# REGULATING THROUGH CULTURE

## A DELIVERY MODEL BASED ON SCIENTIFIC EVIDENCE, ETHICAL BUSINESS PRACTICE AND ETHICAL BUSINESS REGULATION

Professor Dr Christopher Hodges,[1] Srikanth Mangalam[2] and Ruth Steinholtz[3]

## EXECUTIVE SUMMARY

This paper describes a model for 'regulating through culture'. The approach is based on scientific evidence of what drives and affects human behaviour individually and in groups such as commercial businesses and regulatory organisations. The model responds to increasing demand from both regulators and businesses for guidance on how organisational culture can support the achievement of society's goals. Specifically, how do we achieve and balance the traditional economic success goal of business with the regulatory goal of protection? The model is based on the activation of the ethical values of a society and open cooperation between all relevant actors and stakeholders.

The issues that are covered here are:
- The Operational Functions of a Regulatory System.
- Establishing Ethical Principles and Standards.
- Setting Regulatory Objectives.
- Establishing and maintaining Ethical Business Practices (EBP).
- A Framework for Regulatory Authorities – the Regulatory Delivery Model.
- New Approaches underlying Regulating through Culture.
- An Integrated Framework for Regulating through Culture - Ethical Business Regulation (EBR).

The paper also summarises guidance on how to establish and sustain a culture of Ethical Business Practice (EBP) in an organisation. That should be done in both businesses and regulatory bodies. We look here at the elements of the relationship of trust between regulators and businesses that can be characterised as Ethical Business Regulation (EBR).

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[1] Professor of Justice Systems and Head of the Swiss Re Research Programme on Civil Justice Systems, Centre for Socio-Legal Studeis, Oxford; Fellow of Wolfson College, Oxford; Fellow, European Law Institute.
[2] President, Public Risk Management (PRISM) Institute, Toronto, Canada
[3] Author, Managing Partner, AretéWork LLP, and Barrett Values Centre Certified Consultant, London, UK.

# Table of Contents

# 1. INTRODUCTION

## 1.1 The Foundations: Ethical Values, Principles, Trust and Culture

This paper describes a model for the concept of 'regulating through culture'. Since regulation aims to affect the behaviour of the regulated,[4] on a prospective basis, this approach is based on the findings of scientific research into behavioural and organisational science, practitioner experience and emerging approaches to regulatory delivery and disruptive technologies.

Traditional regulation typically involves rules and enforcement. The model described here has deeper roots in the principles and values that apply to actors in a well-functioning society and to their interactions , including a market. The rationale underlying this model of a regulatory system is to support interaction between humans and their organisations that is mutually respectful and thereby maximises the objectives of both society and its market actors by enabling open cooperation and competition rather than being hierarchical or distrustful.[5] The target model has been shown to be more productive, in terms of both compliance with regulatory goals and achievement of business success.[6]

The basic concept is that there should be *trust* between actors, and that is true not just in relation to dealings between individuals or traders but also between the society's representatives (state institutions and officials) and private, commercial or non-governmental bodies and individuals. Trust is built on *evidence*, so the approach aims to require, encourage and make available evidence on which one actor may place trust in another—or decide that trust is low or should be limited. Basing relationships on placing or withhold trust is universal amongst human beings. Decisions to place or withhold trust are typically made inherently by our species based on 'gut feel', intuition and emotional mechanisms. The purpose of regulation is to produce a body of more concrete factual evidence that actors deserve to be trusted—or not.

An approach to regulatory intervention aimed at maximising understanding and compliance should be based on the findings of science. The issue is not a theoretical one of how an organisation might behave on the assumption that its decisions are all based on rational self-interest and maximisation of profit. The issue is how humans behave and take decisions, whether individually or in groups, such as a group with a commercial purpose. In this context, it is necessary to base an approach firmly on the findings of scientific research into behavioural and organisational science.

Scientific discoveries have led to the recognition that humans who work in organisations can be heavily influenced by the behaviour of those around them and by the culture of the group and organisation (and society). This has led to the idea of aiming to affect the culture of organisations as a profoundly powerful means of regulating behaviour. However, the culture of an organisation is created *within* the organisation itself, so attempts to regulate the culture

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[4] In this document, the focus is on commercial businesses but the approach applies equally to non-commercial actors who are subject to regulation (regulatees).

[5] Alan Page Fiske, 'The Four Elementary Forms of Sociality: Framework for a Unified Theory of Social Relations' (1992) 99.4 *Psychological Review* 689

[6] R Sisodia, J Sheth and D Wolfe, *Firms of Endearment. How World-Class Companies Profit from Passion and Purpose* 2nd edn (Upper Saddle River, NJ: Pearson Education, 2014); J Mackey and R Sisodia, *Conscious Capitalism. Liberating the Heroic Spirit of Business* (Harvard Business Review Press, 2014); *Governing culture: practical considerations for the board and its committees* (EY, 2016); D Barton, J Manyika, T Koller, R Palter, J Godsall and J Zoffer, *Measuring the Economic Impact of Short-Termism* (McKinsey & Company, 2017).

of organisations from outside must be more subtle and indirect. Thus, the idea is to regulate *through* culture, which is the subject of this model.

