribery scandals involving BAE Systems, GlaxoSmithKline, Siemens and Rolls-Royce to name but a few. In sport, you might think of FIFA, of doping in professional cycling, and of Russia’s expulsion from the Olympics due to institutionalised doping. A decade ago in public life in the UK, the issue was a collapse of trust in Members of Parliament as a result of the expenses scandal, as well as phone hacking by journalists. On the international scene, countries too numerous to mention have been racked by corruption scandals that in some cases have brought down governments. Evidence of corruption across the world is extensive—for example, the Odebrecht scandal in Brazil, said to involve paying \$3.3 billion to politicians between 2006 and 2014, the equivalent of 80% of the company’s net profits.⁴ In February 2017, some 300,000 Romanians took to the streets to demand the scrapping of a law that would have decriminalised low-level corruption and, once they achieved that, demanded the resignation of government figures who they did not believe were committed to fighting corruption.

One of the fundamental points revealed by the Brexit vote and the election of President Trump has been the seriousness of the rift between what Prime Minister Theresa May has called ‘the marginalised or overlooked’ and those they perceive to be the influential and well-off (depicted as elites). As *The Economist* said, people ‘who feel they have been left behind after the financial crisis have turned to populists’ for a voice.⁵ To this we would add the anger and frustration of the average person when confronted with evidence of corruption amongst the privileged and the lack of accountability that has characterised the institutional response to many of the ethical lapses listed here.

This is also linked to a ‘post-truth’ period, in which factual accuracy is ignored (examples being the Iraq dossier and the numerous statements by President Trump and his press secretary that the media were deliberately falsely reporting

⁴ *The Economist*, 22 April 2017, 39.

⁵ *The Economist*, 7 January 2017, 64.

the numbers who attended the inauguration). All of this is evidence of disrespect for ethical values of truth and honesty, and is magnified by the effect of social media. It is particularly worrying when those who are leaders perpetrate it, as they are role models.

British and American people feel that society suffers from an essential inequality; many around the globe worry about resources being wasted; people are unhappy with their governments and the perceived non-responsiveness of state bureaucracy. The results of National Values Assessments conducted in many countries reveal the extent of the problem.⁶ The moral psychologist Jonathan Haidt argues that if there is a perception that the group is threatened, it produces retrenchment and withdrawal.⁷ Faced with threat, our defensive gene is triggered and may overcome the collaborative, open gene, disrupting trust.

We may wonder how these rifts will be healed. Surely appeals to national solidarity have almost no effect on the ground. The UK Prime Minister has rightly said that: ‘The objective of our modern industrial strategy is to improve living standards and economic growth by increasing productivity and driving growth across the whole country.’⁸ But how is this to be achieved without addressing the deep rifts that currently exist?

Ethical Values as a Political Manifesto

We think that the answers are readily available when we look at the evidence. The answer lies in basing society and business on *fairness* and *ethical values*. This will build trust and relationships based on a firm commitment to such values. We suggest that societies need to re-state a universal Golden Rule, as their own code of ethics, and to build systems that produce evidence on whether people live up to their shared ethical values or not.

We believe that commitment to ethical values is a force for peace and prosperity through supporting humans working together for the common good. It is this ethical dimension of behaviour that has been largely missing from all previous 20th-century conceptions of what regulation, enforcement and compliance are. Models describing regulatory structures miss the human element. Looking at behaviour through the lenses of psychology and genetics now introduces, first, the social element of relationships into the picture and, second, unavoidable elements of human values, against which almost all of us evaluate rules, actions and

⁶ See <https://www.valuescentre.com>.

⁷ J Haidt, *The Righteous Mind : Why Good People are Divided by Politics and Religion* (Penguin Books, 2012).

⁸ *Building Our Industrial Strategy. Green Paper* (HM Government, January 2017), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/585273/building-our-industrial-strategy-green-paper.pdf.

behaviour. If we favour the ethical element in our relationships, everything starts to make sense and drives us towards giving or withholding trust.

These concepts are not new. Polanyi recognised in the 1940s that the basis of compliance with rules and regulation is in fact strongly based on *social* relationships.⁹ This type of collaboration that is inherent in EBR operates outside political ideologies, especially models of the past few hundred years that oppose different groups, such as owners of capital against workers or the ‘high-flying elite’ against ordinary people.

