

# Predicting Risk

A Strategic Culture Framework  
for the C-Suite

**The ethical crisis of our time is a call to action to bridge the gap between stated values and organizational culture.**



## About the Author

**Dr. Caterina Bulgarella** is an expert in organizational culture and behavioral ethics. Her work over the past 15 years with institutions and organizations is focused on advancing ethical practices in business and fostering human-centric work environments. Throughout her career, she has brought a rigorous approach to system design and development – on an organizational, team and individual level – by integrating scientific insights and applied best practices. She’s helped senior leaders and organizations tackle a variety of challenges, including culture change, ethical transformation, evolutionary leadership, agile work design, talent management, employee engagement and digital innovation.

Dr. Bulgarella holds a Ph.D. in Organizational Psychology and Master’s degrees in organizational and personnel psychology. She serves as an adjunct professor in the I/O psychology Master’s program at New York University (NYU).



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# Overview

Today's business operates in an environment of profound change and unprecedented complexity. In this new climate, organizations are more likely to face ethical challenges if they do not take steps to avoid unnecessary dilemmas.

An unresolved gap between stated values and what the organization truly values leads to ethical tradeoffs, forcing the average stakeholder to face difficult choices on a routine basis. By pushing competing priorities onto employees, companies accrue unpredictable risk since ethical decision-making is often affected by a number of biases and pressures. For example, the likelihood of acting unethically increases when a person feels emotionally depleted or cognitively overloaded.

As boards and C-suites evaluate the risk their organizations face today, they are bound to realize that a tactical approach cannot build the resilience and collective capacity needed to prevent high-velocity crises. After all, culture is the root cause of the problem. What is valued, how people behave, and the pressure points and narratives that make it legitimate to run things a certain way—these are at the core of what goes wrong in most corporate downfalls.

SAI Global's risk-predictive culture framework helps senior leaders assess the most consequential aspects of their organization's culture, particularly the two coordinates that can produce the highest level of risk. These are:

- Delegation of Ethical Dilemmas—Whether and how an organization introduces conflicting

priorities that force people to deal with difficult ethical tradeoffs;

- Ethical Capacity—Whether the organization's culture creates adequate internal capacity (i.e., responsibility + reasoning + voice) to do the right thing.

The practice of delegating ethical dilemmas becomes entrenched in organizations as a result of a widening gap between implicit and explicit principles of conduct, lack of positive leadership behaviors, and incentives and sanctions that encourage employees to take 'shortcuts.'

A company's ethical capacity—its depth of resources and level of safeguarding against ethical challenges—is likely to remain low when: 1. Business leaders do not shoulder the responsibility for ethical conduct; 2. Internal conditions hamper sound ethical reasoning (e.g., perceived inequity, pressure to achieve difficult goals, etc.); 3. Employees voices are curtailed.

As highlighted in the framework, there are four outcomes that institutions should also track if they wish to fully assess risk. These comprise observations of unethical behavior, trust in the organization, employee engagement, and employee well-being. When measured together, these outcomes can red-flag challenges and a deteriorating culture.

Overall, SAI Global's framework provides boards and senior leaders with a tool to frame strategic conversations, monitor business activities, measure the effectiveness of specific programs, and re-calibrate internal processes and systems.

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# A Crisis of Ethics

The fourth industrial revolution is happening now and bringing sweeping change. Over the next five years, 50 billion machines will be connected across the globe, on pace to revolutionize the way companies and people operate. Smart factories, delivery drones, online platforms, and sharing services are transforming how products and services are made, delivered, and consumed. Supported by new technologies, supply chains are becoming increasingly globalized, giving business new agility but also exposing it to a host of new risks.

Compounding the velocity of technological change, economic and geopolitical uncertainty, dwindling resources, and profound demographic shifts are forcing today's institutions to face an unprecedented level of complexity. In this climate of high volatility and constant ambiguity, both business and leaders must develop the capacity to both leverage and inject disruption.<sup>1</sup>

Shaped by these forces, the 21st century organization is developing a new genome. On the one hand, technology is streamlining delivery models. On the other, the rise of artificial intelligence (AI), robots, and complete automation is creating a deeper need for unique human capacities.<sup>2</sup> If technology is a 'helix' of this newly emerging DNA, humanity is necessarily the other one.

“Fostering a strong ethical culture is more than a responsibility for business today; it is the only way organizations can build a sustainable competitive advantage.”

Surrounded by relentless change, key stakeholder groups are also feeling pangs of anxiety. The trust deficit<sup>3</sup> of our time not only indicates business' struggle to lead the way, but also reveals the unspoken fear that, at a time of extraordinary opportunity, companies and leaders may fail to do the right thing.

Now, at the dawn of the robot era, older and newer generations are concerned about the jobs AI is set to sweep away. Millennials are fretting over their own futures and the level of commitment employers are willing to make to their professional growth. The public is feeling progressively more vulnerable in the wake of continued data breaches.

And, more constituencies are growing skeptical that organizations and executives are 'in it' to provide solutions to the challenges of our time. As income inequality becomes starker and corporate scandals multiply, the perception that business may be only driven by self-interest is strengthening.

While organizations grapple with the unpredictable demands of today's change, they risk overlooking their biggest test: a gap in credibility; a lack of good will; a failure to build cross-generational, inter-regional, and multi-ethnic coalitions of allies willing to work together for a project of shared prosperity. The crisis of our time is a crisis of ethics that will force stakeholders to confront fundamentally important challenges, from genetics to resources to the very role of humanity.

