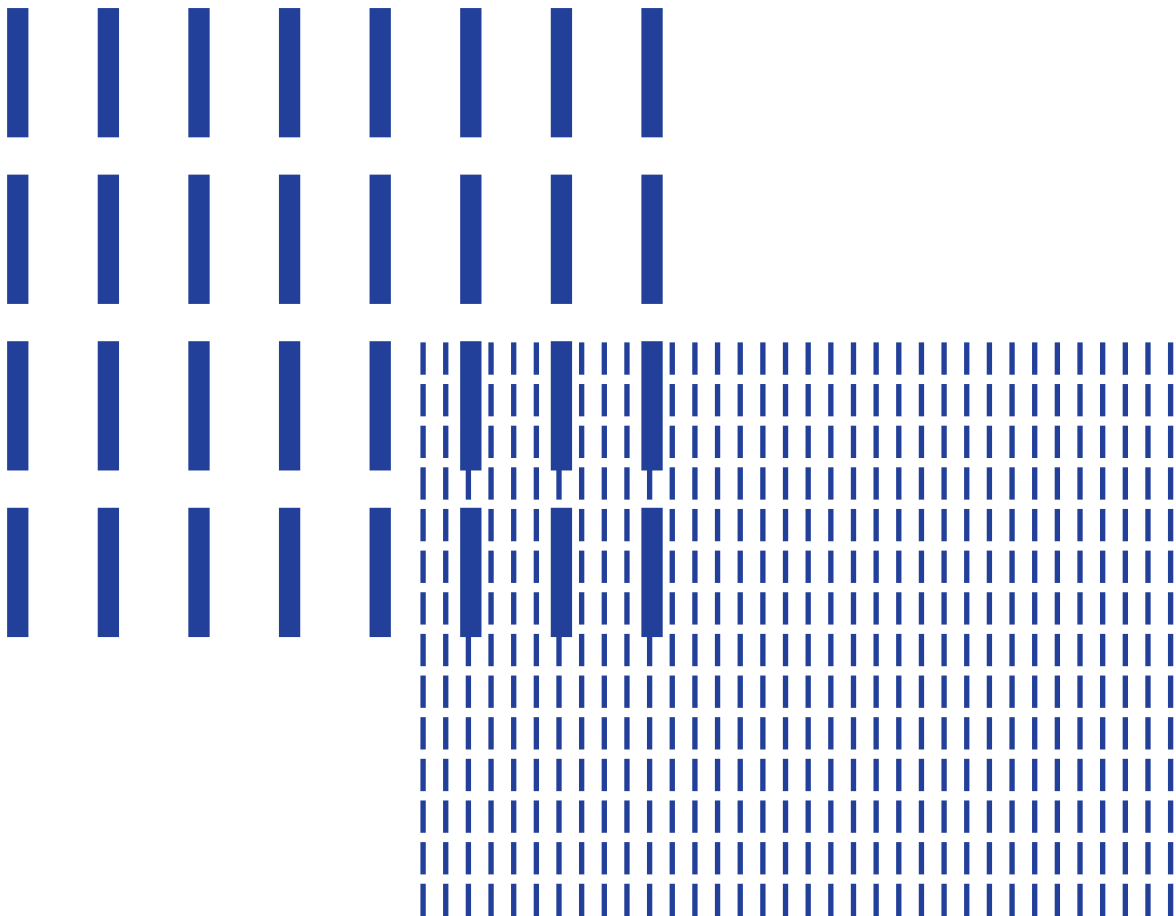




ITB-Arbeitsberichte | Band 10

Klaus-Ulrich Remmerbach | Robin Krumme

The effectiveness of compliance management systems



||||| This working paper addresses the effectiveness of compliance management systems (CMS). The objective is to answer the question whether CMS are effective, and to consider the limits of compliance. For this purpose, the highly legalistic topic is considered in the context of business ethics and behavioural economic foundations. The review of effectiveness is based on the seven basic components set out in the Assurance Standard of the Institut der Wirtschaftsprüfer in Deutschland e. V. [Institute of Public Auditors in Germany, Incorporated Association] (IDW AssS 980).

To answer this question, reference is made to the three levels of business ethics and to selected behavioural economics concepts. For example, performance pressure, peer pressure and variable compensation schemes encourage opportunistic behaviour. It is argued that corporate compliance depends significantly on the behaviour of single individuals and their environment. Especially in the context of economic activity and competition, compliance cannot be equated to morality and ethics, or be expected as a matter of course. On the whole, the interdisciplinary consideration of corporate compliance demonstrates a natural limit whenever ethical and moral standards are contrary to economic interests.

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Münster University of Applied Sciences
Institute of Business Administration & Engineering

The effectiveness of compliance management systems

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Münster University of Applied Sciences
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Management summary

This working paper addresses the effectiveness of compliance management systems (CMS). The objective is to answer the question whether CMS are effective, and to consider the limits of compliance. For this purpose, the highly legalistic topic is considered in the context of business ethics and behavioural economic foundations. The review of effectiveness is based on the seven basic components set out in the Assurance Standard of the *Institut der Wirtschaftsprüfer in Deutschland e. V.* [Institute of Public Auditors in Germany, Incorporated Association] (IDW AssS 980).

To answer this question, reference is made to the three levels of business ethics and to selected behavioural economics concepts. For example, performance pressure, peer pressure and variable compensation schemes encourage opportunistic behaviour. It is argued that corporate compliance depends significantly on the behaviour of single individuals and their environment. Especially in the context of economic activity and competition, compliance cannot be equated to morality and ethics, or be expected as a matter of course. On the whole, the interdisciplinary consideration of corporate compliance demonstrates a natural limit whenever ethical and moral standards are contrary to economic interests.

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List of abbreviations

AO	German Fiscal Code
AssS	Assurance Standard
AWG	Foreign Trade and Payments Act
BGH	Federal Court of Justice
BME	Association for Supply Chain Management, Procurement and Logistics
BMF	Federal Ministry of Finance
CCZ	Corporate Compliance Zeitschrift (journal)
CEO	Chief Executive Officer
Cf.	Compare
CFO	Chief Financial Officer
CMS	Compliance management system
CRM	Cause-related marketing
CRO	Chief Risk Officer
CSR	Corporate social responsibility
DCGK	The German Corporate Governance Code
EBIT	Earnings before interest and taxes
ECJ	European Court of Justice
EEC Treaty	Treaty establishing the European Economic Community
EMAS	Eco-Management and Audit Scheme
ETI	Ethical Trading Initiative
EU	European Union
EUR	Euro
FCPA	U.S. Foreign Corrupt Practices Act
HGB	German Commercial Code
ibid.	<i>ibidem</i> (at the same place)
IDW	Institut der Wirtschaftsprüfer in Deutschland e.V. (Institute of Public Auditors in Germany, Incorporated Association)

ILO	International Labour Organization
ISO	International Organization for Standardization
LG	Landgericht (Regional Court)
NRW	North Rhine-Westphalia
OECD	Organisation for Economic Cooperation and Development
OLG	Oberlandesgericht (Higher Regional Court)
OWiG	Act on Regulatory Offences
para	paragraph
PwC	PricewaterhouseCoopers
QM	Quality management
REACH	Registration, Evaluation, Authorisation and Restriction of Chemicals
SE	Societas Europaea
SEDEX	Supplier Ethical Data Exchange
SMETA	SEDEX Members Ethical Trade Audit
TFEU	Treaty on the Functioning of the European Union
TfS	Together for Sustainability
UKBA	United Kingdom Bribery Act

1 Introduction

“There is no act for which nobody is responsible.”

(Otto von Bismarck).

In light of the above, companies are increasingly endeavouring to establish a holistic compliance approach that is intended to secure *impunity* not only for the company itself, but also for the company’s management. As a result, three-quarters of all German companies with more than 500 employees now have a compliance management system (CMS) in place.¹ Helmut Krenek, Presiding Judge of the Fifth Chamber for Commercial Matters at the Landgericht München I (Regional Court Munich I) and author of the **Neubürger decision** (Chapter 3.3.3, see below; p. 14), criticises the fact that **compliance** is a nice term, but that compliance with the law is by no means a novelty. In fact, it is nothing more and nothing less than a long-established matter of course in all constitutional states.² In contrast, Gregor Gysi, for example, states that it cannot, unfortunately, be assumed that companies will naturally comply with legal regulations and other rules because adherence to rules is either encouraged or hampered by economic incentive structures. He states that legal and economic interests are not identical. As a result, companies reportedly have a general interest in fair competition, but if an opportunity arises to benefit unfairly from an advantage, then they will try to seize it.³ The relevance of non-compliance in particular generally entered public awareness long before the multibillion VW diesel affair in 2015.⁴ The spectrum of violations is varied, ranging from minor violations to global scandals. One only has to think of the continuous data breaches by social networking sites, controversial arms supplies to Saudi Arabia or, for example, ex-DFB President Reinhard Grindel, who ultimately had to vacate office because of an ill-gotten luxury watch. Last but not least, the current United States President Donald Trump has *“included the violation of standards in the government programme.”*⁵ And yet compliance with the law and the observation of ethics and morality is in the fundamental interest of society.

However, the significance attached to compliance by companies is quite contentious, particularly when lucrative business is impeded. How else can it be explained that

¹ Cf. Bussmann, Nestler, Salvenmoser 2018, p. 24.

² Cf. Jäkel 2015, unpagged.

³ Cf. Gysi 2013, <https://www.youtube.com/watch?v=156UMs-BXd4>, accessed on: 3 February 2019.