The model set out here is built on maximising cooperation between all relevant individuals who are involved in the commercial endeavour that is being pursued and regulated. This is done by leveraging the sense of 'right and wrong' that is innate to most humans so as to build evidence that they can trust each other,[7] and do so on an institutional basis because the predominant culture that exists in the organisations in which they work is based on the same ethical values.

The building blocks, therefore, are:
- Shared ethical values
- evidence of trust between individuals
- evidence of ethical culture in organisations (created through the implementation of Ethical Business Practice – EBP)
- leading to relationships of trust between organisations (Ethical Business Regulation – EBR).

Since the people working in organisations own the culture of their organisation, and it is not possible to regulate the culture of an organisation from outside it, the approach is to "Regulate through culture" rather than to try to regulate culture.

The primary elements for implementing this model and thereby creating an effective system of market regulation should include the following elements, which are discussed in subsequent chapters:

- **The Operational Functions of a Regulatory System.**
- **Establishing Ethical Principles and Standards.**
- **Setting Regulatory Objectives**.
- **Establishing and sustaining Ethical Business Practices (EBP).**
- **A Framework for Regulatory Authorities – the Regulatory Delivery Model.**
- **New Approaches underlying Regulating through Culture.**
- **An Integrated Framework for Regulating through Culture - Ethical Business Regulation (EBR).**
- **List of Practical Steps that may be taken by Public Bodies to Create and Support EBR.**

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[7] J Haidt, *The Righteous Mind. Why Good People are Divided by Politics and Religion* (Penguin Books, 2012); EO Wilson, *The Social Conquest of Earth* (New York, Liveright Publishing, 2012).

## 2. THE OPERATIONAL FUNCTIONS OF A REGULATORY SYSTEM

### 2.1 Core Functions

The starting point is to consider the objectives of regulation, and then to identify the *functions* needed to maintain (regulate) a successful market economy and deliver effective protections.

The central idea is that the objectives are to enable the members of the society covered by the operational and regulatory regimes to thrive and to constantly maintain and improve ethical practice, performance, innovation and growth.

The means by which these objectives are achieved is through a system that encourages all actors to behave in accordance with the agreed ethical principles and rules of the society, and to identify those who are striving to do so, by the ability to review evidence that actors deserve to be trusted. The system will also identify those who do not deserve trust and are breaking the society's ethical rules so that relevant action can be taken.
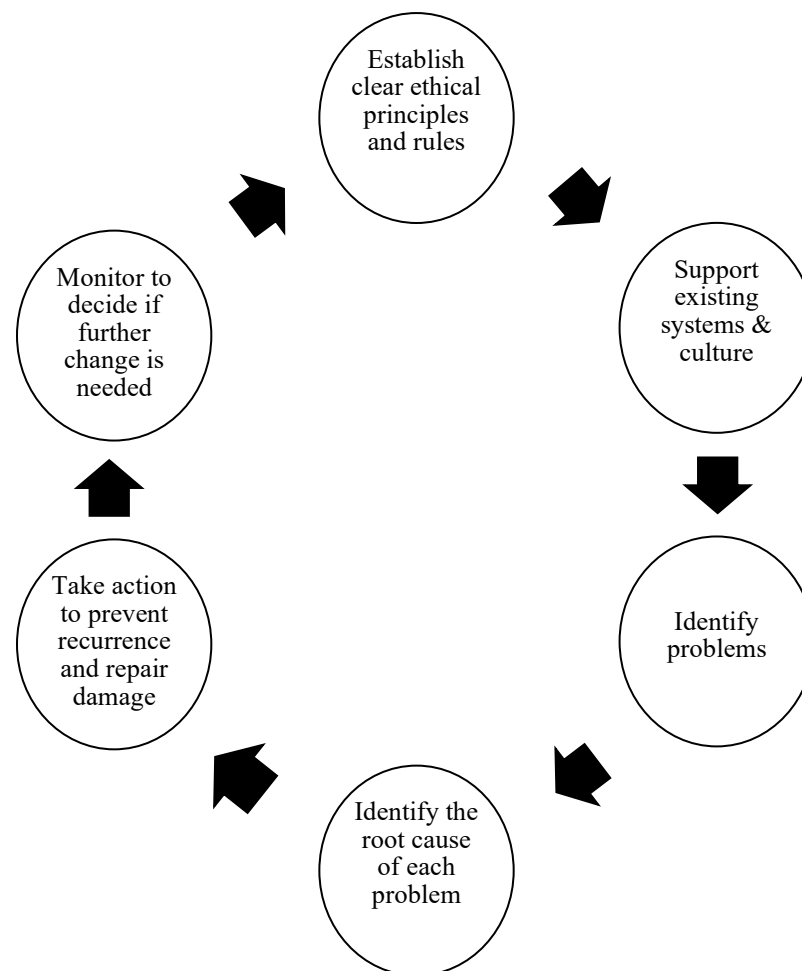


The core functions are, therefore, as follows:

1. **Establishing clear ethical principles and rules.** The society should agree what its values and principles are. They should be seen to be ethical, that is in accordance with the consensus of individuals' prevailing rules of what is right and proper. Specific rules that

apply to conduct should then be made that accord with the ethical principles and give specificity of what is required in particular concrete situations. This can be done in layers of subsidiary rules.