# New Responsibilities for the C-Suite

A new culture of transparency and accountability demands a higher level of responsibility from chief executives. Still reeling from the financial and economic crisis of the past ten years<sup>4</sup>, the public is now holding business personally accountable. The mounting thunder of Tweetstorms and other viral social media content are making companies and executives vulnerable like never before, exposing outdated organizational cultures and their disconnected leaders.

Mirroring the public sentiment, regulators, institutional investors, and governments are also heeding the ethical concerns of this new era, expecting business to model high standards of conduct.<sup>5</sup> For those in top management positions who ignore these demands, the costs may be high: Over the past five years, CEO dismissals due to unethical behavior rose by 36%<sup>6</sup>, and misconduct cost the banking sector more than EUR 200 billion.<sup>7</sup>

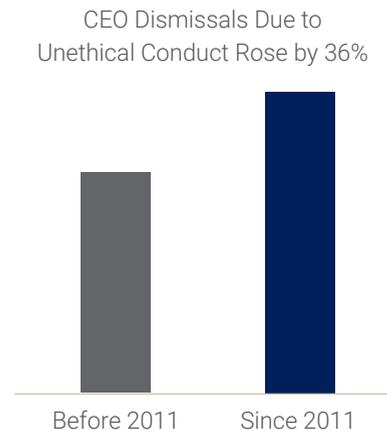
It might be tempting to view the price tags attached to failing corporate conduct as the punishment of an unforgiving climate. But, when examined closely, the stories of Lehman, BP, AIG, Volkswagen, Wells Fargo, and others depict more than high-velocity crises with devastating consequences.

They reveal a widespread miscalculation in the way risk was understood and ethical issues were weighed. They betray a misplaced sense of control over human and system-level dynamics, which, if abetted by the wrong culture, can clearly take on a life of their own. They highlight a failure of imagination across the top echelons of the organization that we can no longer afford. Though

negligence is different from malice, ethical problems caused by lack of foresight are not less acute, nor less consequential.

The increased ethical demands placed on business today present not only burdens, but opportunities. Several studies have highlighted the direct and indirect positive returns of a strong ethical culture. Not only are consumers<sup>8</sup> willing to pay more for ethically made products and inclined to discount the value of unethically made ones, but top job candidates<sup>9</sup> are ready to accept less money to work for an ethical organization. There is also evidence<sup>10</sup> that companies with strong ethics enjoy greater resilience in times of financial decline and superior financial performance over the long term.

Fostering a strong ethical culture is more than a responsibility for business today; it is the only way organizations can build a sustainable competitive advantage.



# Mapping Ethics to Business

Yet ethics and business are still perceived as forming an oxymoron. Some believe that business cannot be truly ethical if its sole purpose is profit; others argue that it cannot flourish under the shackles of regulations. Indeed, organizations are likely to face ethical challenges insofar as they create them. How business positions itself in relation to ethics may trigger the toughest dilemmas, especially when its stance lacks awareness and is filled with contradictions.

When there is a gap between what companies say they value and what they actually value, the average stakeholder in the organization is left with the burden of choosing between competing priorities. Failing to address these potential dilemmas may cause business to accrue its greatest risk.

The systematic delegation of dilemmas is a critical driver of unethical behavior. Many of the recent corporate crises reveal that, beyond short-termism, corporations that held an ambiguous or contradictory position on ethics and/or separated ethics from strategy exposed themselves to disproportionately negative consequences.

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There are at least three ways organizations delegate ethical dilemmas to internal and external stakeholders (e.g., employees, supply-chain partners, etc.). These include:

- Failing to articulate ethical principles;
- Introducing ethical standards that are vague and hard to apply;
- Communicating ethical criteria that are at odds with what the organization truly values.

In each of these scenarios, the responsibility of choosing the right priority is relayed down to local stakeholders and, as such, made fully dependent on their ethical capacity. In these cases, risk is bound to increase for two reasons:

1. *People lack guiding principles that could help them make the right decision;*
2. *The absence of a crystal-clear perspective on ethics discounts the value of doing the right thing.*

Indeed, more and more organizations are heeding the recommendations of long-standing research<sup>11</sup> and embracing an approach to legal compliance that includes shared values. Although this approach is more mature, it is not immune to weaknesses.<sup>12</sup>

Companies that introduce corporate values as the basis for shared principles of conduct may still end up delegating dilemmas. In fact, they do so every single time they give equal or greater importance to competing principles (e.g., short-term results, cost-reduction, profit, etc.).

# Re-framing the Ethical Problem

“Contemporary theories of ethical reasoning acknowledge that the mind takes shortcuts in the face of moral dilemmas.”

By focusing on whether the organization is delegating ethical dilemmas and which tradeoffs are pushed onto different types of stakeholders, the C-suite is given full perspective on the risk the organization faces. The real ethical challenge for business is not to introduce a set of corporate values, but to be deliberate about the implicit criteria that guide decision-making and execution—what business truly *values*.

The notion that organizations manufacture and delegate tradeoffs reminds us that the ethical problems institutions face today are neither static nor well understood. Framing the moral question for individuals and corporations as an issue of innate orientation or intent may lead us astray.

What needs to be addressed is not whether people and companies are inherently good or bad, but whether they make inherently good or bad decisions. Both individuals and organizations should be acknowledged for their aspiration to be ethical but assessed in relation to the constraints that can lead them to act unethically.