⁴ Cf. Remmerbach, David 2016, p. 497ff. and Remmerbach, Baltin, Siring 2019, p. 180ff. Refer to the 2019 book for more information.

⁵ Student 2019, p. 92.

companies with an extensive CMS whose effectiveness is publicly proclaimed are regularly involved in illegal or immoral activities. In the process, around half of all financial crime is committed by the company's own employees (referred to as "insider threats"), and even a quarter of those are perpetrated by the senior management.⁶ Why is that? Is corporate compliance not truly wanted, or does it inevitably encounter limitations? And what effect can CMS claim to have in the process?

2 Principles, terms and definitions

What is this working paper about?

The term **compliance** originally comes from Anglo-Saxon legal terminology, and first found its way into German business law in the financial and insurance sector.⁷ In business jargon, compliance is described in general terms as the "*observance, adherence, conformity, observance of certain imperatives.*"⁸ Since there is no single definition of the term, the literature often distinguishes between a narrow and a broad interpretation of compliance. While the narrow definition is restricted solely to legal conformity, also referred to as **legal compliance**, the broad definition of compliance also takes into account the expectations of stakeholders or social standards that are sometimes over and above the legal requirements, and assumes responsibility with regard to human rights, for instance; in this case, reference is made to **moral compliance**.⁹ The Commission, Deutscher Corporate Governance Kodex (German Corporate Governance Code) (DCGK), defines compliance as follows:

*"The Management Board ensures that all provisions of law and the company's internal policies are complied with, and endeavours to achieve their compliance by the group entities (Compliance)."*¹⁰

⁶ Cf. Bussmann et al. 2018, p. 5.

⁷ Cf. Hauschka, Moosmayer, Lösler 2016, p. 6.

⁸ Ibid.

⁹ Cf. Wieland, Steinmeyer, Grüniger, 2014, p. 18.

¹⁰ DCGK 2017, p. 6, https://www.dcgk.de/files/dcgk/usercontent/de/download/kodex/170424_Kodex.pdf, accessed on: 25 February 2019.

This narrow definition of legal compliance is now widely accepted in general business practice.¹¹ In its Assurance Standard IDW AssS 980 (German version: IDW PS 980), the Institut der Wirtschaftsprüfer Deutschland e. V. (IDW) defines compliance as

*“adherence to rules, provisions of law and the company’s internal policies.”*¹²

However, they also include conventions developed by third parties that the company has voluntarily committed to comply with.¹³

A *CMS* is moreover understood to be the entire body of principles and measures, introduced by the legal representatives of a company (bodies), that, based on the objectives set, are aimed at achieving compliance by all legal representatives and employees.¹⁴ The Management Board should, weighing all relevant and applicable risks, ensure that appropriate measures are taken, and should disclose these measures.¹⁵ Legal areas such as competition law, antitrust law and anti-corruption law are typical subjects of a *CMS*.¹⁶ On top of this, there are industry-specific standards such as the REACH Regulation in the food industry. Other legal areas such as foreign trade law and export control, cybercrime, data protection and tax compliance are now also becoming increasingly important.¹⁷

The term **corporate governance (CG)** describes in general terms the principles of the responsible management and supervision of companies (governance).¹⁸ It differs from *compliance* primarily on account of the perspective taken. While *corporate governance* focuses on the view of the regulator, *compliance* takes the perspective of the regulated entity, i.e. the company concerned.¹⁹ **Corporate social responsibility (CSR)** must also be differentiated from *compliance*. CSR describes companies’ contribution towards sustainable development. Consideration is given not only to economic aspects, but also to environmental and social aspects (sustainability).²⁰

What is going on as regards CG and CSR in Germany? A look at the Case Database of the Bundeskartellamt (German cartel office) offers an appropriate indicator of the current situation. In the opinion of Andreas Mundt, President of the Bundeskartellamt,

¹¹ Cf. Hauschka et al. 2016, p. 6.

¹² Cf. IDW AssS 980 2011, p. 3.

¹³ Cf. *ibid.*, p. 17.

¹⁴ Cf. *ibid.*, p. 3.

¹⁵ Cf. DCGK 2017, p. 6, https://www.dcgk.de/files/dcgk/usercontent/de/download/kodex/170424_Kodex.pdf, accessed on: 25 February 2019.

¹⁶ Cf. IDW AssS 980 2011, p. 16f.

¹⁷ Cf. Ernst & Young GmbH 2016, p. 7, [https://www.ey.com/Publication/vwLUAssets/ey-existing-practice-in-compliance-2016-survey/\\$FILE/ey-existing-practice-in-compliance-2016-survey.pdf](https://www.ey.com/Publication/vwLUAssets/ey-existing-practice-in-compliance-2016-survey/$FILE/ey-existing-practice-in-compliance-2016-survey.pdf), accessed on: 18 March 2019.

¹⁸ Cf. Grützner, Jakob 2015, p. 65.

¹⁹ Cf. Hauschka et al. 2016, p. 6.

²⁰ Cf. Hauschka et al. 2016, p. 8.

every sector is essentially susceptible to antitrust violations.²¹ In fact, 75 cases are listed in each of the two categories “ban on cartels” and “abuse control” alone.²² There are also a large number of further cases listed by the European Commission. In the past two years alone, the European Commission has imposed three record fines of €2.42 billion, €4.34 billion and €1.49 billion on Google for abusing its market dominance.²³ However, the question remains whether such high penalties have a sufficient deterrent effect on companies. Since compliance is not merely limited to competition law, however – one need only think of the VW emissions scandal or the Siemens corruption scandal – the list could be extended indefinitely.

3 The need for an effective CMS

3.1 General information

Although the question of the obligation to manage a **compliance organisation** is the focus of intense debate in the literature, no general consensus has been reached as yet.²⁴ There is no specific legal obligation for all companies to introduce a *compliance organisation*.²⁵ Nevertheless, it is the prime duty of the management to organise and supervise the company for which it is responsible in such a way that the company is in compliance with current law (*duty of legality*). This is the minimum requirement of the managerial task of *compliance*.²⁶ Consequently, the *duty of legality* effectively requires a compliance organisation, at least for companies exceeding a certain size. However, there is no definition of what this should actually look like.²⁷

²¹ Mund 2013, p. 3, https://www.bundeskartellamt.de/SharedDocs/Interviews/DE/Pforzheimer_Jede_Branche_anf%C3%A4hlig_neu.html, accessed on: 10 March 2019.

²² Cf. Bundeskartellamt 2019, https://www.bundeskartellamt.de/SiteGlobals/Forms/Suche/Entscheidungssuche_Formular.html?nn=3589936, accessed on: 26 March 2019.

²³ Cf. European Commission 2019, http://europa.eu/rapid/press-release_IP-19-1770_de.htm, accessed on: 9 March 2019.

²⁴ Cf. Bachmann 2008, p. 65ff.

²⁵ Cf. Größwein, Hohmann 2011, p. 963.

²⁶ Cf. Moosmayer 2015a, p. 1.

²⁷ Cf. Pelz 2016, p. 111.

The **Act on Regulatory Offences (OWiG)** is of considerable importance. This law constitutes the legal basis for the imposition and enforcement of public sector fines.²⁸ A company management's obligations of due diligence generally include the obligation to undertake the supervision of the company. Supervisory duties arise whenever the functions of the company management are delegated not only to members of the management, but also to employees and external third parties. In the case of functions that cannot be delegated, the management always has an overall responsibility, even if employees assist in performing those functions.²⁹ It follows from Section 130 OWiG that the intentional or negligent omission to perform supervisory duties is a regulatory offence where violations occur that could have been prevented, or made much more difficult, if there had been proper supervision. These supervisory measures include, for example, the appointment, careful selection and surveillance of supervisory personnel.³⁰ Nonetheless, Hauschka points out that only a general obligation to introduce certain organisational measures to avoid infringements of law can be derived from Section 130 OWiG, but not the specific requirement to introduce a compliance organisation.³¹ On the contrary, this necessity is based on the **compliance risks** prevailing in the company, which depend on many individual factors such as the size, the sector and previous infringements.³²

3.2 The German Corporate Governance Code

The **German Corporate Governance Code (DCGK)** is a body of rules and standards for the appropriate management and supervision of German listed companies, issued by the Commission of the same name (in German, Deutscher Corporate Governance Kodex) of the Federal Ministry of Justice.³³ However, the *DCGK* does not have any universal legal force either.³⁴ The Code is legitimised by the Section 161 of the Stock Corporation Act (AktG). According to this provision, listed companies are required to comply with the Code, and must publish confirmation of compliance with the Code annually. The Code contains mandatory requirements, recommendations and non-binding proposals. Although non-compliance with recommendations is generally permitted, an

²⁸ Cf. Grützner, Jakob 2015, p. 185.

²⁹ Cf. Pelz 2016, p. 97f.

³⁰ Cf. *ibid.*, p. 98 and Section 130(1) OWiG.

³¹ Cf. Hauschka et al. 2016, p. 14.

³² Cf. Bachmann 2008, p. 65ff.

³³ Cf. Grützner, Jakob 2015, p. 74.