We are intrigued to see the idea of a fair society spreading quickly. At the political level, the Scottish government has a headline policy of a ‘fair Scotland’, and ministers and officials there have been quick and enthusiastic in their adoption of EBR. UK Prime Minister Theresa May has also based her premiership on building ‘a fairer Britain’.¹⁰ At the time of writing, the Scottish government has embraced the EBR approach, whilst the UK government has given several signs of approval of it (see chapter 12), but has stopped short of seeking it as a necessary and integral part of its policy of social and economic renewal. This is promising, since we cannot expect business to focus on building a strong ethical culture based on values if what the regulators require as evidence are tick-box compliance elements. It may be helpful and easy to prove the existence of a speak-up or whistleblowing line, but how much more positive it would be to have an open culture where people are not afraid to speak up to each other and where they are listened to by their managers. This is admittedly more difficult to prove, but far more powerful in bringing about change.

Need for Political Leadership in Basing Society on Ethical Values

We think that broad political approval for EBR will be essential if it is to be fully implemented by all regulators and businesses, and accepted by the public. They can adopt the approach spontaneously, as a number have done, but political leadership is necessary for two reasons. First, political support is needed to defeat the question when something goes wrong of ‘who’s to blame?’ The answer needs to be that we have left the blaming approach behind, as it does not enable us to learn and improve. Instead, we are focusing on fixing the problems and decreasing the likelihood that they will recur.

⁹ K Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, 2nd edn (Beacon Press, 2001).

¹⁰ T May MP, ‘The Government’s Negotiating Objectives for Exiting the EU’, speech delivered at Lancaster House, 17 January 2017. See also *Corporate Governance Reform: Green Paper* (Department for Business, Energy and Industrial Strategy, 2016) and *Building Our Industrial Strategy* (n 8).

Second, the ethical approach will have a speedier impact if it is adopted holistically and consistently across a society. Only a government can adopt such a holistic policy, even if its implementation requires other steps. The policy can be disseminated through education and information channels, and could transform the operation of public bodies and the relationships between citizens, the state and organisations.

Another player must be mentioned here. The media plays a crucial role in shaping public opinion, although that role is no longer exclusive following the advent of social media. However, if the media focuses on blame and champions punishment and deterrence indiscriminately, both regulators and businesses will be caught in a paradox. It will be necessary to educate the media and the public as to the benefits of EBR, and to take advantage of the many social media avenues available to reach opinion leaders, otherwise regulators will be open to accusations of failing to hold business to account. We outline these benefits in this book and we hope that our message will be taken up by others, who will build on this work and will advocate EBR to the various relevant actors.

The Need for a New Approach to Business

Many businesses treat customers fairly and purport to accept their corporate social responsibility, but do ethical values pervade *everything* that they do? There are too many examples that would argue against this assertion. Individuals who pursue goals based upon their own self-interest (and hence the exclusive maximisation of ‘shareholder value’, as well as breaking ethical principles) send a message that the person cannot be trusted. It is no longer enough for businesses to focus solely on maximising profits or shareholder value; the interests of all stakeholders must be furthered by the common partnership. This applies to the needs of all employees, including managers and staff, suppliers, customers, investors, regulators, the public, the environment and governments.

The idea of Conscious Capitalism connects *all* stakeholders, and necessarily takes their needs and interests into account.¹¹ Thus, this represents an important shift from the conception of capitalism driven by maximising owners’ profits or shareholder value. Instead, it is based on a holistic concept of how humans might and should inter-relate through the organisations where they work—whether they are owned publicly or privately. When one person in a group is focused more on his or her own success than the group’s success, then discord and conflict will ensue, and the group will become dysfunctional. With such a culture, the group will never be able to achieve its full potential. The previous short-term focus on

¹¹ J Mackey and R Sisodia, *Conscious Capitalism. Liberating the Heroic Spirit of Business* (Harvard Business Review Press, 2014).

shareholder value has distorted the relationship between senior managers and workers, and this, in turn, has resulted in disengagement and decreasing trust.

Whilst many large multinational businesses currently adopt a great deal of what we suggest, and there are many international moves towards aspects of the ethical approach—such as corporate social responsibility, the UN Global Compact, the PACI Principles and the UN Guidelines on Business on Human Rights, together addressing the environment, local communities and people in the supply chain—some relationships in the regulatory space remain old-fashioned and polarised rather than cooperative. In this state of affairs, the full power of the relationship to deliver good outcomes fails to be realised. It is striking how the need to ensure *long-term sustainability* has taken a high priority, from the context of environmental protection and global warming to that of the safety of investing in corporations to maintain long-term growth and pensions.

