

Fraud and the culture connection

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Introduction

Some of the happiest and most powerful organisations are the ones with an impactful culture. Culture extends far beyond the “vibe” you get when you walk into an organisation. It is the spirit that unifies the diverse and geographically distributed stakeholders through a set of shared values.

Culture drives employee actions in their interactions with clients, vendors, and other stakeholders on a day-to-day basis. In a way, when in a tight spot, culture presents itself in the form of “the right thing to do” and is therefore interlinked with what is considered unacceptable. For example, in case of exchanging gifts as part of corporate pleasantries, there is a code of conduct or a ‘gifting policy’ that needs to be followed. If the gift offered extends beyond permissible limits, then employees are expected to reject it and report the matter to the compliance department.

When applied in a business environment on a day-to-day basis, this set of acceptable behaviours gives the organisation a competitive edge, help boost profits, decrease vulnerability, and improve compliance and productivity.

Organisational behaviour is equally important in creating a positive and inclusive culture. An organisation that doesn’t address the concerns associated with its culture and employees can gradually breed an environment that may propel corporate misconduct or lead to employees displaying unethical behaviour. Some recent corporate scandals across the globe have happened as a result of a dysfunctional workforce at various levels, and a poor organisational culture, including other triggers. Weak internal controls, poor tone at the top, lack of reporting mechanisms, ethics not considered as a set of value-systems upheld by all members of the organisation are associated with an environment which does not keep fraud in check. This, at a certain level, finds its roots in the lifeblood of any organisation - its culture.





Understanding culture and its significance in good governance

Organisational culture is a set of beliefs, values, and attitudes that govern employees and the way business is conducted on a daily basis.

An interesting aspect to culture was pointed out by anthropologist Edward T Hall, who is known for his several findings associated with key cultural factors and developing the widely known Iceberg Model. The iceberg analogy of culture suggests that if the culture of an organisation was an iceberg, then there are some aspects visible above the water, but a significant portion is hidden beneath the surface. In an organisation, there are thought patterns and ethical dilemmas that pervade within and influence individual behaviours, but have a far-reaching impact on the organisation's performance when looked as a whole. Research suggests linkages between how a strong corporate culture is connected closely with leadership and value systems of any organisation.

At the ground level, doing the right thing requires moral courage. If one takes a closer view, it would become clear that the moral fabric of any business motivates its employees to do the right thing, especially when no one is watching. This is facilitated by creating, developing and sustaining a winning combination of value-based leadership tools.

“Culture instills an environment to keep fraud in check. In the long-run, organisations with a strong foundation of corporate culture, continually nurtured from the top, have an edge over others who do not pay attention to this crucial ethical dimension. A healthy culture is one of the strongest shields against fraud risks; and it is in your control.”

Samir Paranjpe
Partner
Grant Thornton India LLP

Corporate governance reports of Grant Thornton International reveal intriguing insights on the growing significance of culture in the governance arena. These are highlighted below:

- Boards are taking centre stage in this area as 80% of the boards in India, and 50% globally, say that culture is now an important part of their agenda.
- 85% of boards in India, and 71% globally, are establishing internal controls that address culture and employee behaviour¹.
- With digital wildfires becoming common, it is crucial that corporate governance strategy is adept to manage the risks that come along with disruption to become fit for the future².
- Boards worldwide are thinking about the culture of their customers and their suppliers when they do business with them, which illustrates that those external stakeholders you deal with can affect your brand and reputation³.

In a nutshell, culture can be considered as a force which empowers organisations to achieve good governance and growth, and in the long-run, becomes a litmus test of their success or downfall.

1. Beyond Compliance, Corporate Governance Report 2017

2. Engagement beyond the boardroom: What do your stakeholders expect? Corporate Governance Report 2018

3. Beyond Compliance, the building blocks of a strong corporate culture, www.granthornton.in, 2017

Connecting the dots

How a weak organisational culture is linked with a high risk of fraud



As highlighted earlier, a damaged work culture gradually builds an environment for fraud to thrive.

In such a scenario, pressure to perform is extreme, and a cut-throat environment positions teams against each other, where making a mistake is unacceptable or has serious repercussions. In this state of affairs, an occurrence of fraud is inevitable. For example, when the sales pressure is unbearable, it may lead employees to “rationalise” the fraud they commit. Not only is the immediate work environment unfavourable, the company policies are unfair too. Some of the red flags associated with such an environment are listed below:

Warning signs of a precarious culture

- A ‘profitability at any and all costs’ mindset
- Under-appreciated employees. Lack of reward and recognition
- Lack of empathy
- Unapproachable or autocratic leadership, or one that is indifferent to warning signs
- Lack of transparency in processes, or weak processes creating opportunity for misconduct
- Fear of retaliation or being fired when reporting or escalating concerns
- Inordinate pressure leading to fear of failure
- Preferential treatment and unfair policies related to hiring, promotion, learning and development opportunities

Road to building and nurturing ethical fabric

Some recommendations to building and propelling an ethical organisational culture are as follows:

1. Setting the right tone at the top

Building an ethical workplace kicks-off from the top. To sustain this, continued commitment of the board and senior executives is crucial.

From the classic crises of the energies, commodity and services company Enron to the recent cases of fraudulent accounts at Wells Fargo⁴ and of cheating the diesel emission tests at Volkswagen⁵, the significance of setting the right tone at the top is constantly reinstated, and repercussions of not doing so are brought to light.

As incidents of flawed corporate governance are on the rise, expectations from the board and senior leadership have only risen exponentially. It is now strongly recommended that the top level reinforces ethical behaviour, which will then have a trickle-down effect on its employees. Employees closely watch and emulate the behaviour of their immediate superior and therefore, this factor is very important in creating an anti-fraud culture.