³⁴ Cf. Laue 2016, p. 1.

explanation must be given and likewise published (**comply or explain**).³⁵ Section 5.1.3 (see below; p. 17) of the Code recommends that the Management Board

*“shall ... institute appropriate measures reflecting the company’s risk situation (Compliance Management System) and disclose the main features of those measures (Compliance Management System).”*³⁶

Compliance with this recommendation is effectively non-binding. Alternatively, however, an annual explanation must be given and communicated as to why no CMS was introduced. This could not be plausibly explained before employees, let alone before a court.³⁷ The Code does not apply directly to non-listed companies, but is used for guidance.³⁸

3.3 Relevant case law

3.3.1 Antitrust law information sheet

Besides the aforementioned legal requirements, significant case law rulings also exist. First, reference is made to the judgment of the Oberlandesgericht (OLG) Düsseldorf (Düsseldorf Higher Regional Court) of 27 March 2006, VI-Kart 3/05 concerning the paper cartel. In the reasons for the judgement, the person concerned was accused of having distributed the *information sheet on Guidelines for correct conduct under anti-trust law* to his employees just once in his role as Managing Director, without making sure later that they were actually being complied with. This was a breach of his supervisory duties in which he acquiesced.³⁹

3.3.2 Mitigating effect of a CMS

In another judgment of the Regional Court Munich I of 3 December 2015, a defence company was ordered to pay a fine of €175,000 as a secondary party for tax evasion during the bribery of the Greek defence minister.

³⁵ Cf. DCGK 2017, p. 6, https://www.dcgk.de/files/dcgk/usercontent/de/download/kodex/170424_Kodex.pdf, accessed on: 25 February 2019.

³⁶ Ibid., p. 6.

³⁷ Cf. Bings 2017, p. 118.

³⁸ Cf. DCGK 2017, p. 6, https://www.dcgk.de/files/dcgk/usercontent/de/download/kodex/170424_Kodex.pdf, accessed on: 25 February 2019.

³⁹ Cf. OLG Düsseldorf Judgement of 27 March 2006 – VI Kart 3/05, BeckRS 2006, 134816.

Following a notice of appeal by the prosecution, the Federal Court of Justice (BGH) set aside the judgment of the first instance court, the Regional Court Munich I, on 9 May 2017.⁴⁰ In the reasons for the judgement, the BGH stated, for the first time, that it was of significance for the renewed determination of the amount of the fine on the company whether it had installed an effective CMS. According to the judgement, however, it is essential that the CMS is designed to ensure that violations of law are avoided.⁴¹ The BGH even went one step further, and confirmed that even compliance measures implemented after the initiation of investigations by government authorities may act as a mitigating measure in calculating the level of the fine.⁴² The other side of this argument is that, in the event of a further comparable breach of compliance, the company must even expect the penalty to be increased.⁴³

3.3.3 The Siemens/Neubürger judgment

The ***Siemens/Neubürger judgment*** of the Regional Court Munich I of 10 December 2013 is probably the most important court decision on *compliance*.⁴⁴ The corruption case demonstrates the overall importance and dramatic effect of contemporary *compliance*. It is a tale of the personal liability of managers, their subjective perception of fair-mindedness and integrity, high-profile investigations by the public prosecutor's office and, ultimately, the tragic death of a family man. Attention is expressly drawn to the article entitled *Tod eines Managers* (Death of a manager), which appeared in DIE ZEIT 23/2015 on 3 June 2015.⁴⁵

Since the beginning of the 1980s, Siemens had operated a system of ***slush funds***, used to pay cash bribes abroad. From 2001 onwards, a special system was developed in which money was transferred to shell companies based on fictitious invoices for fake consultancy agreements.⁴⁶ A major raid by Munich Public Prosecutor's Office in 2016 brought to light around 4,300 bribes amounting to some €1.3 billion. In January 2010, the Group asserted damage claims against the former members of the Corporate Executive Committee. Most of them reached an out-of-court agreement with the Group,

⁴⁰ Cf. BGH judgment of 9 May 2017 – 1 StR 265/16, BeckRS 2017, 114578.

⁴¹ Cf. BGH judgment of 9 May 2017 – 1 StR 265/16, BeckRS 2017, 114578, para. 118.

⁴² Cf. Jenne, Martens 2017, p. 285f.

⁴³ Cf. ndcompliance-Redaktion 2017, <https://beck-online.beck.de/?vpath=bibdata/zeits/NDCOMPLIANCE/2017/-cont/NDCOMPLIANCE.2017.21012.htm>, accessed on: 14 March 2019.

⁴⁴ Cf. Regional Court Munich I judgment of 10 December 2013 – 5 HK O 1387/10, BeckRS 2014, 1998.

⁴⁵ Cf. Bund 2015, <https://www.zeit.de/2015/23/siemens-heinz-joachim-neubuerger-selbstmord>, accessed on: 3 March 2019.

⁴⁶ Cf. Regional Court Munich I judgment of 10 December 2013 – 5 HK O 1387/10, BeckRS 2014, 1998.

but this was not the case with the former Chief Financial Officer. He decided to let the court judge.⁴⁷

The defendant, Heinz-Joachim Neubürger, was head of finances of Siemens AG from 1998 to 2006. According to the Rules of Procedure, one of his tasks was to ensure appropriate risk management and risk control. The Regional Court Munich I ordered the former Chief Financial Officer, as a body with joint and several liability, to pay €15 million in damages. This was the first time that a court referred to the need for an effective CMS.⁴⁸ The first official head note of the judgment reads as follows:

“In the case of existing hazards, a member of the Executive Board is only in compliance with his organisational duties if he establishes a compliance organisation that is designed to prevent damage and control risk. The type, size and organisation of the company, the rules to be respected, geographical presence and suspected cases from the past are crucial in determining the exact scope.”⁴⁹

Neubürger is said to have been told at least once about a €4 million bribe paid to a supposed business consultant in Nigeria, but he delegated the case to the divisional head of finance, and did not pursue it further. However, Neubürger was the first member of the Corporate Executive Committee to assure before high-ranking Siemens managers that corruption would not be tolerated and runs counter to the Siemens principles of integrity.⁵⁰ Finally, it should be noted that the Group already had a Code of Conduct in place at the time of the corruption scandal. This Code of Conduct was part of the Executive Board employment contract, and contained aspects such as requirements concerning compliance, leadership responsibility, and supervision and control duties.⁵¹

⁴⁷ Cf. Bund 2015, <https://www.zeit.de/2015/23/siemens-heinz-joachim-neubuerger-selbstmord>, accessed on: 3 March 2019.

⁴⁸ Cf. Regional Court Munich I judgment of 10 December 2013 – 5 HK O 1387/10, BeckRS 2014, 1998.

⁴⁹ Regional Court Munich I judgment of 10 December 2013 – 5 HK O 1387/10, BeckRS 2014, 1998, first head note.

⁵⁰ Cf. Bund 2015, <https://www.zeit.de/2015/23/siemens-heinz-joachim-neubuerger-selbstmord>, accessed on: 3 March 2019.

⁵¹ Cf. Regional Court Munich I judgment of 10 December 2013 – 5 HK O 1387/10, BeckRS 2014, 1998.

4 Universal compliance standards

A number of different national and international compliance standards are discussed in the literature. Examples include the *US Resource Guide to the FCPA*, the *Annex to the UK Bribery Act*, the German Assurance Standard of the Institut der Wirtschaftsprüfer IDW AssS 980, ISO 19600:2014⁵² and the OECD Principles of Corporate Governance.⁵³ In the following, emphasis is particularly placed on the two standards prevailing in Germany: ISO 19600 and IDW AssS 9800. These two standards do not contradict each other. For example, the ISO standard can initially be used to establish and document the CMS, whereas IDW AssS 980 is primarily used to assess the effectiveness of CMS.⁵⁴ However, one advantage of ISO 19600 is that it has a similar structure to the globally established *ISO 9001* standard for quality management systems.⁵⁵

At this point, a brief look at *DIN ISO 26000:2010 Guidance on social responsibility* seems to be in order, since this standard goes beyond mere legal compliance towards an understanding of moral compliance. The objective of DIN ISO 26000:2010, which cannot be used for certification, is to contribute to sustainable development, whilst stressing the voluntary nature of the standard.⁵⁶ For example, the standard defines principles of social responsibility on the core subjects of *human rights, labour practices, the environment, and fair operating and business practices*, and makes recommendations for action concerning them.⁵⁷ Although it is generally recommended to comply with this standard, it is not used as a basis for assessing CMS.

IDW AssS 980 was originally envisaged as an assurance standard for auditors. However, it can also be used by companies to implement and review their own CMS. In the context of voluntary CMS assurance, only certain parts such as anti-corruption law, competition law or antitrust law are ever reviewed.⁵⁸ Business processes such as procurement or sales processes can also be the subject of CMS assurance.⁵⁹ IDW stipulates different assurance scenarios for them. *Concept assurance* primarily involves assessing the completeness of CMS elements that have been implemented, whereas the appropriateness test goes a step further, checking whether they have also been

⁵² Cf. Hauschka et al. 2016, p. 17.

⁵³ Cf. IDW AssS 980 2011, p. 30.

⁵⁴ Cf. IDW 2014, p. 1, <https://www.idw.de/blob/26656/bb0731a7886fd261ad83385de67b54ac/down-ak-pruefungsfragen-betriebswirtschaftliche-fragen-grc-data.pdf>, accessed on: 21 March 2019.

⁵⁵ Cf. Merz 2016, p. 989.

⁵⁶ Cf. Spießhofer 2016, p. 324f.

⁵⁷ Cf. DIN ISO 26000 2011, p. 10ff.

⁵⁸ Cf. IDW 2017, p. 93ff.