It is an essential function of a legislator to specify the ethical values and principles. Detailed technical rules can be made at subsidiary levels, such as by regulatory or standards bodies, involving suitable consultation with all stakeholders. A Code (in many cases a Code that it is mandatory to observe) can be an effective model. The rules of the Code and any relevant guidance may be amended, updated and extended relatively quickly.

Irrespective of how the principles and rules are made, they should be subject to open consultation between all relevant parties, allowing all stakeholders to have a voice in their consideration, and for all practical issues over delivery of the rules to be taken into account.

2. **Methods and systems to achieve effective economic performance and compliance with principles and rules.** All actors (public and private) should put in place and consistently operate relevant systems and culture to succeed in their legitimate endeavours. This will involve systems for operating (management, operations, feedback, evaluation and other systems) and controlling (regulation and ethical performance and compliance systems).

In the case of regulatory bodies, the core model is the Regulatory Delivery Model (RDM) [8] that is discussed further below. In the case of commercial businesses, management and operational systems will be required. In both cases, it is fundamental to aim to observe the *ethical principles* rather than (just) the rules, and this is done by having frameworks that aim at achieving an *ethical culture* rather than just compliance with rules.

3. **Leadership development, behaviours and practices to create the conditions for ethical values and behaviour to prosper**. All organisations should focus on recruiting and developing leaders at all levels in the organisation with the character and skills required to nurture ethical cultures.

4. **The ability to identify problems.** Both commercial and regulatory bodies should strive to identify problems, rather than just focusing on breaches of rules. A problem might or might not be identified as a breach, and a breach might be considered to be serious enough to enable a real problem to be identified, so the risk-based aim is to take a wide focus and identify actual or potential problems.

Various means of identifying problems should be in place, such as a culture of psychological safety[9] that facilitates the raising of issues, monitoring activities, tests, inspections and audits. A key advance is to adopt frameworks and practices that support and maintain an ethical culture in organisations and hence trust between them and the people involved.

5. **Analyse problems so as to identify their root cause.** This 'root cause' approach is now widely adopted in technical contexts. It aims to identify the real and often multiple and systemic causes of a problem, rather than just the proximate individual who 'caused' an incident or breach of a rule. The objective is to be as effective as possible in addressing the problem, rather than to sanction breach of a rule and hence fail to take more effective or widespread action.

6. **Taking action to prevent recurrence of the problem.** Action might be taken at 'ground level' by immediate actors, or more systemically at organisational level, or externally by

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[8] Set out in detail in G Russell and C Hodges (eds), *Regulatory Delivery* (Hart, 2019).

[9] AC Edmondson, *The Fearless Organization* (John Wiley & Sons, Inc., 2019).

a regulator. Whenever appropriate, relevant information and action should be notified to, and discussed and agreed between, responsible people at relevant levels, whether internal or external.

7. **Taking action to repair any damages caused**. The previous function is prospective, aimed at reducing future risk, and this function is retrospective, aimed at putting things right and back to balance. It may involve making repairs, recalling dangerous products, restoring the environment, paying compensation for loss or similar actions. Efficient systems should be in place to achieve these outcomes swiftly and economically.

8. **Monitoring the situation and action taken to see if any further or corrective action is needed**. Such corrective action might involve changes to rules (no 1 above) or to systems and approaches (no 2). It might involve cultural measurement over time to determine if cultural transformation efforts are succeeding.  Thus, the model is circular, representing continuous activity (rather than activity just based on individual activities, such as inspections, identifying breaches and imposing sanctions).

The core functions that are needed across the legal system are illustrated in the Figure below.[10] Versions of this list have been quoted with approval by the Irish Law Reform Commission[11] and the Australian Law Reform Commission.[12]


## 2.2 Mechanisms and Institutions for Implementing and Performing the Functions

The next question that arises is: what mechanisms and institutions are needed to deliver the above functions? This is a question that needs to be asked in each country and regulatory regime. The answers to the question may indicate the need for significant change in existing arrangements. For example, many historical systems may have regulatory and legal systems that impose requirements, inspect operators' compliance, prosecute breaches and (separately) provide for private claims for redress. In contrast, some modern systems have a small number of bodies that deliver all of the above functions as part of an integrated holistic system that operates more effectively and efficiently than historical models.

Important lines of inquiry are:

- Can the functions be delivered more effectively?
- Can greater impact be achieved?
- Are there gaps in the delivery of functions in the circle?
- Are the various elements in the circle adequately connected, so that the system operates as an effective whole?
- Can the various public and private actors and intermediaries that deliver the various functions be integrated in more effective and efficient ways?

It is noteworthy that a number of new intermediaries are appearing in markets to provide more effective and efficient solutions for consumers and small businesses.[13] Where markets

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[10]  C Hodges, 'Mass Collective Redress: Consumer ADR and Regulatory Techniques' (2015) 23 *European Review of Private Law* 829-874; C Hodges, 'Consumer ombudsmen: better regulation and dispute resolution' (2015) 15(4) *ERA Forum* 593.

[11] *Report on Regulatory Powers and Corporate Offences. Volume 1: Regulatory Powers* (Law Reform Commission, 2018), 51.