Behavioral research indicates that our ethical capacity may be limited by several biases. For example, we know that:

- People overestimate their ability to do the right thing<sup>13</sup>
- The average person lies on a regular basis<sup>14</sup>
- People are less likely to behave ethically when they are under pressure<sup>15</sup> and/or when they feel emotionally depleted<sup>16</sup>
- We commonly adjust our personal ethical standards to correct perceived inequity<sup>17</sup> or to reciprocate the kindness of others<sup>18</sup>
- We discount moral lapses that strengthen our self-image<sup>19</sup>
- Being in a creative flow may reduce a person's honesty<sup>20</sup>

Contemporary theories of ethical reasoning acknowledge that the mind takes shortcuts in the face of moral dilemmas. Not only do people use heuristics when they encounter ethical tradeoffs<sup>21</sup>, but they rationalize or justify their conclusions after the fact. Because our minds constantly adjust to account for a myriad of situational and experiential factors, ethical evaluations can be as irrational as other forms of decision-making.

Even if ethics are at stake, people may end up re-arranging their personal standards to accommodate competing criteria. Most likely, they will do so not because they are amoral or immoral, but because they are blind to the automatic correction their mind applies as it weighs ethical concerns against other motives.

# From the Individual to the Organization

If people's ethical capacity is bound to shrink or expand based on contextual factors, organizations are also subject to the same constraints. A company's collective capacity for ethical reasoning is inextricably tied to its people's. What we know about ethical lapses at the individual level tells us that:

- Organizations are exposed to a higher risk of misconduct when they are under pressure—for example, when an important deadline is nearing or overly ambitious goals are set, or when a business is facing a crisis;
- Having a lofty purpose may, paradoxically, make organizations less sensitive to their own ethical liabilities;
- At the corporate level, the occurrence of unethical conduct may be justified to keep things running and support key stakeholder groups;
- Companies that try to push the envelope may be more prone to ethical failures.

The ethical challenges that individuals and organizations face today shouldn't be reduced to absolute rights and wrongs. Framing ethical problems this way could limit our understanding of risk at a time when the velocity and intensity of change is likely to create greater opportunity for ethical dilemmas and complex decision-making.

“The ethical challenges that individuals and organizations face today shouldn't be reduced to absolute rights and wrongs.”



# Culture, After All

From a strategic standpoint, the ethics problem that both business and people face is one and the same: Old models are becoming obsolete, and a new economy is emerging, its shape and values still unclear. The nature of this transformation is multifaceted and radical, re-writing, on a daily basis, the boundaries of what is right and wrong. In this new environment, the questions and challenges organizations face cannot be addressed by tinkering at the edges of existing programs.

Business can no longer deal with emerging crises by pointing the finger at ‘a few bad apples,’ while distancing itself from the perpetrators. Nor can corporate scandals be framed as ‘something that happened to us.’ Even if invoked for legal reasons, such claims are unlikely to help organizations rebound from the dark pit to where their problems led.

And even if we were to believe that a few people alone could undo entire organizational systems, this wouldn’t unburden the C-suite. A frail business is no more reassuring than a broken one. In either case, chief executives would be left with the responsibility to fix a systemic issue.

While some problems can be band-aided, there are no quick patches for deep-seated failures like those revealed by recent corporate scandals. As boards and C-suites evaluate the risk their organizations face today, they are bound to realize that a tactical approach cannot build the resilience and collective capacity needed to prevent high-velocity crises.



After all, culture is the root cause of the problem. What is valued, how people behave, and the pressure points and narratives that make it legitimate to run things a certain way—these are at the core of what goes wrong in most corporate downfalls.



# What Is Culture?

To put culture at the epicenter of it all may seem like evoking a ghostly figure. Culture is not only hard to see but difficult to understand and measure. Yet, for all its intangibles, its importance cannot be downplayed.

Taught to new members as the correct way to **perceive, think, and feel**, culture comprises a system of assumptions that the organization learns as it adapts to the external environment and gets better integrated internally. Culture encompasses implicit beliefs about the organization's purpose (i.e., mission, strategy, and goals), the necessary means to achieve it (i.e., systems, structure, and processes), the appropriate feedback mechanisms to gauge progress, and the remedial strategies to use at times of crisis.

Culture also encompasses what the organization believes when it comes to language; group boundaries; power, authority and status; the rewards and punishments used to encourage and censor behavior; and the meaning of unexplainable events, human nature, and appropriate human activity. Many of the beliefs that shape the culture of an organization are implicit rather than explicit and evaluative in nature.

They tell us what the organization values, which brings up a very important point:

Culture does not simply encompass the things an organization believes but the things it values.

A good analogy to understand culture is the iceberg. On the one hand, culture hides in the way people think and the values the organization preserves over time—the underwater part of the iceberg. On the other, it surfaces in behaviors and the organizational systems built to codify central beliefs—the above-water part of the iceberg.

Because culture is all-encompassing, it cannot be reduced to only one thing. Aristotle considered behavior as what defines us, but Buddha viewed man as shaped by his own thoughts. For an organization, both views are true: behaviors, beliefs, values, and other schemas, along with the systems used to regulate them, mold and perpetuate the organization's culture.

“Culture does not simply encompass the things an organization believes but the things it values.”



# A Strategic Approach to Ethics

As the C-suite addresses threats of disruption, employee disengagement, millennial turnover, skill obsolescence, and other 21st century challenges, they can either be tactical or strategic. With culture in the situation room, the solution approach is likely to pay high dividends. Organizations must apply a strategic focus to the ethical challenges they face today.