⁵⁹ Cf. IDW AssS 980 2011, p. 16f.

integrated fully into business processes. Finally, effectiveness assurance examines whether the measures implemented were indeed effective within a given review period, such as within a financial year.⁶⁰ The *Global Economic Crime and Fraud Survey 2018*, conducted by PwC in cooperation with the Martin Luther University Halle-Wittenberg, reveals that *IDW AssS 980* is the most commonly used standard for CMS assurance in Germany.⁶¹

5 The seven basic components of a CMS according to IDW AssS 980

5.1 Compliance culture

The central element of a CMS is the promotion of a positive and good compliance culture, which is essential to the effectiveness of the measures and rules in place. Employees will only feel responsible and will reliably obey the rules if the management also shares and positively transmits these values.⁶² For this to happen, the management must be clearly committed to compliance and to what it means for the company. In compliance, such commitment is referred to as the *tone at the top* and, as such, is the basic requirement for a good compliance culture.⁶³

The *code of conduct* should not be perceived as a sign of mistrust, but as a compass pointing the way in day-to-day business. All managers must be taken to task – by setting an example, they have a decisive impact on the effectiveness of the *compliance culture*. Other factors that may have a positive or negative impact on the compliance culture, including leadership style, the compliance organisation, target agreements and incentive schemes, will be addressed in the sections below.

⁶⁰ Cf. Moosmayer 2015a, p. 83.

⁶¹ Cf. Bussmann et al. 2018, p. 46.

⁶² Cf. IDW 2017, p. 103.

⁶³ Cf. Schmidt 2016, p. 1425.

5.2 Compliance targets

Compliance targets are defined by legal representatives⁶⁴ and form the basis for the compliance risks to be assessed.⁶⁵ IDW AssS 980 requires that compliance targets are aligned to the general corporate objectives and are clearly distinct from business processes and legal areas that fall within the scope of the CMS.⁶⁶ When defining targets, care must be taken to ensure consistency, comprehensibility, practicability, the measurability of target achievement and alignment with available resources.⁶⁷ The defined targets are the basis for deriving the measures designed to effectively help achieve the goals.⁶⁸

It goes without saying that the measurability of the degree of compliance with all applicable laws, directives and regulations, especially competition law and anti-corruption law, is directly dependent on the effectiveness of the supervision and control measures in place.

5.3 Compliance risks

Risk analysis is extremely important in the context of *compliance*. Concerning this, those risks that would lead to **breaches of compliance**, and hence the failure to meet the predefined **compliance targets**, must be identified.⁶⁹ As a result, risk analysis must effectively include all legal areas and thematic areas that fall within the scope of the CMS. The identified risks must be assessed with respect to the probability of their occurrence and the potential consequences involved (extent of damage).⁷⁰ According to IDW AssS 980, the identification and assessment of **compliance risks** constitutes the basis for an effective compliance programme.⁷¹

A control process is expected to manage compliance risks.⁷² Risk analysis should therefore be repeated at least once a year. In this connection, more attention should be paid to the causes and effects of compliance risks. At the same time, compliance risks can also be managed in the context of general corporate risk management, i.e. it is not

⁶⁴ Cf. Brandt, Feege 2016, p. 206.

⁶⁵ Cf. IDW AssS 980 2011, p. 6.

⁶⁶ Cf. IDW 2017, p. 103.

⁶⁷ Cf. IDW AssS 980 2011, p. 21.

⁶⁸ Cf. Cammann, Hartke 2016, p. 29.

⁶⁹ Cf. IDW 2017, p. 104.

⁷⁰ Cf. Gnädiger 2016, p. 46.

⁷¹ Cf. IDW AssS 980 2011, p. 21.

⁷² Cf. *ibid.*

necessary to have a separate compliance risk management system. This conclusion is also drawn by Hauschka, who sees no real difference between general business risks and specific compliance risks.⁷³

5.4 Compliance programme

The **compliance programme** constitutes the entire measures and rules resulting from the compliance risks identified and that aim at ensuring the compliant behaviour of employees in order to achieve the compliance targets and avoid breaches of compliance.⁷⁴ It includes, for example, the separation of functions, authorisation concepts, signature policies and authorisation procedures,⁷⁵ as well as guidelines on gifts, travel expenses and donations.⁷⁶ Great importance is attached to avoiding breaches of the rules by specifying conduct regulations and providing information. This also includes the early identification and management of compliance risks, such as through an anonymous whistleblowing system and independent cross-checks.⁷⁷ In addition, an internal process must be installed that, in the case of uncovered breaches of compliance, ensures internal communication to all relevant bodies, a comprehensive root cause analysis, and the ability to take effective measures to correct the CMS.⁷⁸

The provision of guidelines and codes of conduct inevitably leads to a need for training.⁷⁹

During compliance training, participants may be asked questions as to the substance of relevant compliance incidents and practical examples, for instance.

⁷³ Cf. Hauschka et al. 2016, p. 7.

⁷⁴ Cf. *ibid.*

⁷⁵ Cf. IDW 2017, p. 104.

⁷⁶ Cf. Brandt, Feege 2016, p. 211.

⁷⁷ Cf. IDW AssS 980 2011, p. 22.

⁷⁸ Cf. *ibid.*

⁷⁹ Cf. Herb 2016, p. 543.

5.5 Compliance organisation

Companies must install a robust **compliance organisation** with clearly assigned roles and responsibilities as a basis for an effective CMS. However, this does not necessarily mean that a separate *Compliance department* must be established specially. The operative coordination may also be assigned to other corporate functions, such as a compliance officer.⁸⁰ This entails the clear definition of tasks, hierarchical positions, organisational integration and reporting channels.⁸¹ Hauschka notes that such positions should only be filled with individuals

“whose specialist qualifications, integrity and reliability are beyond doubt. The management takes great care in its choice of compliance officer or holder of the compliance function”⁸²

In addition, both IDW AssS 980 and the relevant literature recommend maintaining a *compliance committee* as part of an effective compliance organisation. Such a committee would include not only the Compliance department, but also departments such as Internal Auditing, Legal, Finance and Human Resources.⁸³

5.6 Compliance communication and anonymous whistleblowing systems

According to IDW AssS 980, **compliance communication** must ensure that employees always have a knowledge and understanding of the rules of conduct and measures of the compliance programme that are relevant to them.⁸⁴ This is essential as employees can only perform the tasks incumbent upon them properly and act in a *compliant* manner if they are informed on relevant roles, responsibilities and rules of conduct.⁸⁵ Effective compliance communication also requires the determination of reporting obligations and reporting channels for actual and suspected breaches of compliance. It is only possible to undertake root cause analysis, draw consequences and initiate improvements to the CMS if breaches of compliance are communicated to the relevant bodies.⁸⁶

⁸⁰ Cf. IDW 2017, p. 104.

⁸¹ Cf. IDW AssS 980 2011, p. 22.

⁸² Hauschka et al. 2016, p. 1938.

⁸³ Cf. Moosmayer 2015a, p. 33 and Größwein, Hohmann 2011, p. 963.

⁸⁴ Cf. IDW AssS 980 2011, p. 23.

⁸⁵ Cf. *ibid.*, p. 6.

⁸⁶ Cf. *ibid.*, p. 23.

An effective CMS is also dependent on communication in the opposite direction, i.e. from employees to the company. Concerning this, clear reporting obligations and reporting channels must be defined and communicated.⁸⁷

PwC's Global Economic Crime and Fraud Survey 2018 shows that the key factor inducing people to commit fraud is opportunity (59%), followed by incentive schemes and performance pressure (21%) and rationalisation (11%).⁸⁸ Consequently, inadequate supervision fosters opportunistic behaviour. In the anonymity of the company, it can therefore never be completely ruled out that potential free riders will display behaviour that runs counter to the company, for whatever reason.

Anonymous whistleblowing systems are used to clarify and address criminal offences and breaches internally, with the help of the knowledge of employees and external stakeholders.⁸⁹ There is no generally applicable legal obligation to maintain such a system in Germany at present. In March 2019, however, the European Parliament agreed with EU Member State representatives on common, binding standards to protect **whistleblowers** for the first time. The draft was formally approved by the European Council and the European Parliament in April 2019. All Member States now have two years to transpose the directive into national law. Under this directive, all companies with more than 50 employees or with an annual turnover of over €10 million will have to set up such a body.⁹⁰

For this purpose, a variety of options are generally available to companies. These include the appointment of an **ombudsperson**, a classic letterbox, a telephone hotline, an email system or a web-based system.⁹¹ According to the study on economic crime in Germany in 2018, conducted by KPMG, most of the companies surveyed with a turnover of between €250 million and €3 billion have letterboxes (51%), intern ombudspersons (53%), dedicated email addresses (56%), telephone hotlines (53%), an external ombudsperson (27%) or a web-based system (16%).⁹² Internal bodies, however, are quite often associated with the risk of the loss of anonymity and objectivity.

Although the ombudsperson function, described more aptly as the external counsel of trust, is part of the compliance organisation, it does not belong to the company, and is therefore not subject to instructions or control. The main task of the ombudsperson is to receive indications of non-compliance in confidence and, under certain legal conditions,

⁸⁷ Cf. IDW AssS 980 2011, p. 23.

⁸⁸ Cf. PwC 2019, p. 24, <https://www.pwc.com/gx/en/forensics/global-economic-crime-and-fraud-survey-2018.pdf>, accessed on: 20 May 2019.

⁸⁹ Cf. Beyer, Lakner, Stauder 2016, p. 79.

⁹⁰ Cf. European Commission 2018, http://europa.eu/rapid/press-release_IP-18-3441_en.htm, accessed on: 22 April 2019.

⁹¹ Cf. Tur 2014, p. 707ff.