Some of the best practices to reinforce this sentiment include:

- **Stay vigilant:** Leaders must keep a close watch on employee engagement through surveys, anonymous feedbacks, etc. A proper feedback may reveal warning signs of an environment that acts as a propeller of fraudulent behaviour. Consistent focus of middle management, achieving bottom lines at any cost, compromising ethos to gain new wins are some of the signs which, when spotted timely, can help the management take corrective steps with lesser ramifications involved.
- **Report wrongdoing timely:** Devising appropriate mechanisms to report fraudulent conduct is critical to keep such behaviour in check. Closely monitoring the programme to ensure its success is equally important. An effective whistle-blower programme must be independent, confidential and encourage reporting wrongdoing. It must evade the fear of retaliation or discrimination at work with respect to a job role and responsibility, position, career progression, etc.

- **Walk the talk:** Board, management and all C-level executives must exhibit accountability and compliance to company's code of conduct at all times. This endorsement to corporate integrity must never fail. Stalwarts, when faced with crisis, have provided the right direction to their organisations to restore the faith of their consumers, shareholders and employees. The firm's culture, when aligned with its values, charts the way forward for leaders and employees alike during difficult times.
- **Leverage technology to seek feedback:** At a time when companies are using sentiment analysis to gauge consumer response to their products and services, top management can utilise the power of digital platforms to hear what stakeholders have to say about the firm and its culture.
- **Be transparent:** Management's role is crucial in creating a more transparent organisation, which is characterised by greater accountability, information sharing and flagging concerns before the situation goes out of hand. One of the classic success stories of transparency in action is the case of crisis at Johnson & Johnson, which is highlighted below:

Leading from the front during crisis

In 1982, Johnson & Johnson was hit by a crisis that was a nightmare for any drug maker. Seven people died in Chicago after consuming Extra-Strength Tylenol capsules laced with cyanide by a perpetrator, who had tampered with the product. It was predicted by marketers that the company would fail to recover from this sabotage, but they were proved wrong.

The company's then chairman James Burke was widely admired for his leadership and transparency in dealing with the media and public. A series of actions began with a nationwide recall of the Tylenol capsules, costing \$100 million and an aggressive communication plan. With efforts in the right direction, the product was re-launched in a span of two months in tamper-proof packaging. The nightmare became a heroic saga of how the company lived the credo of its responsibility to consumers. The product went on to regain its position in the market with a share of 35% as earlier. It was the company's core values of keeping the customer first that guided the top leadership in its action. Today, this case is a benchmark in crisis management.

Source: The perfect crisis response, PR Week, Oct 2015

⁴. <https://edition.cnn.com/2018/10/22/investing/wells-fargo-misleading-investors-settlement/index.html>

⁵. <https://www.theguardian.com/business/2015/dec/10/volkswagen-emissions-scandal-systematic-failures-hans-dieter-potsch>

2. Actionable compliance and ethics programme

The ethical journey of any organisation begins with establishing a strong value system, which becomes the foundation of a positive behaviour and conduct. Shared values, when laid down and clearly communicated, set a standard for all employees and serve as a guide in decision-making. It is crucial that such code of conduct defines and exemplifies to-do for employees during difficult situations, simplifies tough decision-making, and leaves no room for ambiguity. Organisations are also considering appointing chief ethics officers to build and sustain a culture of ethics.

The other side of the coin is setting and communicating the compliance framework, which keeps employees informed about the various legal and regulatory requirements in a business basis its industry, operating region, etc. Companies must invest time and effort in establishing and maintaining a robust compliance framework. Compliance-related requirements must be considered as 'business enablers' as this drives intent both in spirit and letter. Appointing ethics and compliance champions at various levels can also be considered as it could act as a powerful tool for leaders to gauge the real-time progress being made in various aspects, as well as the challenges faced.

3. Build awareness

When employees are well-informed of what is right and wrong, half the battle is won. A variety of tools including internal social platforms within the company, branding in the organisation and pep talks by leadership to publicise and encourage ethical behaviour can work wonders. Similarly, training employees is a crucial component in this regard, and can be achieved by conducting routine trainings, webinars, podcasts, etc.

4. Treat fairly

One of the important components of a value-driven, anti-fraud culture begins with fair and equitable treatment of all employees. This mindset must be prevalent across departments and hierarchies in decisions relating to recruitment, rewards and promotion, and downsizing and succession planning. When employees know they will be treated fairly for their efforts, it serves as the right motivation. As a result, the employees echo company values, serving as a strong first line of defence against fraud.

5. Evaluate, monitor and measure success

The best of internal controls can fall flat if success is not measured. Metrics on both culture and internal controls, which measure the progress of compliance framework should be in place and measured on an ongoing basis. Organisations must consider involving their boards and independent directors actively in evaluating and monitoring progress on these aspects.

Consider taking the following metrics to the board:

- Efficacy of internal controls on compliance framework
- Performance of reporting mechanisms
- Employee engagement

When these three aspects are monitored on an ongoing basis and the board is actively involved in shaping their success, it is a promising start to build and sustain a fraud-averse culture.

Conclusion

An ethical corporate culture brings with it strategic and monetary benefits in the form of high investor confidence, profitability, employee trust, and most importantly, a lower risk of vulnerabilities to fraud incidents. Organisations must attempt to foster a culture built on the tenets of transparency, integrity and engagement.

The most important element for the success of culture is the commitment of the board and management. Conversations on the subject are more recurrent today as the need for the board to play a crucial role in risk oversight echoes from all quarters. As fraud risks take a paradigm shift, only companies with fraud-averse cultures will reach the finishing line.

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