There are two sets of tasks senior leadership must prioritize to create organizational resilience and stamina to manage complexity. First, they must understand the ethical dilemmas the organization is currently driving down; second, they must deploy organizational resources—culture first—to bolster people's ability to face up to difficult ethical issues.

As it adopts this strategic approach, the C-suite must think in terms of synergies. To maximize the ethical focus and capacity of an organization, all levers should be used and calibrated appropriately.

Values, beliefs, behaviors, and systems, including the specific ethics and compliance (E&C) activities that most organizations focus on, all have a role to play. But no E&C initiative—however well-crafted—can have a meaningful impact on the organization when its overall culture is flawed.

Programs that target human capacities such as ethical decision-making have little influence in a weak organizational culture because culture affects all human capacities in the organization.

Values

Beliefs

Behaviors

Ethics

# SAI Global's Culture Framework

<b>Is the Organization Delegating Ethical Dilemmas?</b>	Principles of Conduct	Are there clear ethical standards?	Is there a conflict between these standards and what the organization values?	Are potential conflicts being addressed?
	Leadership Behavior and Exercise of Power	What criteria guide the hiring of management?	What are leaders focusing on in words and deeds?	Do leaders view their role as responsibility or entitlement?
	Incentives and Sanctions	What rewards and sanctions does the organization use?	How are top performers treated when they act unethically?	Are employees rewarded for achieving results in conflict with ethical standards?
<b>What's the Organization Ethical Capacity?</b>	Ethical Ownership	Is the E&C responsibility siloed or shared with business lines?	Are business leaders held accountable through ethical goals?	How are ethics framed throughout the organization (e.g., chore or opportunity)?
	Ethical Reasoning	What training and insights are available? How are they used?	What contextual factors and/or experiences may hamper ethical reasoning?	Are managers promoting an open dialogue around ethical issues?
	Ethical Voice	What channels are available for reporting and speaking up?	What is the cost of sharing bad news or being a whistleblower?	How has the organization used employee feedback in the past?
<b>What's the State of Key Outcome Variables?</b>	Observing Unethical Behavior	Have employees observed misconduct or unethical behavior?		
	Feeling Engaged	Do employees feel energized, proud, and committed to the organization?		
	Trusting the Organization	Do employees trust the organization?		
	Experiencing Well-Being	Do employees experience physical and emotional well-being?		

# Predicting Risk: SAI Global's Culture Framework

If culture is difficult to pin down, how can it be measured? Culture is like a prism with many facets: Depending on the angle from which we examine an organization's culture, our understanding of it may shift. All the stories the culture 'prism' generates hold truth and value, assuming the measurement tools applied to reveal them are not flawed. Yet, not all stories are equally important or informative.

The question is not whether culture can be measured, but what aspects should be measured to assess the organization's exposure to risk, what prism face will lend the most telling insights, and what approach is likely to produce the most efficient strategic analysis. We developed a risk-predictive culture framework that could meet all three goals successfully and provide the C-suite with the strategic perspective needed to understand and act on risk. The framework offers an assessment of risk across two coordinates:

- The extent to which the organization delegates ethical dilemmas—Whether and how an organization introduces conflicting priorities that lead to difficult choices;
- The strength of the organization's ethical capacity—Whether internal stakeholders feel responsible for the organization's ethics, engage in sound moral reasoning, and use their voice to stop/prevent unethical outcomes.

The framework provides a dynamic view of culture consistent with the top-down / bottom-up forces that shape business. On one hand, there are the priorities that govern decision-making and execution—what the

organization values. On the other, there are the internal and external conditions that shape people's ability to control ethical outcomes and do the right thing.

Along each coordinate, the framework shows the culture determinants that define it. These break down into structural and intangible components, providing organizations with a concrete method to assess the systemic risk they are exposed to at any given time.



Does the Organization Delegate Ethical Dilemmas?

# Culture Determinants

There are six culture determinants in the framework. Three are critical to measuring delegation of ethical dilemmas, and three are central to assessing ethical capacity. A discussion of each determinant follows.

## **Determinants that Shape Delegation of Ethical Dilemmas**

Risk is inherently linked to difficult choices. Although organizations cannot prevent all types of dilemmas, they are in a position to avoid fundamental ones. These concern what the organization explicitly and implicitly values. Ethical dilemmas that are not addressed through a cohesive approach to mission, strategy, purpose, and values are relayed down to stakeholders. In this way, organizations create risk and lose control over it.

There are three culture determinants through which the practice of delegating dilemmas becomes entrenched in the organization: implicit and explicit principles of conduct, leadership behavior, and systems used to incentivize and sanction employees.

## **Principles of Conduct**

At its core, the culture of an organization is informed by the beliefs and values shared across its social *fabric*. Values and ethical principles do more than codify the organization's ethos; they communicate an aspiration to be ethical.

We know that moral ideals and emotional commitments<sup>22</sup> can outweigh self-interest and reduce the incidence of unethical behavior if people are reminded of them before making decisions.<sup>23</sup>

By creating behavioral expectations, ethical principles also make it more difficult for people to disengage morally.<sup>24</sup> However, moral reasoning is also intuitive and routinized.<sup>25</sup> This is why implicit principles of conduct shape the way people respond to ethical issues.