⁹² Cf. Geschonneck, Scheben, Gnädiger 2019, p. 39.

to disclose such information to a designated internal body, which will usually be the Compliance Officer. In the process, the ombudsperson does not generally benefit from a filter function – it is the responsibility of the internal compliance bodies to finally assess the matter.⁹³ Consequently, the nature and purpose of the ombudsperson is primarily to protect the identity of the whistleblower and to provide initial legal advice. Information may be disclosed in confidence, without mentioning names. However, since some matters can only be clarified with the disclosure of the whistleblower's name, the ombudsperson – being a legal expert – should encourage potential whistleblowers to also disclose this information. Since legal expertise is required, only lawyers should be considered for the role of ombudsperson.⁹⁴ However, a client-lawyer relationship is not established – the ombudsperson remains the lawyer of the company in the form of an agency agreement.⁹⁵ The disadvantage of the ombudsperson is that two individuals come into direct contact with each other. For one thing, whistleblowers may fear that the ombudsperson, given their position of authority, will consider the suspected compliance issue to be unreliable. Another aspect that might put off whistleblowers is fear of a lack of anonymity. Obstacles will therefore inevitably be encountered in the case of personal contact. Other criticisms with regard to an ombudsperson relate to their temporal and spatial availability, and any language barriers that may exist.⁹⁶ On the other hand, personal contact gives the ombudsperson the opportunity to provide in-depth advice and support.

The supposed weak points of the ombudsperson, outlined above, are the very advantages of web-based solutions. But at the same time, web-based solutions do not offer the possibility of establishing direct personal contact, restricting the ability to provide individual advice. In addition, web-based solutions are far best at ensuring the anonymity of whistleblowers.⁹⁷ In contrast to the ombudsperson, the first subjective barrier to blowing the whistle is likely to be lower in the absence of personal contact, promoting the general willingness to provide information. This is particularly the case for suspected compliance issues where the whistleblower feels uncertain and does not want to accuse anyone wrongly. But it is in cases such as these that objective advice appears to be particularly important.

The ***whistleblowing report*** 2019 states that around 40% of companies were affected by a compliance issue case in the previous year.⁹⁸ Companies should counter this risk by installing effective whistleblowing arrangements, knowing full well that an any-

⁹³ Cf. Buchert 2016, p. 1308.

⁹⁴ Cf. *ibid.*, p. 1309.

⁹⁵ Cf. *ibid.*, p. 1310.

⁹⁶ Cf. Tur 2014, p. 710.

⁹⁷ Cf. Hauser, Hergovits, Blumer 2019, p. 59.

⁹⁸ Cf. Hauser et al., p. 11.

mous whistleblowing system can never provide full protection. According to German companies, the three main reasons for introducing an anonymous whistleblowing system are, first, the desire to strengthen the company's image as an ethical and moral company, followed by the belief in the effectiveness of the system and, in third place, to avoid financial losses.⁹⁹ Once again, it becomes apparent that this tool is also primarily based on extrinsic motivation. Based loosely on the old saying "I love treason but hate a traitor" (Augustus 63 BC to 14 AD), whistleblowers continue to be wrongly punished for their involvement. Reference is made at this point to the extraordinary example of Martin Porwoll, who, in 2017, uncovered a pharmacy scandal in which cancer drugs had intentionally been underdosed for years. In addition to bringing him recognition, however, Porwoll's tip-off to the public prosecutor also led to his instant dismissal and long-term unemployment.¹⁰⁰ This is where the new EU Directive necessarily takes effect, providing extensive protection to whistleblowers.

The introduction of an anonymous whistleblowing system must represent a conscious business decision. After all, it can be assumed that complaints and tip-offs about genuine breaches will be made, requiring investigation, and possibly even robust action. This may also become personally unpleasant in some circumstances, such as when long-time colleagues are concerned. Unfortunately, compliance incidents that are uncovered internally continue to be perceived as a failure of the CMS, and yet the opposite is the case.¹⁰¹

5.7 Supervision and improvement of compliance

Last but not least, companies must set up effective procedures for the systematic supervision and improvement of the CMS.¹⁰² Supervision is undertaken by process-independent bodies such as Internal Auditing. The ultimate aim of compliance supervision is to be able to draw conclusions about the effectiveness of the CMS. To this end, adequacy of resources, and clear responsibilities and reporting channels are crucial.¹⁰³ The results of compliance supervision need to be evaluated. Where deficiencies are identified, effective remedial measures to improve the system must be introduced. Examples include better communication of the compliance programme or additional training and control measures.¹⁰⁴ In the case of serious breaches of compliance, action un-

⁹⁹ Cf. *ibid.*, 2019, p. 20.

¹⁰⁰ Cf. Optiz, Kuhrt, Lauerer 2017, unpaginated.

¹⁰¹ Cf. Moosmayer 2015c, p. 50f.

¹⁰² Cf. *ibid.*, p. 8.

¹⁰³ Cf. *ibid.*, p. 23.

¹⁰⁴ Cf. IDW 2017, p. 104.

der employment law, up to and including dismissal, must be considered.¹⁰⁵ Other control measures proposed by Moosmayer include self-assessment of the CMS by the management, anonymous employee surveys, and entries in whistleblowing systems on the simulation of breaches of compliance. It is also essential to carry out spot checks to determine whether all entries in the accounts are supported by correct invoices and whether allocations to third parties have been properly accounted for.¹⁰⁶

In the literature, great importance is attached to the much-discussion subject of **internal auditing**. In the context of compliance, this department is responsible for tasks such as the implementation of internal audits and the review of risk management. Occasionally, internal auditing does not do justice to its aspiration to produce a real added value for the company if formal rather than material findings are usually made during audits.¹⁰⁷

6 The limits of compliance

We explore why compliance is not a matter of course, and what the reasons are for the limits of compliance in the context of business ethical and behavioural economic principles.

6.1 Levels of business ethics

In business ethics, a differentiation is generally made between three levels, which are linked as shown in Figure 1. Integrative business ethics must be implemented simultaneously at all levels, referred to as the **places of morality**. In this connection, order ethics represents the *macro level*, **business ethics** the *meso level*, and *individual ethics* the *micro level*.¹⁰⁸

¹⁰⁵ Cf. IDW AssS 980 2011, p. 23.

¹⁰⁶ Cf. Moosmayer 2015a, p. 80f.

¹⁰⁷ Cf. Grützner, Jakob 2015, p. 199.

¹⁰⁸ Cf. Remmerbach 2015, p. 34.

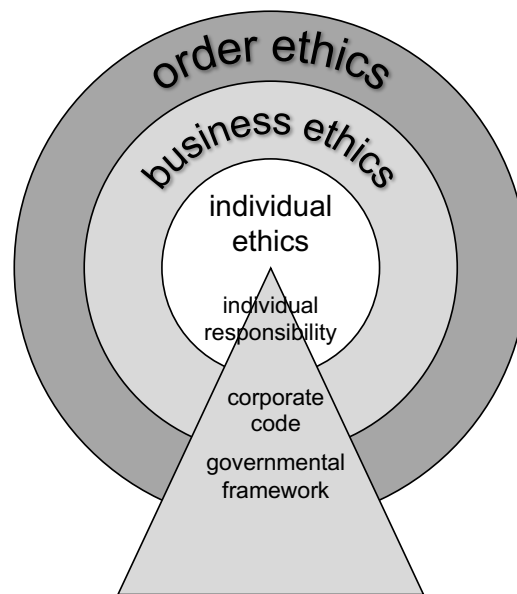


Figure 1: The three levels of business ethics¹⁰⁹

Individual ethics explores a person's behaviour towards himself/herself or towards others. In this respect, it is assumed that primarily self-responsibility is inherent in humans, as individuals, regardless of any social or institutional responsibility.¹¹⁰ Individual ethics focuses on the question of whether "*an individual person's actions, motivations, etc. are good or bad, right or wrong*"¹¹¹. Individual ethics tries to find an answer to *Kant's question: What should I do?* And yet only those ethics that take into account the complexity of current prevailing systems can be successful in the long run.¹¹² Dietzfelbinger assigns acts such as bribery and corruption, loss of morality, workplace bullying and unfair business practices to the individual level.¹¹³

Business ethics, belonging to the institutional level, regards companies as supra-individual institutions that are characterised by the individuals belonging to them, but are not dependent on them. It involves a company's practices, characterised by its individuals, decision situations and balancing of interests.¹¹⁴ The rules established by an institution have a significant impact on the conduct of its individuals.¹¹⁵ Decisive factors include aspects such as working, team and organisational structures, corporate values

¹⁰⁹ Cf. Noll 2013, p. 44.

¹¹⁰ Cf. Dietzfelbinger 2015, p. 57.

¹¹¹ Remmerbach 2015, p. 37.

¹¹² Cf. Lütke, Uhl 2017, p. 34.

¹¹³ Cf. Dietzfelbinger 2015, p. 15.

¹¹⁴ Cf. *ibid.*, p. 58.