[12] *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders. Final Report* (Australian Law Reform Commission, 2018), para 8.30.

have too many gaps in the circular system, or too many bodies (e.g. too many regulatory authorities, or ADR/Ombuds) then the system will not work well.

At a more granular level, one might ask fundamental questions about how problems are identified. This is a wider question than asking how breaches of rules are identified. Traditional tools may be inspection regimes, reporting requirements, and monitoring complaints. But in a digital age, there are other approaches that may be more effective and reveal more issues more quickly, so contribute to reducing the risk of harm and the implementation of improved performance.

The holistic resolution of all issues of behaviour/culture and of redress simultaneously is highly efficient, delivers rectification of markets and redress to consumers speedily, and provides an incentive for businesses to behave ethically.[14] These techniques have been approved by UNCTAD.[15]

The key insight is that the adoption of 'regulation through culture' (EBP and EBR) will have a profoundly powerful effect on the effectiveness and efficiency of achieving the set of functions. It will do this by facilitating open collaboration between all the relevant actors and bodies, not only between business(es) and regulator(s) but also between different regulators, also involving relevant third parties.

The following sections of the document provide suggestions and recommendations to regulators who intend to adopt and implement a "regulation through culture" approach in their respective sectors. Specifically, the document will provide guidance on developing the three core elements of the regulatory model.

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[13] C Hodges, *Delivering Dispute Resolution: A Holistic Review of Models in England & Wales* (Hart, 2019).

[14] C Hodges and S Voet, *Delivering Collective Redress: New Technologies* (Hart, 2018); C Hodges, 'Collective Redress: The Need for New Technologies' *Journal of Consumer Policy* (2019) 42:59–90.

[15] *Manual on Consumer Protection* (UNCTAD, 2018), chapters 6 and 11.

## 3. ESTABLISHING ETHICAL PRINCIPLES AND STANDARDS

A society of humans should agree what its values and principles are that govern the basis on which they interact. The values and principles should be seen to be ethical, that is in accordance with individuals' prevailing rules of what is right and proper. Specific rules that apply to conduct should then be made that accord with the ethical principles and give specificity of what is required in particular concrete situations. There can be layers of subsidiary rules.

The ethical principles that are applied in a relevant society (group of all people involved and affected by their interactions) should be based on a consensus of all those involved. It is an essential function of a legislator to specify the ethical principles. Detailed technical rules can be made at subsidiary levels, such as by regulatory or standards bodies, involving suitable consultation with all stakeholders. A Code (in many cases a Code that it is mandatory to observe) can be an effective model and should be agreed by all those affected. The rules of the Code and any relevant guidance may be amended, updated and extended relatively quickly.

Irrespective of how the principles and rules are made, they should be subject to open consultation between all relevant parties, allowing all stakeholders to have a voice in their consideration, and for all practical issues over delivery of the rules to be taken into account.

It is necessary to have a mechanism for reviewing and revising the ethical principles, standards and rules, to ensure that they remain in accordance with society's values as they change and that the subsidiary rules remain consistent with the principles in a relevant, coherent and effective matrix.

In establishing these principles, some of the key lines of inquiry[16] should include:

- How are ethical values and principles established?
- What structures are used internationally, by the state, by the regulatory agency and other agencies, by business?
- Do the mechanisms involve all stakeholders?
- Do the mechanisms need to be improved?
- Do the mechanisms support engagement between all stakeholders?

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[16] Examples: the periodic agreement in the Netherlands of terms and conditions involving trade associations and consumer associations under the auspices of the Council of State. UK mechanism for industry Codes to be approved under the CTSI's Code Approval scheme.

# 4. SETTING REGULATORY OBJECTIVES

## 4.1 Protection and Growth

The fundamental objective of regulation is to optimise good outcomes for human society—and avoid or reduce bad outcomes—by maximising decisions that conform to ethical values and minimising the converse. The desired good outcomes are those shared by all those living and working in the particular society. The collective sum of outcomes will be the overall strategic impact of the regime, by which its success or lack of it should be evaluated. Good outcomes can only be those considered to conform to the ethical principles of the society's members. Thus, the ethical principles and outcomes should be shared by all, or at least identified and agreed by the majority of members through a fair process that respects their individual rights and freedoms. Hence, outcomes that favour the interests of some members, but disadvantage others, should be subject to suitably wide scrutiny and relevant modification, so that the guiding principle is achievement of the common good, provided it, and the means of achievement, are in compliance with ethical principles.

## 4.2 Alignment and Convergence in Objectives

During the past 70 years a convergence in the goals of businesses and regulators has occurred. The single goal for business used to be maximising profit and that for regulators used to be achieving compliance. Both 'sides' should now overlap and *share* the same goals of achieving shared best outcomes encompassing the objectives of all stakeholders, namely success in social, economic and environmental goals. The contemporary approach is to select the right intervention to ensure that future outcomes are those desired, i.e. compliance, performance and hence growth.

This sharing of objectives between society and business opens the possibility of deeper and more productive cooperation between them. Such cooperation has to be built on trust, which is based on evidence that one can trust the other. The OECD said in 2019 that 'Trust underwrites every one of our economic relationships'.[17] The relationship has to be based on treating each other as responsible adults, and not with the State treating commercial or civil organisations as irresponsible children who should be blamed and punished if something goes wrong.

