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INSIGHT: Employee Reporting Is Best Line of Defense Against Corporate Misconduct

By Alex Dimitrief

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Anger and distrust over corporate missteps is rising, with even presidential candidates jumping in to offer solutions. Alex Dimitrief, former GC at General Electric, explains that providing clear and open internal communication lines for employees to report potential integrity lapses without fear of reprisals is the best first step to prevent corporate malfeasance.

In my 30-plus years in law and business, I've never encountered such deep-seated and widespread distrust of big business.

To be sure, people were furious with Wall Street during the financial crisis for nearly killing the American Dream. But the rash of corporate scandals since then (e.g., VW's emissions fraud, Wells Fargo's fake customer accounts, Purdue's opioid campaign, Facebook's repeated missteps with user data, GM's ignition switch failures, the Theranos scam, the 737 Max) have left regulators, shareholders, and voters outraged that senior executives still don't "get it" and are punished lightly (if at all) for misconduct.

The anger has only grown as CEOs insist that their companies welcome higher standards of conduct and more rigorous scrutiny of their behavior.

The response to this outcry has been as predictable as it has been stout. We've seen well-meaning articles proffering laundry lists of proposed corporate governance improvements, from enhanced chief ethics officer positions to beefed-up codes of conduct. In April, the Justice Department issued 18 pages of detailed guidelines for evaluating the "adequacy and effectiveness" of compliance programs. Enforcement agencies are trying to hold executives personally responsible for malfeasance at companies, imposing astronomic fines, offering millions in bounties to whistleblowers, requiring admissions of misconduct as a condition of settlements, relentlessly expanding the concept of "fraud" in civil and criminal proceedings, piling on top of each other with redundant enforcement actions and launching "antitrust investigations" that have little to do with traditional concepts of competition law.

Presidential candidates are proposing to cap compensation, abolish share buybacks, require employee representation on boards, criminalize poor exercises of business judgment and break up large banks and technology companies.

Missing the Mark

These initiatives, however well-intentioned, miss the mark. In my experience, the behavior of a company depends on a single critical factor—whether its culture encourages employees to raise concerns. Unless companies get employees to speak up, they'll remain vulnerable to failures of integrity.

Given human nature, it's inevitable that some people will cross lines to advance their interests or those of their company. There's really no way to stop this, even with the best-designed performance incentives, codes of conduct, compliance training or regulations.

Rather than wring our hands, we need to bolster our defenses. That starts with intense efforts to promote "open reporting"—to get employees to call out potential problems to their managers, in-house lawyers, compliance officers, auditors, directors, ombudsmen or ombudswomen or internal "hot lines."

There are operational and financial as well as moral benefits to robust open reporting. Empirical research by Stubben and Welch confirms that publicly-traded U.S. companies whose employees raise more concerns through internal channels face fewer lawsuits and pay out smaller settlements.

Employees Are the Best Early Warning System

Employees have noses for trouble and readily outperform even the most sophisticated "early warning systems."

Open communication about potential integrity lapses enables managers to address issues before they become litigation or enforcement nightmares. A few employees speaking up can turn what could have been a disaster into a manageable situation. And fundamentally, encouraging employees to raise concerns is the most credible and effective way for leaders to communicate the importance of conducting a company's affairs with integrity.

The only way to get employees to speak up is to convince them that their careers won't suffer as a consequence. That's much harder than it looks, which is why any integrity program that does not consciously focus on employee input at the center is doomed to failure. No company can afford to pretend to be perfect. General Electric had it share of issues to address and we learned, in significant part through open reporting, that we always had room for improvement.

Reassuring employees that we supported open reporting was one of my top priorities as general counsel of GE. But we didn't just "set the tone at the top" with statements from senior executives and ombuds offices in all our divisions. We also made two strong commitments to our employees—to investigate and resolve their concerns credibly and to protect them from retaliation.

Our average for resolving concerns ranged from six to nine weeks across GE's divisions. When concerns were well-founded, we responded with corrective training plans, improved policies and communications and disciplinary actions. We also publicized outcomes through case studies so that our teams could see that raising concerns was worthwhile. Few things are as therapeutic for a company's culture as an effective system of organizational justice.

Transparency

To back up the case studies, we posted aggregate ombuds statistics on our website. The numbers included not just the concerns received each year by policy and region, but also the number of cases that resulted in discipline. It's no shame to reveal these numbers. Employees always have concerns, and low numbers usually mean only that employees are opting not to raise those concerns.

Even with this transparency, and despite repeated messaging from our senior executives, we discovered instances of managers retaliating against employees who had raised concerns. We terminated those managers. It wasn't pretty and sometimes struck people as disproportionate. But it had to be done; otherwise, our hard work to promote open reporting would have gone to waste.

In exceptional circumstances, we also issued awards to employees who had raised concerns to emphasize how much we valued our employees' input (and, in tougher cases, their courage to have raised their hands).

Even all of this wasn't enough. The general counsel's office, after all, is far away, while employees have to work with their managers every day. So we also encouraged "setting the tone in the middle." We wanted managers to make a point of reassuring their teams that people could speak frankly and safely and that, indeed, they were counting on everyone to raise their concerns. So we taught managers how they benefited when employees speak up about potential problems.

After all, most integrity failures don't start out clear-cut. They get that way only as teams scramble to fulfill challenging commitments, or harried colleagues exercise poor judgment and cut corners. The best way to avoid the squeeze is to air potential problems early. A manager might have misgivings about a decision but still be inclined to go along with it until a subordinate reinforces those misgivings. Early on, managers are likely to be fairly open to such challenges.

In the end, employees need to be convinced that their leaders genuinely care about open reporting and, therefore, integrity. Unless leaders are authentically engaged in promoting a culture of open reporting, where employees are confident that it is safe and valued for them to raise concerns, everything else a company does—from ombuds programs to board reporting mechanisms—will have little value.

I still cringe whenever I think about how a manager once began what was supposed to be an open and thoughtful discussion about an integrity issue with a pronouncement that "we don't have this problem here." No process can overcome a team's perception that a leader won't take their concerns seriously.

Shifting Enforcement Policy

Enforcement agencies and other policymakers have an important role here too. They should change policies, regulations and laws so as to disallow enforcement actions when companies self-identify and remediate integrity lapses before they cause any significant damage.

A shift like this to a rule more absolute than the uneven exercise of prosecutorial discretion would do far more than heightened standards or stiffer penalties to improve corporate behavior by giving leaders a powerful incentive to put significantly more effort into promoting robust open reporting at their companies.

I don't have anything against integrity performance indicators, character tests in CEO hiring, ethics training or other common remedies for corporate malfeasance. Nor do I oppose serious punishment for intentional misconduct. All these measures can be useful, and GE has used most of them. But they are no substitute for the main line of defense: employees willing to speak up about potential problems.

This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners.

Author Information

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