Accordingly, to measure delegation of dilemmas across the organization, the culture framework doesn't simply focus on external core values but also on implicit decision-making criteria (i.e., what people automatically value when they make decisions), and whether the two are in conflict. A tension between what the organization says it values and what it values creates dilemmas that stakeholders must face and address in their daily work experience.

## **Influence of Leadership and Role of Power**

Understanding the way power and leadership are exercised is essential to gauging the extent to which dilemmas are driven down on employees. Leaders can be '*agents of virtue or vice*'<sup>26</sup> within an organization, shaping the overall ethical climate and people's commitment to the organization's best interest.

When leaders demand results and profit at all costs, they reinforce principles of conduct that are amoral at best. Having to choose between loyalty to one's manager and ethical standards is the type of trade-off that creates the pre-conditions for poor ethical decision-making. Research shows that when people feel obligated to reciprocate, they are more likely to discount ethical principles.<sup>27</sup>



“Ethical leaders act fairly, avoid double-standards, and do not abuse their power.”

This is why the impact managers can have on their direct reports' work life may be enough to create a sense of obligation far greater than the desire to uphold ethical standards.

Because ethical leadership from the top is likely to be felt across other levels of the organization<sup>28</sup>, it can help prevent or reframe dilemmas. Ethical leaders feel genuine concern for others<sup>29</sup>. They act fairly, avoid double-standards, and do not abuse their power. In contrast, unethical leaders place power above ethics, foster unfairness, and, through their behavior, encourage others to engage in unethical conduct. Several studies indicate that when confronted with organizational injustice, people lower their ethical standards to level the playing field.<sup>30</sup>

Leaders who abuse their power also create greater potential for dilemmas by increasing the value of privilege (e.g., people in power can do whatever they want) at the expense of ethics. Those who observe this behavior may feel disadvantaged by the fact that some are cheating and gaining unfairly. This, in turn, may create the motivation to act unethically.

### **Impact of Rewards and Sanctions**

Incentives designed to reward unethical behavior create powerful dilemmas<sup>31</sup>. Similarly, sanctions that are applied unevenly to protect top performers undermine the organization's ethics, making it easier for employees to entertain competing priorities (e.g., self-interest, personal gain, etc.) at the expense of moral concerns.

### **Determinants That Shape Ethical Capacity**

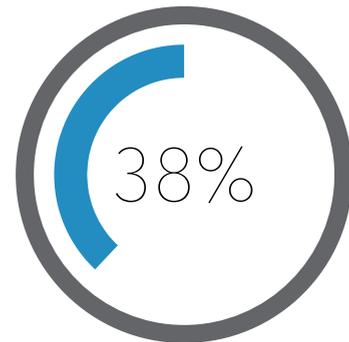
On one hand, risk depends on the frequency and implications of the ethical dilemmas the organization delegates to stakeholders. On the other, it is shaped by the organization's ethical capacity. An organization possesses ethical capacity if people feel that the ethical issues they encounter are their own responsibility, their judgment is not automatically curtailed by contextual biases, and their voice can make a difference.

### **Ethical Ownership**

The way an organization structures ethical and compliance responsibilities is a key contributor to its ethical capacity. Recent data<sup>32</sup> shows that only 38% of CEOs play a central role in strategic planning around ethical challenges; in many instances, senior leaders



“The ethical capacity of an organization boils down to whether people feel a sense of responsibility toward ongoing ethical challenges; whether they can engage in sound ethical reasoning; and whether they can affect ethical outcomes. Culture shapes all three components.”



38% of CEOs play a central role in strategic planning around ethical challenges

# Culture Determinants

(cont'd)

delegate most compliance and ethics oversight activities to the Ethics and Compliance function.

When ethics and compliance are siloed responsibilities, the organization falls short on ethical ownership—the belief that ethical issues are one’s own immediate concern<sup>33</sup>. If local leaders consider the E&C function as the main owner of ethical problems, they will not act proactively to avoid ethical dilemmas and curb risk.

Several factors shape ethical ownership: for example, whether the E&C function works locally and closely with business leaders, whether local leaders shoulder and are held accountable for specific E&C responsibilities, how ethical issues are framed, and so on.

## **Ethical Reasoning**

While ethical ownership is essential, people must also engage in sound ethical reasoning. This entails understanding the implications of their actions and decisions (i.e., moral awareness<sup>34</sup>) and controlling the influence of contextual factors (i.e., moral framing) on their decision-making.<sup>35</sup>

At this level, the framework evaluates ethical capacity by focusing on a number of components: for example, the types of learning and development opportunities offered to employees; the current climate (e.g., whether people feel treated unfairly or experience competition, etc.); whether managers increase awareness of dilemmas and help employees recognize the influence of certain

contextual factors; and the extent to which ethical conversations punctuate everyday work life.

By surfacing potential biases and assessing the conditions that help employees address ethical challenges more thoughtfully<sup>36</sup>, this portion of the framework also evaluates the quality of judgments people are likely to make in the face of a dilemma.

## **Ethical Voice**

In addition to ethical ownership and sound ethical reasoning, people must also feel they can exercise their voice, blow the whistle and/or report unethical conduct.

This component of ethical capacity is closely tied to the value the organization gives, in general, to employee voice and the personal cost of speaking up. Research<sup>37</sup> shows that people are more likely to blow the whistle when they know that their reporting will be taken into consideration, and when the whole organization, not just managers, is committed to ethics.