Examples of the convergence of objectives, and the emergence of an adult, respectful relationship between regulators and businesses, can be seen to have emerged in various contexts. For example, the UK Regulators' Code has enshrined the approach of *supporting* regulatees to comply and, since 2017, of supporting economic *growth*:

(1)     Regulators should carry out their activities in a way that *supports those they regulate to comply and grow*;[18] and
(2)     Regulators should ensure clear information, guidance and advice is available to *help those they regulate meet their responsibilities to comply*.[19]

The 'growth duty' specifies that regulators need to ensure that they:[20]

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[17] *OECD Business and Finance Outlook 2019. STRENGTHENING TRUST IN BUSINESS* (OECD, 2019).
[18] From 2017, UK regulators must 'have regard to the desirability of promoting economic growth': Deregulation Act 2015, s 108.
[19] Regulators' Code, provisions 1 and 5.

[H]ave a level of understanding of the business environment, their business community, individual businesses, and the impact of regulator activities on them that is appropriate to their duties and responsibilities, enabling them to deliver a risk-based, proportionate approach in their day-to-day activities.

A similar transformation in policy has occurred on the business side. The U.S. Business Roundtable stated in 2019 a highly significant restatement of the purposes of a corporation, which rejected a profit-maximising capitalist model to a purpose-driven stakeholder-regarding model encompassing achieving the well-being of 'All Stakeholders': customers, staff, suppliers, communities and long-term value for shareholders.[21]

> While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders. We commit to:
> - Delivering value to our customers. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations.
> - Investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.
> - Dealing fairly and ethically with our suppliers. We are dedicated to serving as good partners to the other companies, large and small, that help us meet our missions.
> - Supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.
> - Generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate. We are committed to transparency and effective engagement with shareholders.
> Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country.

Corporate governance requirements are being amended to require companies to adopt a clear relationship between the concepts of purpose, values and culture. The OECD has specified:[22]

The purpose of corporate governance is to help build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies.

The UK's 2018 revision of its *Corporate Governance Code* said:[23]

Companies do not exist in isolation. Successful and sustainable businesses underpin our economy and society by providing employment and creating prosperity. To succeed in the long-term, directors and the companies they lead need to build and maintain successful relationships with a wide range of stakeholders. These relationships will be successful and enduring if they are based on respect, trust and mutual benefit. Accordingly, a company's culture should promote integrity and openness, value diversity and be responsive to the views of shareholders and wider stakeholders.

Thus, the organisation's purpose is achieved through the alignment of its values, strategy and culture, all of which must be confirmed by its board.

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[20] *Growth Duty: Statutory Guidance. Statutory Guidance under Section 110(6) of the Deregulation Act 2015* (Department for Business, Energy & Industrial Strategy 2017) para 2.2.
[21] www.opportunity.businessroundtable.org/wp-content/uploads/2019/09/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures-1.pdf
[22] *G20/OECD Principles of Corporate Governance* (OECD, 2015).
[23] *The UK Corporate Governance Code* (Financial Reporting Council, July 2018).

This convergence and mutual adoption of shared objectives of public and private organisations in the regulatory space is the basis on which a fully cooperative approach can operate between them. It should improve outcomes and increase the achievement of good outcomes for all. It is based on ethical values and shared principles, goals, relationships and modes of working.

## 4.3 Outputs, Outcomes and Impacts

Sophisticated regulators focus not on compliance or outputs but on outcomes and impacts.[24] These terms have been defined as:[25]

Outputs are the direct product of an activity and typically are tangible and countable. Outputs generally refer to what is being done or what is being produced.

Outcomes are the intended and unintended results and consequences of your activities, and tend to be categorised into short-, medium- and longer-term results. In this context, impacts are considered to be long-term outcomes with a wider impact on the community or environment. They include changes in economic and financial conditions, in social conditions (e.g. reduced violence or increased cooperation) or in environmental and political conditions (e.g. participation and equal opportunities).

Impacts are the strategic, long-term, permanent, and hopefully positive, consequences that a regulatory regime has delivered. Impact is the fundamental criterion by which the regime should be judged. Those responsible for the regulatory scheme should periodically evaluate it to determine what has changed, for the better or worse, as a result of the regime, and see whether it needs to be revised (regulatory evaluation).

Regulatory objectives are traditionally about *protection* of society—from particular harms, such as physical or economic harms, which frequently involve maintaining the quality of goods or services delivered (such as electrical safety aspects or standards of education services). Legislators and regulators should set clear objectives for a regulatory regime, which should lead to specifying particular impacts and more detailed outcomes. Measuring attainment of regulatory objectives and impacts through regulators' outputs (such as numbers of inspections, or fines imposed) is inadequate.

However, as noted above, it should be part of the objective or a regulatory regime to attain a desired level of protection whilst simultaneously *balancing* the achievement of a sustainable and competitive market and the *growth* of ethical businesses within it. This involves balancing the cost of protection with the benefits delivered by business—the concept of proportionality. Ensuring that objective, balanced and proportionate evaluations are maintained may involve a regulator to be  one actor amongst wide-ranging discussions with stakeholders.