It is no longer enough for businesses to have perfunctory codes of ethical practice. The organisations that claim to live by such statements of ethical values must be genuine; in other words, the values must be *lived and demonstrated* in the decision-making and behaviours of everyone working for the organisation daily.

A Critical Leadership Role for Business

We think that there is a huge opportunity for leadership by business here. We are struck by the increasing number of commentators who advocate that a culture based upon a firm commitment to ethical values and their application to relationships with all stakeholders—staff, managers, suppliers, customers and investors—is what really transforms business success. Those businesses that have evolved towards a holistic ethical approach achieve outstanding results because they take care to satisfy all their stakeholders' interests and thus gain from their enthusiastic support and energy. But some will see this as a fundamental redefinition of the objective of a business. It is no longer to make profit at all costs; rather, it is to understand that profit comes from a focus on doing the right thing. Put another way, one must take a medium to long-term view of what drives profit. This has been recognised by many in financial regulatory circles,¹² but again requires systemic change and less of an emphasis on short-term results. The transformation comes from applying ethical values to the governance framework required by the Financial Reporting Council. Making this transformation can involve major changes in how businesses operate, but the forces required to drive that change are understood and are summarised in this book. Perhaps what has been missing so

¹² See the work of the Financial Reporting Council on the importance of corporate culture, referred to in ch 9 below.

far is a sense of urgency. The time, however, is now. As Mackey and Sisodia, respectively a leading businessman and a business scholar, have said:

Capitalism is under attack for several reasons:

1. Business people have allowed the ethical basis of free-enterprise capitalism to be hijacked intellectually by economists and critics who have foisted on it a narrow, self-serving, and inaccurate identity devoid of its inherent ethical justification. Capitalism needs both a new narrative and a new ethical foundation, one that accurately reflects its intrinsic goodness and virtue.¹³

Richard Barrett says that: ‘Values-driven organizations are the most successful organisations on the planet.’¹⁴ He refers to the idea of ‘Business as saviour’. Could it be that business provides the critical environment that society has lost through secularisation away from religion, which can be used to re-embed ethical values in society in a way that will unlock mutual re-engagement? It is heartening to see announcements in mid-2017 that Volvo intends to switch its cars from liquid to electric fuels and Swiss Re to switch all its £130 billion investment portfolio to ethical investments.¹⁵

We suggest that if all those who work in business in any capacity could conceive of their commitment to ethical values not only as a basis on which to do business, but also as a central unifying force to bring about positive change across the societies of the globe, levels of trust in business and government would begin to rise and everyone would reap the benefits.

Overview of this Book

The book is divided into four parts. Part I summarises the scientific evidence for the ideas and hence the basis for the EBR model. Part II sets out the current state of corporate governance and of regulatory policy in the UK, so that we can see what role ethics does—or does not—play on both sides of the regulatory space. Part III outlines the concept of the EBR model, namely how a relationship between a regulator and a business based on ethical principles should operate. In Part IV we set out the essential requirements for EBP, based on two parallel frameworks: first, the cultural and leadership framework and, second, the ethical and compliance framework. This explains how organisations should place values, culture, ethical behaviour and decisions at the foundation of all their activities. We set out at the end a series of checklists that we hope businesses will find useful.

¹³ Mackey and Sisodia (n 11).

¹⁴ Barrett (n 1).

¹⁵ Z Williams, ‘Is a Carmaker about to Save the Planet?’ *The Guardian*, 10 July 2017, https://www.theguardian.com/commentisfree/2017/jul/10/volvo-motor-industry-electric-car-environment?CMP=share_btn_link; J Revill, ‘Swiss Re Shifts \$130 Billion Investments to Track Ethical Indices’ *Reuters*, 6 July 2017, <http://uk.reuters.com/article/us-swissre-ethical-idUKKBN19R22Y>.

Throughout the book, we include case studies that illustrate good and bad practice. We also refer to some of our personal experiences from the business world. At the end of each chapter, there are conclusions.

Part I. The Ideas

We set out to ask some simple but often overlooked questions. Why do people observe rules? Why do people break them? Answering these simple questions seems fundamental to knowing how we should design and operate compliance systems in businesses and public regulatory systems.