¹¹⁵ Cf. Remmerbach 2015, p. 97.

and mission statements.¹¹⁶ Virtue-ethical demands on institutions that, being economic agents, are subject to existential competition, are only reasonable within an institutional order.¹¹⁷

For this reason, the primary task of **order ethics** is to ensure the moral “*assessment and shaping of the social framework for economic activity*.”¹¹⁸ Given the ongoing trend towards the subordination of policy to the logic of the market, there needs to be a contemporary regulatory standardisation so that it is still possible for society to shape one of the markets that serve it.¹¹⁹ The challenges facing order ethics include globalisation, mixing of cultures, new patterns of poverty, increasing economisation, social injustice and a shift in values.¹²⁰

“As a form of ethics of the system, a market economy based on competition pays tribute to the realisation that numerous highly complex systems prevail in today’s world that cannot be regulated by morality, i.e. appeals to the individual.”¹²¹

Despite currently having a world economy, there is no functioning global policy, and hence no adequately valid standards either. In this regard, national standard-setters in particular are overwhelmed. Standard-setters must ensure that the standards imposed by them can be complied with in the first place, because otherwise we would be nurtured to breach the standards as a matter of principle.¹²² The latter can also be applied to companies, being standard-setters for employees.

Companies appear as supra-individual institutions which, at the same time, have an impact on their employees as setters of standards and values (e.g. **code of conduct, tone at the top**); are in direct competition with market participants; and act as a link in the value chain between customers and suppliers. After all, companies encounter complex conditions, market economies and legal systems in international business transactions. In such a process, different addressees are reciprocally addressed. In this respect, compliance merely serves as a minimum requirement of business ethics.¹²³

As a result, corporate compliance can only be effective if it is not reduced to the institutional level, but is instead understood in a holistic and integrative way. If, however, just one of the three levels of business ethics is neglected, the whole complex compliance

¹¹⁶ Cf. Dietzfelbinger 2015, p. 15.

¹¹⁷ Cf. Ulrich 2008, p. 310.

¹¹⁸ Remmerbach 2015, p. 35.

¹¹⁹ C. Ulrich 2008, p. 362; Remmerbach 2016, p. 573f.

¹²⁰ Cf. Dietzfelbinger 2015, p. 15.

¹²¹ Lütke, Uhl 2017, p. 34.

¹²² Cf. Gysi 2013, <https://www.youtube.com/watch?v=156UMs-BXd4>, accessed on: 3 February 2019.

¹²³ Cf. Lütke, Uhl 2017, p. 161 and Remmerbach 2016, p. 573f.

construct is at risk of failing. The next sections explore which different challenges are faced on each of the three levels, and whether an economically motivated compliance approach is at all capable of coping with them.

6.2 Economic principle versus business ethics

It is immediately apparent that, as disciplines, compliance and business ethics are closely linked, and yet the literature states that they have completely different backgrounds. Whereas compliance primarily involves avoidance of liability, and therefore primarily follows extrinsic motivation (observation of rules), normative business ethics initially substantiates the intrinsic motivation for just or unjust actions. This has implications for employees: “A decision that is covered by the programme is right. A decision that contradicts the programme is wrong. ...the commitment to values has ... a certain plausibility. However, the problem is that values, unlike programmes, offer only very vague guidance for decisions.”¹²⁴

Thielemann and Ulrich criticise the fact that, according to the instrumentalist conception of the economic principle, companies only follow those ethics that contribute to company profits in the long run. This signifies **business ethics without morality**, which, taking into account current stakeholder expectations, is only accepted, rather than legitimated.¹²⁵ This is aptly termed an “**economistic concept of ethics**.”¹²⁶

“This marks a fundamental setting of courses, namely between business ethics with morality on the one hand, and, on the other, an understanding of corporate governance that only touches on “ethics” in that social constraints (including legal law) conceive their implicit or explicit pressure subjectively as an expression of ethically grounded issues. In one case, ethics constitutes the requirement and vested interests are the subject of reflection. In the other case, the reverse is true.”¹²⁷

With that in mind, it is understandable that there is a call for “**ethical compliance**”¹²⁸ that does not consider ethics solely as a criterion for competitive differentiation.

¹²⁴ Cf. Kühl 2018, <https://sozialtheoristen.de/2018/06/11/das-moralisierende-unternehmen/>, accessed on: 22 September 2019.

¹²⁵ Cf. Thielemann, Ulrich 2009, p. 30ff.

¹²⁶ Cf. Thielemann, Weibler 2007, p. 189.

¹²⁷ Thielemann 2005, p. 36.

¹²⁸ Cf. *ibid.*, p. 41.

The article entitled “*Menschenrechte in der Compliance*” (Human rights in compliance), published in the prestigious journal CCZ as recently as 2015, is also symbolic of the understanding of compliance without morality described above. It states that:

*“corporate responsibility for the protection of human rights now goes far beyond moral and ethical aspects, and has become an issue of compliance”*¹²⁹

The author therefore takes the view that a compliance approach is more comprehensive than ethics and morality. However, it must be countered that compliance only exists as a regulatory approach because ethics and morality partly or fully fail in society and business. In contrast, in business, “*a new definition of what is ethically and morally okay is produced almost every day,*”¹³⁰ depending on whether a deal is pending, or not. Finally, the author calls on all companies to

*“closely observe the ever-changing legislative landscape in this area (human rights), and to meet the increased expectations on corporate activities with a proactive human rights compliance approach.”*¹³¹

Precisely this approach illustrates business ethics without morality. Companies are requested to take into account only those human rights that stakeholders expect and that are beneficial to corporate profit. As such, the article seems to be exemplary for the understanding of morality and ethics in the context of compliance. This impression is also corroborated by an article from the latest issue of Manager Magazin. Titled “*Ein Quantum Trump*” (Quantum of Trump), the article denounces business ethics demands with populist platitudes such as “*cleanliness guardians*”, the “*gender police*” or “*Kant does not fill stomachs*”. Today’s CEOs reportedly find themselves increasingly faced with having to explain their ethics and morality. In the article, the author strikingly highlights parallels in behaviour between Germany’s economic elite and Donald Trump.¹³²

This understanding of compliance without any moral grounding turns also the external image of the company and communications with its stakeholders, and especially consumers, into a purely instrumentalist marketing tool. In line with this understanding, reference is made to the “*CSR strategy*” and CSR being described in the relevant literature as a

*“corporate communication instrument” which “... provides a corporate marketing tool that can build a strong corporate image and reputation.”*¹³³

¹²⁹ Kroker 2015, p. 120.

¹³⁰ Student 2019, p. 94.

¹³¹ Kroker 2015, p. 126.

¹³² Cf. Student 2019, p. 92.

¹³³ Parguel, Benoit-Moreau, Larceneux 2011, p. 5.

As a result, “**CSR communication**” evolves into an instrument for differentiating between companies and brands.

If, then, things are not looking good with the sustainability of CSR, owing to a lack of value grounding in compliance, it is not unusual for communication efforts to degenerate into notorious “**greenwashing**” or “**bluewashing**”. While greenwashing seeks to create an ecological image using misleading means, bluewashing (blue in the style of the United Nations’ blue logo) involves referring to UN values in PR measures and addressing aspects such as protecting the environment, eradicating poverty or championing human rights.

“One must proceed from the premise that, like all marketing in a capitalist system, green marketing is an investment. And like all business investments, green marketing, and the CSR paradigm that anchors it, are actualized in the expectation of future financial returns.”¹³⁴

No matter whether the intention is greenwashing or bluewashing, companies seek to provide

“an embellished presentation of themselves, ... sanctimoniousness and hypocrisy, ... sprucing up the visible face of organisations.”¹³⁵

In keeping with “**CSR marketing**”, some companies also use what is referred to as **cause-related marketing** (CRM). In essence, CRM usually involves part of the purchase price of a product benefiting a good cause or an NGO. The widely-known “Rainforest Project” (1 create of beer = 1 m² rainforest) by Krombacher brewery is considered a successful “**CSR marketing campaign**”. CRM says nothing about the actual importance of the company’s sustainable, ethical or environmental principles.

This popular phenomenon – also referred to as the separative approach – envisages a strict separation between ethics and the core business. In this way, it suffices to give back compensation to society retrospectively (**donation ethics/CSR**). Alternatively, the need for ethical demands is ascribed to business practices, but consideration of those demands is rejected as impossible, on the grounds of competitive conditions (**impossibility theorem**).¹³⁶ As a consequence, a natural limit of compliance can be derived already from the general desire to make profit – that is, insofar as compliance claims to constitute ethically correct behaviour. Companies are therefore always called upon to

¹³⁴ Alves 2009, p. 11, cf. also Aggarwal 2014, p. 61-66 and Heidbrink, Seele 2007, unpagged.

¹³⁵ Kühl 2018, <https://sozialtheoristen.de/2018/06/11/das-moralisierende-unternehmen/>, accessed on: 22 September 2019. On the critical debate over corporate activities accompanying the UN climate summit in September 2019, cf. Götze 2019, <https://www.spiegel.de/wissenschaft/mensch/klima-gipfel-in-new-york-wenn-sich-konzerne-als-klimaschuetzer-inszenieren-a-1287778.html>, accessed on: 23 September 2019.