Accordingly, the framework captures how much importance is given to employee voice and what costs employees incur if they choose to speak out. Examples include what channels and mechanisms are available to report unethical behavior and/or share difficult feedback, whether the organization is open to receiving bad news, and whether people experience retaliation when they share controversial feedback.

# Outcomes of Interest

There are four outcomes that organizations should also track if they wish to fully assess risk. These comprise observations of unethical behavior, trust in the organization, employee engagement, and employee well-being. When measured together, these outcomes can red-flag challenges and a deteriorating culture.

As the organization starts delegating ethical dilemmas to stakeholders, its risk increases, and unethical behavior and misconduct become more frequent. Tracking where and to what extent employees have witnessed unethical conduct sheds light on the culture's most damaging effects and what areas need to be closely monitored going forward.

Most organizations measure employee engagement as a leading indicator of growth.<sup>38</sup> Importantly, this outcome has also been linked to ethical leadership and corporate culture.<sup>39</sup> As a gauge of how employees feel, employee engagement can provide a real-time window into evolving challenges.

Measuring trust in the organization also gives insight as to what risk the organization is experiencing. When people are exposed to unfair treatment or feel failed by larger systems, they lose trust.<sup>40</sup> Declining trust in the organization is, thus, likely to signal organizational practices that may fall short on fairness and/or ethics.

Finally, employee wellbeing provides additional context, especially if organizations wish to spot unethical leadership<sup>41</sup> early on. The relationship between employee wellbeing and organizational culture<sup>42</sup> clarifies the costs of delegating dilemmas to internal stakeholders.

When the organization lacks a true north star, employees may experience a state of dissonance in relation to their personal values. Forced to choose between competing priorities or address unwanted pressure, they may feel psychological strain.

Profiled together, the four outcomes offer initial insight into emerging issues and potential ethical challenges. Added to the other levels of measurement in the framework, they clarify what is happening in the organization and where risk is likely to reside. Finally, with the appropriate analytical insights, they can help organizations understand critical relationships among culture determinants and employees' experiences at work.



# Understanding Culture Through the Framework

If the reader is wondering why the culture of an organization should be understood in terms of delegation of dilemmas and ethical capacity, it's worth noting that the two coordinates were distilled to provide the most consequential, informative, and efficient reading of culture from the standpoint of risk. Instead of a generic approach, the model focuses on how the culture of an organization creates or mitigates risk.

By highlighting the extent to which organizations delegate ethical dilemmas, the framework underscores that culture is first and foremost about what an organization values. By measuring ethical capacity, it emphasizes that risk is highly dependent on people's ability to own and properly address ethical issues. Not only can this ability be weakened by internal and external conditions that undermine reasoning and enhance blind spots, but it can also be discouraged, leading to moral disengagement and other forms of amorality.

## **What We Mean by Delegation of Ethical Dilemmas**

Along this coordinate, the model presents those aspects of the organization's culture that determine the importance given to ethical principles. When the organization discounts ethics, it creates tradeoffs, which are automatically delegated to key stakeholders. Delegating ethical dilemmas creates ripe conditions for risk: People may feel encouraged to discount ethical standards, competing priorities may become more prominent, individuals and teams may 'observe' and 'learn' paths to personal success that downplay ethics, and so on. Organizations delegate

ethical dilemmas in a number of ways—for example, by valuing things that clash with their formal values, or by incentivizing behavior at odds with the behaviors people are formally expected to demonstrate.

## **What We Mean by Ethical Capacity**

Ethical capacity refers to those elements in the organization's culture that affect people's ability to address ethical challenges effectively. It presumes a sense of ownership toward ethics and the presence of internal and external conditions that curb the impact of blind spots and other contextual biases. For example, a culture in which people feel pressured to meet high performance expectations all the time can deplete people's ability to see ethical dilemmas for what they are, or fear of retaliation may reduce people's confidence that they can influence important ethical outcomes.

“Measuring trust in the organization, employee engagement, unethical behavior, and employee well-being, can help red-flag challenges.”



## Type of Culture and Level of Risk

The more an organization delegates ethical dilemmas, the greater its risk. Risk is highest when the organization discounts ethics entirely, signaling that people should do whatever it takes to achieve results and meet performance goals. Risk is lowest when the organization places ethics above all else.

Few organizations sit at either end of the spectrum: the bulk of today's business experiences some level of tension between ethics and profit.

Looking at risk from the standpoint of ethical capacity provides a bottom-up view of the culture, showing us how likely people are to engage in responsible decision-making. When it comes to ethical capacity, risk is highest when an organization has none, and it is lowest when people have the resources to address ethical dilemmas.

Taken together, the two coordinates offer a comprehensive view of risk. For simplicity, let's focus on the most clear-cut organizational types: Immature, Ambivalent, Righteous, and Mature organizations.

- Immature organizations delegate ethical dilemmas and lack ethical capacity
- Ambivalent organizations have ethical capacity but delegate ethical dilemmas
- Righteous organizations avoid delegating dilemmas but lack ethical capacity
- Mature organizations have ethical capacity and do not delegate ethical dilemmas

It's easy to see why risk is highest in Immature organizations. In addition to being overly focused on profit, these organizations do not help people address the ethical tradeoffs they are likely to encounter.

Risk is lowest in Mature organizations as a result of their strong commitment to ethics, which manifests both in the resolution of ethical dilemmas at the top of the organization (mission, strategy, values, and purpose are aligned) and the steady and dynamic creation of ethical capacity.