A good and practical example of objectives and outcomes relevant to human society irrespective of geographic or sectoral difference are the sustainable development goals (SDGs) established by the United Nations.

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[24] The goal of achieving outcomes is specified in *Regulatory Futures Review* (Cabinet Office 2017); Sir Michael Butler, *Delivering better outcomes for citizens: practical steps for unlocking public value* (HM Government, 2017); *Primary Authority: Statutory Guidance* (Department for Business Energy and Industrial Strategy 2017), para 1.27.

[25] 'Impacts and Outcomes Toolkit: Summary' (Local Better Regulation Office, 2010).
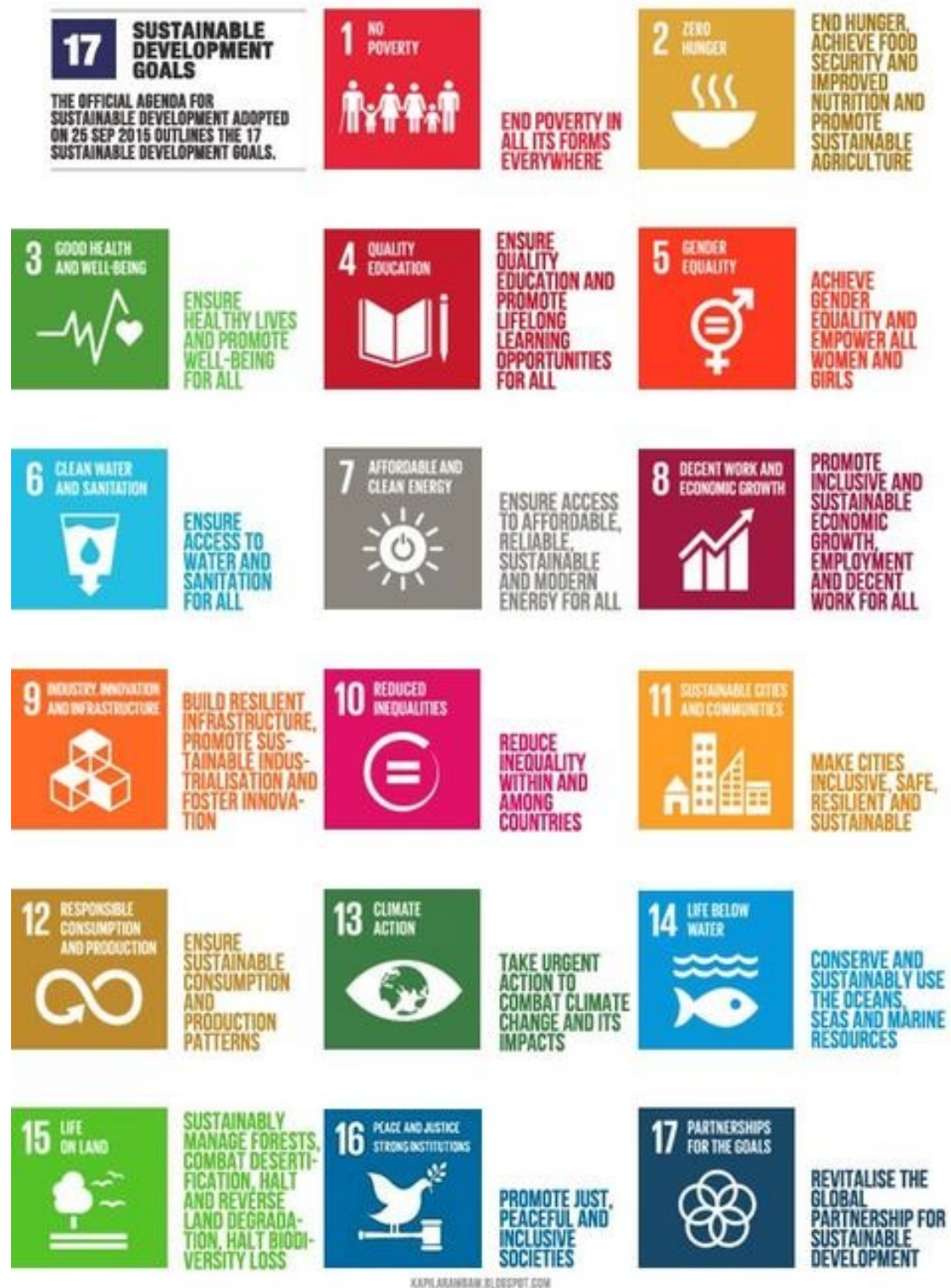
The essential objective of the system of interactions is to optimise 'good' outcomes and impacts, that is, decisions, actions and outcomes that conform to the prevailing ethical values and minimise the converse. This involves:

1. Consensus on the fundamental ethical principles and values.
2. A system that values decisions being made in accordance with those ethical principles and values.
3. Wide perception that such a situation is operated.

## 4.4 Ethical Business Practices and Regulatory Objectives

The concept of regulating through culture using EBP and EBR leverages the ethical values shared by most humans and aligns these with organisational objectives. The statement of the purpose, objectives and desired outcomes of the regulatory regime, the regulator and individual businesses is an essential step.