¹³⁶ Cf. Thielemann, Ulrich 2009, p. 30ff.

ensure *corporate integrity*, which, in the context of **integrative business ethics**, is contingent on internal discourse with the company's business interests and the willingness to forgo *profit maximisation*.¹³⁷ Thielemann and Ulrich call on companies to make a clear declaration as to which means and principles may not be used to generate profit.¹³⁸ Against the backdrop of the so-called **problem of reasonableness**, it is said that companies cannot, of course, be expected to sacrificially operate at a loss for the benefit of society. In contrast, however, it is considered generally advisable to forgo ruthless profit maximisation in favour of a desire to make profit that is guided by principles.¹³⁹

6.3 Management derailment

The concept of **management derailment** is generally understood to mean the derailment or failure of managers and the management.¹⁴⁰ There are two accepted hypotheses as to the cause of management derailment: one sees a person as the root of the problem, the other believes that the surrounding system or a situation is the cause (system derailment). Personal derailment may be triggered by a variety of factors. Either it is triggered by a personal disaster, such as due to illness or setbacks in one's career (**individual derailment**), due to the ruthless pursuit of self-interest, which often goes hand in hand with unethical or even illegal activities (**moral derailment**), or by a management that does not only harm the perpetrator himself/herself, but also the company or society at large (**complete derailment**).¹⁴¹ The state in which an individual is not, or is no longer, capable of assessing the ethical implications of his/her actions is also termed ethical blindness. This is often also accompanied by a temporary dissonance between actions and inner values and views.¹⁴²

Individual derailment is linked to the manager's personality or character. "**Disqualities** ("dark sides") – bad traits that come under the term of the "**dark triad of personality**" (narcissism, psychopathy, Machiavellism)" follow later (see below; p. 33).¹⁴³

It goes without saying that a lack of **integrity** on the part of a manager leads to the failure of a CMS. Quite a few managers obviously do not come from "the best of all

¹³⁷ Cf. *ibid.*, p. 40.

¹³⁸ Cf. *ibid.*, p. 42.

¹³⁹ Cf. *ibid.*, p. 38f.

¹⁴⁰ Cf. Csef 2016, p. 164.

¹⁴¹ Cf. Kuhn, Weibler 2016, p. 133ff.

¹⁴² Cf. Remmerbach 2016, p. 508.

¹⁴³ Cf. Weibler, Kuhn 2016, <https://www.leadership-insiders.de/management-derailment-wenn-fuehrungskraefte-aus-der-spur-kommen/>, accessed on: 22 September 2019.

worlds”, and fail to act as role models and points of reference, leading to the conclusion: “*The management has shortcomings*”¹⁴⁴

and: “*Once again, we need more reputable merchants.*”¹⁴⁵

One must therefore agree with Niewiarra when she says:

*“The compliance measures must focus on people. They are the origin of every crisis and also the ones who can prevent, tackle and – importantly – learn from them.”*¹⁴⁶

Individual derailment does not happen in a vacuum, but is embedded in existing structures, cultures and processes, and will develop into **system derailment** if authenticity and behaviour with integrity are connected to personal risks.

*“When organisations stress the value of integrity to their employees, this does not mean that they will develop more moral behaviour. Morality does not work like a trivial machine where you insert the call for moral-based attitudes one side and then moral actions come out on the other. The effect of integrity campaigns is merely that employees must present their actions differently. Being charged with values by the top of the organisation, they must no longer not only present their actions as being compliant with the regulations, but also as being morally exemplary. Such integrity campaigns produce the very thing that they set out to prevent – hypocrisy. Integrity becomes an abstract formula that everyone must commit to – if they want to get ahead in their career within the organisation. The wording of values, imposed from above, is practised at meetings sometimes resembling church services to a surprising extent. All that changes an organisation. But one thing it will definitely not become because of it – a morally better organisation.”*¹⁴⁷

System derailment is often characterised by a clear shareholder value orientation and exacerbated by modern-day financial market capitalism, according to which companies primarily act as a profitable investment for shareholders and investors. This also puts greater performance pressure on the management. To ensure that senior managers meet their shareholders’ return expectations, performance-based compensation schemes and incentive schemes (*incentives*) are increasingly introduced, which in turn

¹⁴⁴ Hauser 2014, <https://www.zeit.de/2014/03/manager-ethik-beraterin-annette-kleinfeld>, accessed on: 22 September 2019.

¹⁴⁵ Zeit Online 2016, <https://www.zeit.de/karriere/beruf/2016-10/compliance-unternehmen-regeln-fuehrungskraft-mitarbeiter>, accessed on: 22 September 2019.

¹⁴⁶ Ibid.

¹⁴⁷ Kühl 2018, <https://sozialtheoristen.de/2018/06/11/das-moralisierende-unternehmen/>, accessed on: 22 September 2019.

foster management derailment.¹⁴⁸ In the process, major shareholders like to schedule business ethics demands for resubmission, such as for when a deal is pending.¹⁴⁹

6.4 Behavioural business ethics

A CMS can also fail even if there are no derailment stimuli – because of people. **Behavioural business ethics** investigates the actual (im)moral actions of decision-makers, of people in their corporate environment. In the process, it does not fall back on normative approaches of ethics, nor does it assume a specific view of human beings. It set its sights on “ordinary people”, covering 70-80% of decision-makers, excluding free riders and moralists, who largely act autonomously.¹⁵⁰

Decisions are invariably contingent. The situational context can have such an impact that managers and employees succumb to the aforementioned phenomenon of ethical blindness: in the specific situation in which they find themselves, they are not (any longer) aware that they offend morality. It is therefore quite understandable that behavioural business ethics gives in-depth attention to the so-called **frame** (specific situational context), the decision drivers and the decision-making architecture of actors.

There are three main context categories that have a situational impact, some of which have already been touched on:¹⁵¹

Personal factors such as certain character traits;

Institutional factors: the values and practices of the company as an external frame of the organisation, which inevitably acts inward;

Organisational factors such as corporate culture and leadership styles.

Due to the wide range of psychological and psychosocial backgrounds, we address below a selection of findings from behavioural business ethics that are particularly suited to demonstrating that even an comprehensive CMS has its limitations.

Practised power stimulates narcissistic behaviour.¹⁵² **Milgram's experiment** shows in a frightening way what impact this can have, even on *ordinary citizens*.¹⁵³ Some of the main personality traits that can trigger individual antisocial derailment include the aforementioned **dark triad of personality**, attributed to Paulhus and Williams: a com-

¹⁴⁸ Cf. Kuhn, Weibler 2016, p. 135f.

¹⁴⁹ Cf. Student 2019, p. 93.

¹⁵⁰ Cf. Remmerbach 2019. For a more in-depth exploration of behavioural business ethics, see Remmerbach 2019.

¹⁵¹ Cf. Remmerbach, Püllen 2019, p. 12ff.

¹⁵² Cf. Csef 2016, p. 166.

¹⁵³ Cf. Remmerbach 2016, p. 28f.

combination of **narcissism**, **Machiavellism** and **subclinical psychopathy**. Such individuals are characterised by an antisocial orientation, an enormous ego, a lack of empathy and the inclination to manipulatively exploit others.¹⁵⁴ People within this spectrum are disproportionately often found in management positions, not just because they feel drawn to such positions, but also because they are able to obtain them.¹⁵⁵ The fact that the management poses a disproportionately high risk is also shown in the Global Economic Crime and Fraud Survey 2018, conducted by PwC. According to this study, companies are damaged by their own employees in almost half of all corporate criminal offences (46%). Another noteworthy fact is that more than half of such perpetrators belong to middle or senior management (56%).¹⁵⁶ For the purposes of moral business ethics, this is doubly critical because managers must set a good example and bear responsibility.¹⁵⁷ What is more, managers have a direct influence on the behaviour of employees due their *goal achievement* and *group preservation role*.¹⁵⁸ A similar picture emerges from the 2018 study on economic crime, conducted by KPMG. The main risk factors for fraudulent actions named in this study include a lacking sense of wrongdoing, the absence or lack of controls, carelessness, negligence and a lack of sanctioning. However, financial pressure or bonuses also play an increasingly important role.¹⁵⁹

An experiment by Welsh and Ordóñez shows that aggressive performance goals in companies promote a negative environment, leading not only to severe exhaustion, but also to an immediate willingness to behave unethically, particularly when the company is more interested in achieving the goals than in how to get there.¹⁶⁰ As a consequence, junior and middle managers in particular feel forced to behave opportunistically. This is quite often attributable to the senior management, and thus also to the entire system of the company, due to active requests to behave unethically or simply disinterested. Their findings indicate that unethical behaviour is often tolerated, as long as economic success is achieved.¹⁶¹

“Conversely, unfair behaviour has a [far more serious] effect when underachievers are involved.”¹⁶²

Care should also be taken with variable compensation and economic **incentive schemes**. The aim of these is to induce employees to behave in a certain way so as,

¹⁵⁴ Cf. Externbrink, Keil 2018, p. 3f.

¹⁵⁵ Cf. Kuhn, Weibler 2016, p. 133ff.

¹⁵⁶ Cf. Bussmann et al. 2018, p. 60.

¹⁵⁷ Cf. Remmerbach 2015, p. 56f.

¹⁵⁸ Cf. *ibid.*, p. 24f.

¹⁵⁹ Cf. Geschonneck et al. 2019, p. 18f.

¹⁶⁰ Cf. Welsh, Ordóñez 2014, p. 86.

¹⁶¹ Cf. Kuhn, Weibler 2016, p. 141ff.