Because Righteous organizations do not delegate ethical dilemmas, they experience lower risk than Immature organizations. However, their risk is higher than Mature organizations since people don't have much ethical capacity. These organizations create high risk when they impose their ethical principles on people in a cult-like manner, disabling the muscle of independent reasoning.

Ambivalent organizations experience less risk than Immature organizations due to their higher ethical capacity, but greater risk than Mature organizations due to their tendency to delegate dilemmas.

Because Ambivalent organizations force people to make difficult choices, their exposure to systemic risk is still high. Employees may blow the whistle or resist the internal pressure, but ethical dilemmas are so widespread that people will eventually feel depleted. Overall, Ambivalent organizations remain exposed to considerable risk and should be monitored closely.

## How Does Risk Change Across Culture Types?

<b>Mature</b> Ethical dilemmas are addressed at the top, ethical capacity is consistently matured	<b>Low Risk</b> and growth is ethical
<b>Righteous</b> There are clear ethical standards but little is done to build ethical capacity	<b>Moderate Risk</b> ; inflexible principles may inhibit ethical capacity
<b>Ambivalent</b> Ethical tradeoffs are pushed on employees; the organization takes steps to build ethical capacity	<b>High Risk</b> ; intense pressure and deep misalignment are widespread
<b>Immature</b> There is high delegation of dilemmas combined with low ethical capacity	<b>Very High Risk</b> ; growth is not sustainable

# Using SAI Global's Culture Framework to Assess Risk at Wells Fargo

To illustrate the diagnostic power of SAI Global's Culture Framework, we used it to evaluate the state of Wells Fargo's culture prior to the corporate scandal that rocked the organization starting in 2014. The table on the next page provides a summary description of each culture determinant and a risk assessment based on its health.

Based on Wells Fargo's profile, it can be noted that:

- The culture determinants that created systemic risk were in the red zone, foretelling Wells Fargo's eventual failure.
- While all the culture determinants that shape 'Delegation of Ethical Dilemmas' were *solidly red*, the organization possessed some degree of ethical capacity, as demonstrated by the fact that several employees tried to blow the whistle.
- In terms of culture maturity, Wells Fargo oscillated between the Immature and Ambivalent states—two culture types that, as discussed, are exposed to high levels of risk.

A closer look at the state of the six culture determinants helps us understand why Wells Fargo was bound to experience systemic failure.

## **Delegation of Ethical Dilemmas.**

Armed with an inspired vision, the organization started out by placing a premium on ethics. Its Vision and Values booklet, which all employees were given upon joining, made it clear that the company's business had:

*Nothing to do with transactions, pushing products, or getting bigger for the sake of bigness. It's about building lifelong relationships one customer at a time. ... We*

*strive to be recognized by our stakeholders as setting the standard among the world's great companies for integrity and principled performance. This is more than just doing the right thing. We also have to do it in the right way.*

Yet, employees eventually learned that other things were also important. In 1998, Dick Kovacevich, Wells Fargo's CEO at the time, told Fortune magazine that banks had to figure out how to sell money. He believed that financial instruments were consumer products, the same way "... Wal-Mart sells socks or Home Depot sells screwdrivers. Much like those businesses, financial services is huge (\$1.9 trillion in assets) and fragmented."

According to Kovacevich, in order to maximize growth, banks needed to engage in cross-selling, getting customers to buy as many products as possible. Handing employees the Vision and Values booklet with the right hand and Kovacevich's cross-selling credo with the left, Wells Fargo set the stage for widespread delegation of dilemmas.

The delegation of ethical dilemmas was a prominent aspect of Wells Fargo's culture not only due to the organization's conflicting principles of conduct, but also because leadership and incentives discounted ethics in favor of revenue and sales targets. Leadership used its influence to impose unrealistic goals on employees. In the wake of the scandal, senior leaders disavowed the conduct that had led Wells Fargo to open more than 2,000,000 unauthorized accounts; however, both employee reports and lawsuits were crystal-clear about the unethical role of local leadership.

Culture Coordinates	Culture Determinants	Wells Fargo's Profile	Level of Risk
<b>Delegation of Ethical Dilemmas</b>	Principles of Conduct	Wells Fargo's internal and external values <sup>43</sup> were strongly at odds. On the one hand, the company proclaimed its commitment to the customer and fostering trust. On the other, it pushed employees to sell 'customers as many products as possible.' <sup>44</sup>	High
	Leadership & Power	Local leaders used their influence to force overly ambitious goals on employees. <sup>45</sup>	High
	Rewards & Sanctions	Incentives were tied to cross-selling: <sup>46</sup> Salespeople received between 15% to 20% of bonus compensation if they met their sales goals. Though roughly 5,000 salespeople were let go between 2011 and 2016, these layoffs touched only 1% of the workforce.	High
<b>Ethical Capacity</b>	Ethical Ownership	The company's official position was that the businesses owned ethics, <sup>47</sup> yet senior leadership framed the scandal as a 'compliance and operations' problem. <sup>48</sup>	High
	Ethical Reasoning	The ethics program trained employees to spot conflicts of interest <sup>49</sup> and provided them with a Code of Conduct—valuable but inadequate resources to help employees cope with the sales pressure they experienced daily.	High
	Ethical Voice	Wells Fargo fostered a culture of threat, intimidation, and retaliation to discourage employees from speaking up. Five percent of the workforce eventually joined forces to file a petition <sup>50</sup> that asked the company to discontinue its cutthroat culture.	Medium

# Using SAI Global's Culture Framework to Assess Risk at Wells Fargo

(cont'd)

In a company structured to boost regional autonomy, branch managers aggressively pushed for unrealistic goals. Not only did they demand results, but they also expected complete allegiance.