Many compliance and regulatory systems seem to focus on different questions, such as ‘How do we increase deterrence so firms will obey the law?’ and ‘How do we produce a lot of data that shows that we have extensive compliance systems, so that we can argue for lower penalties to be imposed when we break the law?’ The latter question seems both less important than the former question and to miss the point.

As we are talking about human behaviour, the logical place to start looking for answers to the first questions would be in the science of human behaviour. There is now a considerable body of convincing evidence from evolutionary biology, behavioural psychology, and sociolegal research into regulation that provides a coherent basis for making a profound change in regulatory practice. The scientific findings have been applied under headings such as ‘behavioural economics’ and ‘nudge’, but have not percolated widely into businesses’ internal approaches to corporate compliance or public regulators’ or enforcers’ approaches to maximising observance of law.

Chapter 1 summarises the scientific evidence on what factors affect the brain in producing the behaviour that people observe or break rules. We find that fairness is a critical value for human rule-systems. Research into behavioural psychology has identified important findings on why people observe or break rules. We now know many reasons why people may fail to observe a rule—notably because of inertia, procrastination, the influence of others (especially social groups), misframing of issues, mistakes in assessing probability, not knowing exactly what to do and so on.¹⁶ We often bend the rules and think that we comply when we don’t. Biological research suggests that the emergence in humans of an ‘ethical gene’ is far more recent than the basic defensive or selfish gene that we have long needed to survive. The two genes—protective/selfish and collaborative/ethical—can obviously be in conflict, and when we feel threatened, the older protective one may be

¹⁶ See generally T Gilovich, D Griffin and D Kahneman (eds), *Heuristics and Biases: The Psychology of Intuitive Judgment* (Cambridge University Press, 2002); D Kahneman and A Tversky (eds), *Choices, Values, and Frames* (Cambridge University Press, 2000).

more powerful than the open trusting one. But it is through supporting the open trusting gene that we can create evidence on which we can place trust in others, and hence increase cooperation. Success is so often based on the strength of social relationships, even at work—if those relationships are ethical, this drives good outcomes.

Although it might be depressing to read in chapter 1 that human beings often behave irrationally and may be prone to breaking rules in some circumstances, chapter 2 provides reason for optimism by looking at the many human characteristics that can be developed to build an ethical, cooperative and effective society. We note the importance that most humans place on the value of behaving fairly and being seen to do so. We also note evidence that humans evolve through increasing levels of consciousness, and each level produces the need to develop new means of organising people to improve cooperative action. We believe this to be an optimistic book, built on the shared belief of the authors that positive change is possible if we are conscious of the need for it, open and honest enough with ourselves to learn from our experience and realise the importance of being ethical.

Chapter 3 looks at the traditional approach to making people conform, namely deterrence. We look at examples of where it still applies and note the shift by some public authorities from attempting to deter companies to attempting to deter individuals. We then summarise a growing number of problems with deterrence as a theory, and note that it is primarily based on theory and that there is very little empirical evidence that supports it. We also note that although deterrence remains the fundamental enforcement theory that is applied by some legal systems (such as that in the US) and regulators (competition, financial services), a significant number of regulators and enforcers have left it behind and have adopted a responsive and supportive approach aimed at improving performance and outcomes (and hence improving compliance). We also note the ideas of Maslow, Laloux and Barrett that as humans evolve through different stages, we need to develop new ways of organising ourselves. Laloux thinks that we are going through a new stage and need to replace fear with collaboration.

Chapter 4 notes that adopting a fair approach to wrongdoing involves observing the expectation that the rules will apply to everyone and that if people do bad things, we expect that society will impose a proportionate response. The critical issue is the moral intention with which people acted: was it ethical or not?

Chapter 5 notes that modern business, and hence compliance with the rules and regulation, depends critically on cooperation. The relevant systems depend on constant circulation of information, and everyone has a part to play in this, otherwise the system will not work and we will not be able to operate safely and effectively or be able to improve.

Chapter 6 looks at the critical issue of trust. It is a state of mind based on evidence that we can place trust in others to do what they say they will do, or what we expect them to. People who want their future actions to be trusted need to produce certain types of evidence of past behaviour and present intention, systems and culture on which others can form a judgement. The evidence shows that

humans are most productive and innovative when they work together, and base their actions on ethical principles, which creates trust between them.