¹⁶² Student 2019, p. 93.

for example, to boost sales or profitability. From a business ethics perspective, such instruments should be renounced altogether, where possible, which, however, does not exclude using a bonus scheme to reward achievement.¹⁶³ After all, incentive schemes are in danger of the incentive contradicting the intention, rather than serving the intended purpose, leading in the worst case to opportunistic behaviour.¹⁶⁴

“In a corporate world driven by ambitious performance targets and bonus schemes, such requirements often collide with the temptation to fiddle a deal.”¹⁶⁵

Variable compensation schemes have helped to ensure that the boundaries of present-day managers' salaries have shifted drastically. For example, Tesla CEO Elon Musk drew a salary of \$2.3 billion in 2018,¹⁶⁶ which meant that he earned more than 40,000 times more than his employees' average salary.¹⁶⁷ Such phenomena occur quite often on account of legally admissible, yet unethical business practices. This leads to **“dirty profits”** and high returns for managers.¹⁶⁸

In everyday business, it is sometimes the case that employees perceive tension between the actions (required of them) and their convictions and inner values in the course of their work. This mismatch is widely referred to as **cognitive dissonance**. Since this state triggers a strong feeling of discomfort in people, they do everything they can to avoid or release such a feeling. To this end, they can either change their behaviour or adapt their attitude or cognition.¹⁶⁹

“Cognitive dissonance governs perception and information processing behaviour. The greater cognitive dissonance is felt, the stronger the motivation to eliminate it and, presumably, the stronger the tendency to perceive information received selectively and to process it in a dissonance-reducing way.”¹⁷⁰

This behavioural principle is of particular importance to managers because they act as decision-makers in companies and, as such, also make the wrong decisions or are faced with wrong decisions made by their employees. When assessing decisions, care

¹⁶³ Cf. Thielemann, Ulrich 2009, p. 62.

¹⁶⁴ Cf. Remmerbach 2016, p. 269.

¹⁶⁵ Klawitter 2019, p. 64.

¹⁶⁶ Cf. Eavis 2019, <https://www.nytimes.com/2019/05/24/business/highest-paid-ceos-2018.html>, accessed on: 26 May 2019.

¹⁶⁷ Cf. Equilar Inc. 2019, <https://www.equilar.com/reports/table-equilar-200-new-york-times-highest-paid-ceos-2019.html>, accessed on: 26 May 2019.

¹⁶⁸ Cf. Kuhn, Weibler 2016, p. 136f.

¹⁶⁹ Cf. Remmerbach 2016, p. 20f.

¹⁷⁰ Raab, Unger, Unger 2016, p. 49.

must be taken to ensure that they are not distorted by cognitive dissonances.¹⁷¹ Such decision situations in which a decision-maker has the choice between at least two mutually exclusive alternative courses of action are widely described as a **dilemma**, but are only perceived as such when the decision situation is very distinct and puts the decision-maker under mental strain.¹⁷² Individuals who have taken a supposedly unethical decision, possibly to achieve an economic goal, will subsequently personally justify their decision and suppress critical thoughts. The result is distorted or selective perception, due to poor self-reflection. On the contrary, the economic successes or personal benefits achieved in the process will even encourage such behaviour in the future. Consequently, the principle of cognitive dissonance may act as a limit of compliance at the individual level.

Interaction and confrontation in groups and organisations are also of considerable importance. When entering a new group, individuals tend to adapt at least some of their own behaviour patterns to those of the group, whilst retaining their original convictions.¹⁷³ In addition, non-conformity to the prevailing will of the group, referred to as **group mentality**, is perceived as dissonance and psychological strain. As a consequence, individuals tend to avoid group conflicts, instead attaching importance to recognition.¹⁷⁴ The experiment conducted by Asch as early as 1950 illustrates the extent of this desire for conformity, or **peer pressure**.¹⁷⁵

The so-called **bystander effect**, better known as **diffusion of responsibility**, is also of particular importance. The phenomenon, dating back to a socio-psychological study conducted in 1968, indicates that, as the number of witnesses to an incident who are not in contact with each other increases, the percentage of people who will intervene and respond falls. In contrast, the time taken for a person to intervene or respond increases drastically in an inversely proportional manner. The greater the number of individuals present, the less responsible each individual feels because everybody thinks that the others will intervene. It was possible to replicate this diffusion of responsibility in all kinds of situations; it was therefore not limited only to emergency situations, but can be assumed to be fundamentally valid.¹⁷⁶ A second experiment describes the phenomenon of **pluralistic ignorance**. In contrast to diffusion of responsibility, the individuals are aware of the others' behaviour, but falsely view their passive behaviour as a lack of need to respond, and consequently often remain passive themselves.¹⁷⁷ A third

¹⁷¹ Cf. Remmerbach 2016, p. 21.

¹⁷² Cf. Remmerbach 2016, p. 379f.

¹⁷³ Cf. *ibid.*, p. 163.

¹⁷⁴ Cf. *ibid.*, p. 163f.

¹⁷⁵ Cf. *ibid.*, p. 447.

¹⁷⁶ Cf. Frey, Bierhoff 2011, p. 74f.

¹⁷⁷ Cf. Frey, Bierhoff 2011, p. 75f.

limitation lies in the so-called **fear of evaluation**, according to which individuals are reluctant to act for fear of being evaluated by witnesses who are also present.¹⁷⁸ As a result, a wide range of limits of compliance can be derived from the group effects explained above, since these can be transferred to companies.

There is inevitably a certain proportion of **free riders**, also referred to as **opportunists**, in society. Such people are always driven by the motto of striving for individual gain and profit. In the process, their principles and values are fluid, and it is virtually impossible to rely on such people.¹⁷⁹ Empirical findings show that the attractiveness of opportunistic actions increases as the willingness of others to cooperate grows, and in the absence of penalties.¹⁸⁰ As the anonymity and size of a company or institution increases, greater diffusion of responsibility sets in, and it becomes more difficult to identify which individuals act as free riders, ignoring the dominant interest of the company (n-person **prisoner's dilemma**).¹⁸¹ While most individuals measure their willingness to cooperate based on how many other individuals are ready to contribute, i.e. exhibit **reciprocal behaviour** (tit for tat), free riders are unwilling to invest in a group project, even if the other members make much larger contributions.¹⁸² Ulrich notes, however, that reciprocal moral expectation is so deeply anchored in the human psyche that it is impossible to drop out of this basic structure completely, acting only in an opportunistic manner.¹⁸³ Since, therefore, free riders cannot be controlled by codes of conduct, but instead always act in their own interest and not in the interest of the company, this constitutes a clear limit of CMS.

The so-called **framing effect** shows how easy it is to influence individuals' behaviour, and that this depends to a large degree on the context. This effect refers to different ways of depicting the same information, evoking different emotions as a result of varying formulations.¹⁸⁴ The framing effect is not limited to monetary issues, but is also applicable to emotional issues.¹⁸⁵ In this connection, even minor modifications to the wording of a decision problem may result in far-reaching preference changes.¹⁸⁶

These effects, shown by way of example, emphasise the fact that the compliance approach, particularly when oriented primarily to liability reduction, has extensive limits. Corporate compliance cannot therefore be equated to ethical behaviour.

¹⁷⁸ Cf. *ibid.*, p. 76.

¹⁷⁹ Cf. Aßländer 2011, p. 433.

¹⁸⁰ Cf. Remmerbach 2016, p. 491f.

¹⁸¹ Cf. Frey, Bierhoff 2011, p. 150.

¹⁸² Cf. Remmerbach 2016, p. 491f.

¹⁸³ Cf. Ulrich 2008, p. 27.

¹⁸⁴ Cf. Kahnemann 2014, p. 115.

¹⁸⁵ Cf. Remmerbach 2016, p. 213.

¹⁸⁶ Cf. Kahnemann 2014, p. 334.

6.5 Summary

In practice, compliance is usually considered from a purely legal perspective. It is a matter of adherence to rules and avoiding penalty. It follows from the consideration of behavioural economic principles that ethics in the context of business is in most cases subject to extrinsic motivation. As a result, companies often only pursue compliance as required for business success, i.e. to increase EBIT. Consequently, compliance cannot be equated to ethics and morality. To make matters difficult, high return expectations and the accompanying performance pressure on the management promote unethical behaviour. This is a critical point, particularly because a disproportionately high number of narcissistic and Machiavellian individuals (“dark triad”) can often be found in the management, who are more likely to egotistically strive for economic success than to demonstrate ethical and moral virtues.

In addition, aggressive performance targets and variable compensation schemes increase the likelihood of opportunistic behaviour, which quite often leads to tangible breaches of compliance in everyday business. This also explains the risk of management or system derailment, which accompanies the target of increasing earnings. Moreover, group effects such as the principles of the diffusion of responsibility and of pluralistic ignorance can change individuals’ behaviour. Last but not least, free riders who do not behave reciprocally, and who make up around 10 to 15% of most institutions, always act in their own interest and cannot therefore be controlled by codes of conduct.

In the light of the limits of compliance shown above, even comprehensive compliance management systems reach their limits, have only a purely legal orientation, fail to produce ethical/moral behaviour, and cannot therefore be equated to ethics and morality.

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After earning a degree in Business Administration at the Westfälische Wilhelms-Universität in Münster, Remmerbach completed his doctorate (Dr. rer. pol.) under the supervision of Professor Meffert in 1987. He then worked for Arthur D. Little International in Wiesbaden. In 1990, he joined Robert Bosch GmbH, where he worked as Chairman of the Executive Board of Bosch Siemens Hausgeräte AG in Italy and as head of Sales of the Power Tools Division in Germany. From 1998, Remmerbach was the Vice President of Sales and Marketing for Robert Bosch Telecom GmbH and a member of the “Mobile Devices” product line management. He was appointed Professor of Management at the Institute of Business Administration & Engineering of Münster University of Applied Sciences in 2001.

Robin Krumme

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Institute of Business Administration & Engineering (ITB)

The Institute of Business Administration & Engineering was established at Münster University of Applied Sciences in 1998, laying the foundation for teaching, continuing education and research in Business Management in Technology at the higher education institution. A combination of business and technical expertise constitutes the core of course content, creating the basis for many research topics. Working hand in hand with the engineering departments at Münster University of Applied Sciences, ITB ensures the diverse and interdisciplinary nature of its teaching.

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