Key lines of inquiry when developing regulatory objectives based on ethical business practices may include:

- What mechanisms exist for setting regulatory objectives?
- Do the mechanisms involve all stakeholders?
- What level of alignment or conflict is there between the objectives of different stakeholders, such as those of business, investors, workers, the state, customers, suppliers, communities, the planet?
- What mechanism exists for the resolution of any conflicts?
- How serious are the conflicts and what steps should be taken to address them? What changes should be made?

## 5. ESTABLISHING AND SUSTAINING ETHICAL BUSINESS PRACTICE

The critical regulatory 'tool' is to encourage regulated entities to produce evidence that they can be trusted,[26] and their culture is ethical. The models used here are for a business (and the regulators) to adopt Ethical Business Practice (EBP) and for the level of trust thereby generated between business and regulator to give foundation for a relationship that is strong enough to be characterised as Ethical Business Regulation (EBR).[27]

EBP is the starting point, and is equally valuable for commercial success and market health as for regulatory objectives. The essence of EBP is that a business strives to create and maintain a culture (or set of sub-cultures across a large organisation, perhaps differing in different functional or geographical areas) that is based on ethical values and produces all relevant evidence of this over time. Two Frameworks are specified for EBP: a Cultural and Leadership Framework and a Values-based ethics and compliance framework, which is now referred to as a Values-Based Integrity Framework although it includes elements associated with "compliance". EBP is not about perfection. It refers to a genuine, holistic and consistent effort to implement ethical business practices that maximise the ability of people to do their jobs and "do the right thing". The elements of EBP are aspects of achieving an effective ethical culture.

Leading businesses are increasingly focusing on ethical cultures as a fundamental mode of organising their activities. One aspect is the adoption of social purpose.[28] A second element is the adoption of practices that will create 'no blame' open cultures, which have been shown to be essential in achieving the safety of high-risk activities involving multiple actors and organisations, such as safety in civil aviation.[29] All of this must be underpinned by consciously identified values specific to that organisation.

An EBP organisation will:
(a) have a clear and inspiring social purpose that motivates its people and drives its culture;
(b) be based on ethical values, as identified through a process of assessment and consultation with all staff (and potentially also other stakeholders);
(c) aim to provide long-term sustainability and stability (unless the nature of the business, e.g. a start-up, dictates otherwise, in which case this should be made clear);
(d) aim to deserve the trust of all stakeholders (owners, staff, suppliers, customers, communities, society, states);
(e) produce adequate evidence that supports such trust, on a transparent, consistent, ongoing and adequate basis;
(f) involve all stakeholders in discussions on the nature, operation, performance, culture and outcomes achieved by the organisation.

The EBP model builds on maximising the ability of an organisation to consider what its internal and external relationships are based on, and demonstrate, positive values in each of

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[26] See *Strengthening Trust in Business. OECD Business and Finance Outlook 2019* (OECD, September 2019).

[27] C Hodges and R Steinholtz, *Ethical Business Practice and Regulation: A Behavioural and Values-Based Approach to Compliance and Enforcement* (Hart, 2017).

[28] *The UK Corporate Governance Code* (Financial Reporting Council, July 2018); *Principles for Purposeful Business. How to deliver the framework for the Future of the Corporation* (The British Academy, 2019).

[29] 'Open and just cultures' are the foundation of civil aviation safety. See also *Strengthening Trust in Business. OECD Business and Finance Outlook 2019* (OECD, September 2019).

the seven levels of the maturity of an organisation.[30] The Seven Levels of Organizational Consciousness Model (see below) was developed in 1995 by Richard Barrett[31] based on Abraham Maslow's hierarchy of needs[32] as a way of mapping the consciousness of leaders, organisations and communities. It became the basis for a cultural measuring system known as the Cultural Transformation Tools (CTT) which has been used globally to map values and measure their distribution across all levels of needs that an organisation or group must master in order to achieve its potential and serve its stakeholders. The first three levels focus on the basic needs of business; the fourth level is focused on growth, change and adaptability and the focus of the upper levels is on the common good. The common good is characterised first by organisational cohesion, the ability to build mutually beneficial alliances and partnerships and to safeguard the well-being of society and the planet.[33] This mapping then forms the basis for a conscious programme of culture change towards a desired set of values and behaviours underpinning a healthy culture.

**7 Levels of Organizational Consciousness Model**

| | |
|---|---|
| **Service** | **Service to Humanity and the Planet** <br> Social responsibility, future generations, long-term perspective, ethics, compassion, humility |
| **Making a Difference** | **Strategic Alliances and Partnerships** <br> Environmental awareness, community involvement, employee fulfilment, coaching/mentoring |
| **Internal Cohesion** | **Building Internal Community** <br> Shared values, vision, commitment, integrity, trust, passion, creativity, openness, transparency |
| **Transformation** | **Continuous Renewal and Learning** <br> Accountability, adaptability, empowerment, teamwork, goals orientation, personal growth |
| **Self Esteem** | **High Performance** <br> Systems, processes, quality, best practices, pride in performance, bureaucracy, complacency |
| **Relationship** | **Employee Recognition** <br> Loyalty, open communication, customer satisfaction, friendship. manipulation, blame |
| **Survival** | **Financial Stability** <br> Shareholder value, organisational growth, employee health, safety, control, corruption, greed |

The presence of fear-driven values and behaviours in the levels related to financial stability, relationships and high performance (Levels 1-3 below) is due to the inability of the organisation to meet their basic needs and will ultimately undermine the organisation's culture and performance. Barrett calls this dysfunction Cultural Entropy, and explains that it the amount of energy expended by employees doing unnecessary work or unproductive work- the amount of conflict, friction and frustration…that prevent them from meeting their needs and the organization from achieving peak performance.[34] It can also be thought of as culture

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[30] R Barrett, *The Values-Driven Organization: Cultural Health and Well-Being as a Pathway to Sustainable Performance,* 2nd ed (Routledge, 2017).