To make matters worse, incentives were designed to reward the number of products employees sold, irrespective of the means adopted to achieve individual targets. Most employees were rewarded based on their sales numbers, while the company's top management was compensated for achieving the financial results set for the year.

It is unclear how sanctions were applied throughout the organization. Between 2011 and 2015, Wells Fargo laid off roughly 1,000 employees per year for allegedly ethical reasons. Yet it's not known whom these sanctions were targeting. Several ex-Wells Fargo employees were penalized for not wanting to partake in the cross-selling scheme. Moreover, even if the company tried to right some of its wrong, the employees dismissed for unethical conduct were only the tip of the iceberg—unless we are to believe that those 5,000 people were responsible for opening millions of fraudulent accounts.

Not only was Wells Fargo incentivizing risky sales behavior, but it was probably failing to sanction top performers who engaged in unethical conduct.

## **Ethical Capacity**

Though Wells Fargo's culture had some level of ethical capacity, it lacked enough to counteract the ethical dilemmas pushed on employees. For example, local

branches were more likely to numb employees' ethical awareness than to own the negative consequences of a corrosive sales culture. If, on the one hand, people were trained to recognize conflicts of interest, managers were compounding ethical dilemmas. Furthermore, contextual factors such as loyalty expected from superiors, pressure to sell, and emotional distress were widespread, making it difficult for stakeholders in the organization to control the effects of potential biases.

Interestingly, the organization's ethical voice was not completely restricted. Though many were intimidated and threatened for not complying with sales goals, as many as 5,000 employees petitioned the company to try and stop its cut-throat practices. As work processes became increasingly inconsistent with basic principles of integrity, the balance at Wells Fargo tipped from individual fear to collective efficacy.

The totality of these factors describes a broken culture, widespread ethical challenges, and systemic risk. The fact that Wells Fargo didn't get caught for a number of years shouldn't be taken as a sign that things were under control. Instead, it should be viewed as proof that once organizations trigger a risky pattern of corporate and individual behavior, traditional governance systems will not be enough.

Had Wells Fargo's board been provided with the culture and risk map presented on the previous page, it could have connected the dots, potentially saving the company from itself.

# Looking Ahead

The crisis of ethics of our time is a call to action for the C-suite. To manage risk effectively in this extraordinary phase of corporate and human evolution, organizations must fully understand the challenges they are facing, properly diagnose the practices that aggravate these

challenges, and clearly envision the strategic approach needed to prevent them. None of this can be achieved without a deliberate and thoughtful analysis of the cultural dynamics that shape risk in the organization.





# Looking Ahead

*(cont'd)*

The culture framework presented in this document is intended as a strategic resource for boards and executives. In its simplest implementation, the framework can be used to inform internal discussions on culture and risk. It can also be leveraged to orient the work of independent monitoring committees and create a scorecard of culture and risk for the board to review regularly.

The framework also provides a blueprint of the culture determinants senior leaders must focus on to shape their organization's internal ethos and to better control the impact of key systems. Importantly, our framework also offers a scientific perspective to evaluate the impact of programmatic initiatives such as those deployed as part of an organization's Ethics and Compliance program.

There is nothing more insightful, relevant, and specific for an organization to measure the effectiveness of its Ethics and Compliance initiatives than tracking delegation of ethical dilemmas and the organization's ethical capacity. While ineffective programs will not move the needle along the framework's two coordinates, effective programs can help organizations avoid difficult tradeoffs on the one hand, and create ethical capacity, on the other.

Finally, the framework is a tool for stakeholders who operate in different areas to connect the dots and control risk across the entire ecosystem (e.g., supply-chain partners, distributors, etc.).

By integrating external values, implicit beliefs, individual behaviors, and key systems, SAI Global's approach is designed to help organizations prepare for risk in a dynamic way—to anticipate and properly manage threats rather than to succumb to them; to continue to grow and thrive rather than to crumble under the pressure of external forces; to control all strategic levers rather than to be taken by surprise. Too many corporate failures have left organizations, employees, customers, and larger eco-systems shell-shocked. For some what happened was unexplainable; for others, there were signs of what was afoot.

But for all, one thing became eventually clear: They had underestimated the methodical, insidious, and relentless impact of their culture and the risk that would eventually ensue as a result.

While business grapples with the ethical demands of this new era, companies make sense of their new DNA, and senior leaders are forced to address the most profound changes, no organization can afford to delay in creating the internal capacities that all these challenges require. The stakes are simply too high. Get in touch with us today to learn more about SAI Global's Strategic Culture Framework and how you can use it to manage risk strategically. And join us to help us advance the conversation on ethics in business.



# About SAI Global

**SAI Global** helps organizations proactively manage risk to create trust and achieve business excellence, growth, and sustainability. Our integrated risk management solutions are a combination of leading capabilities, services and advisory offerings that operate across the entire risk lifecycle, allowing businesses to focus elsewhere. Together, these tools and knowledge enable clients to develop an integrated view of risk.

We have global reach with locations across Europe, the Middle East, Africa, the Americas, Asia and the Pacific. For more information, visit [www.saiglobal.com](http://www.saiglobal.com).

# Endnotes

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