Chapter 7 introduces the critical point that people will not volunteer information if they fear that they might be criticised—and hence socially ridiculed, disciplined, prosecuted or sued. As such, an organisational and regulatory culture that includes blaming will not support constant learning, improvement and performance. Those responsible for the safety of critical operations, notably in civil aviation, learnt some time ago that ‘no-blame’ cultures are vital to maintaining safety. Aviation safety is now based firmly, in some countries at least, on an ‘open, just culture’, which supports people to share all relevant information. Aviation no longer talks about compliance, but performance. It recognises that no human activity is fully risk-free and that we will fail if we simply concentrate on compliance.

Chapter 8 looks at why we should behave ethically. What’s in it for others and for us? There is plenty of evidence that organisations that systemically do the right thing, and seek to achieve good outcomes for all stakeholders, are outstandingly successful in their outcomes.

Part II. Where We are Now

In Part II, we take a snapshot of the status of ethical values on the two sides of the regulatory fence, namely in business—specifically in current policy on corporate governance—in chapter 8 and in regulatory policy in chapter 9. We find clear moves to include culture at the centre of corporate governance, as a response to the collapse in confidence in business around the 2008 financial crash, but a reluctance to take the further step of specifying that an *ethical* culture is required. There seems to be a disconnect between those involved in creating corporate governance and compliance frameworks and those who understand organisational change.

Chapter 10 explains the moves towards stronger relationships between regulators and businesses that have taken place both in general UK regulatory policy and in practice by an increasing number of regulators, including civil aviation, water, energy, gambling and equality and human rights. It notes the creation of many structures, arrangements and relationships that support EBR, so that EBR is the logical next step. Indeed, it shows that EBR has been adopted as policy by a number of regulators in 2016–17.

Part III. What is Ethical Business Regulation?

Part III explains what we mean by EBR. It develops the ideas of a relationship between public bodies and businesses based on a relationship of trust, built on suitable evidence that businesses (and public bodies) place ethical values at the core of their activities. The basic concept is explained in chapter 11, and chapter 12 gives a number of examples of where EBR implicitly exists in the policies and

practices of a range of UK regulators. It also notes moves in a different direction in the regulation of financial services, where deterrence remains the primary approach. This sector is important to consider, as the lack of a values-driven culture has been identified globally as a fundamental problem that led the financial services sector to behave dysfunctionally, and was a major cause of the financial crisis that began in 2008.¹⁷ These examples together form a significant body of evidence and experience on which future practice can be developed.

Part IV. How to Implement Ethical Business Practice and Ethical Business Regulation

Part IV looks at what businesses and regulators should do to adopt EBR in practice. We explain two frameworks that are required for EBP. Chapter 13 sets out the framework of culture and leadership that will nurture EBP, and chapter 14 sets out the framework of ethics and compliance, founded upon the organisation's values that will anchor and support EBP. These chapters therefore form practical 'how to' manuals. They set out the various essential features that we think are necessary if an organisation is going to operate consistently and sustainably on an ethical basis. The essence here rests on applying ethical values, and this can only be done effectively within supportive frameworks.

The adoption of EBP is a choice by individual businesses and the people who work in them. If they produce evidence of EBP, it will be the responsibility of regulators and other stakeholders to respond by giving them the credit. Convincing evidence of intention and a track record of achievement is the key to EBP and therefore EBR.

Appendices

We include several checklists regarding different aspects of EBP and EBR.

Conclusion

We believe that focusing on ethical values can transform economic and innovative performance. It is good for business and for regulatory performance. We also believe that adopting an ethical approach is currently an essential move for the

¹⁷ *Report of the High-Level Group on Financial Supervision in the EU* (European Commission, 2009); *Toward Effective Governance of Financial Institutions* (G30, 2012); *A New Paradigm: Financial Institution Boards and Supervisors* (G30, 2013); *Report of the Collective Engagement Working Group* (Collective Engagement Working Group, 2013); *A Report on the Culture of British Retail Banking* (New City Agenda and Cass Business School, 2014).

interconnected world we live in, in order to transform globalisation into a force for societal well-being. However, if EBR is to crystallise and support sustainable social and economic growth, as we believe it can, both regulators and businesses need to change. We set out in this book the evidence on the need for change and on how such change can be achieved. It is a vision of a better world—and how to get there.