[31] Ibid, 63 n28.

[32] AH Maslow, *Motivation and Personality* (Harper Collins, 1987); *Toward a Psychology of being* 2nd ed (New York, Van Nostrand Reinhold, 1968); *The Farther Reaches of Human Nature* (Penguin/Arkana, 1993).

[33] Barrett, above, 68.

[34] Barrett, above, 16.

risk. Culture risk enhances the ability of people to rationalise unethical behaviour and therefore must be minimised. One can measure the extent of culture health vs. culture risk using CTT to gain insight into the forces operating in the culture. It is then possible to take targeted action to minimise culture risk, track progress over time and provide evidence of commitment to an effective ethical culture. For that reason, Ruth Steinholtz, working together with the Barrett Values Centre, has applied the Seven Levels Model to EBP as a means of illustrating the values and behaviours that can promote or inhibit the development and maintenance of an ethical culture.[35]

# 7 Levels of Ethical Business Practice

**SERVICE**
Service to Others, Humanity and the Planet, Ethics, Human Rights, Social Responsibility, Long-term Perspective, Compassion, Humility, Wisdom

**MAKING A DIFFERENCE**
Strategic Alliances and Collaborative Partnerships, Making a Difference, Sustainability, Collective Action, Employee Well-being (physical/emotional/mental/spiritual)

**INTERNAL COHESION**
Building Internal Community, Integrity, Shared Values, Shared Vision, Honesty, Fairness, Trust, Commitment, Leading By Example, Transparency, Openness, Meaning and Purpose, Clarity, Humour/ Fun

**TRANSFORMATION**
Continuous Improvement and Learning, Accountability, Information Sharing, Risk Taking, Equality, Diversity, Empowerment, Courage

**SELF–ESTEEM**
High Performance, Pride, Brand Image, Compliance Systems and Processes, Discipline and Enforcement, Policies and Procedures, Due Diligence, Ambition, Bureaucracy, Silo Mentality, Long-hours, Shame, Power, Information Hoarding, Complacency, Wilful Blindness

**RELATIONSHIP**
Harmonious Relationships, Open Communication, Care, Respect, Listening, Loyalty, Manipulation, Empire-Building, Being Liked, Blame, Bullying/Harassment, Conflict Avoidance

**SURVIVAL**
Financial Stability, Results Orientation, Caution, Health & Safety, Licence to operate, Job Security, Profit, Insecurity, Short-Term Focus, Greed, Corruption, Control, Exploitation

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In addition to values that enhance the development of an effective ethical culture such as integrity, honesty, fairness, respect, continuous improvement and courage, there are values that detract from it. The obvious ones are greed and corruption, however others may act to create fear, wasted energy or frustration and thereby increase unethical conduct due to the ability to rationalise such behaviour. Also, certain values, such as loyalty, have the potential to result in either ethical or unethical behaviour. For example, one might lie for a friend out of loyalty rather than being honest to one's employer. Values must be consciously nurtured and clearly defined. Organisations must be vigilant also for clashes between positive values (e.g. family vs. professionalism) and not blame individuals caught in dilemma; but rather provide the opportunity for people to openly discuss and learn about the role values play in their lives.

If an organisation wishes to be trusted, it should produce, over time, adequate and consistent evidence that that its intentions and outcomes are ethical. Satisfactory evidence should be generated with regard to all aspects of EBP and in general given to the following aspects:[36]

1. What evidence shows the presence or absence of ethical purpose?

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[35] P Clothier and R Steinholtz, '7 Levels of Ethical Business Practice' at www.valuescentre.com/resource-library/ethical-business-practice/

[36] See C Hodges and R Steinholtz, *Ethical Business Practice and Regulation: A Behavioural and Values-Based Approach to Compliance and Enforcement* (Hart, 2017), Appendix 1 'EBP in Organisations'.

a. Purpose beyond profit
b. Governance framework
c. Self- interest or common good regarding?
d. Actions and outcomes that are intentional or unintentional?

2. What factors affect the focus of individuals and groups on these purposes, ethical goals and good/bad outcomes?
   a. Beliefs, values – education, reminders?
   b. Leading by example by leadership at all levels.
   c. Awareness of others and their views – exposure to diversity and channels for listening and communication?
   d. Awareness of ethical considerations, of potential conflicts of interest, of possible consequences of proposed actions, of targets, incentives or factors that may produce undesirable outcomes?

3. What structures, systems, procedures affect actions?
   a. Are internal management and operational systems aligned and consistent with external ethical and regulatory requirements?
   b. What can prevent bad actions? Time to reflect; ethical decision making models, opportunity for challenge; AI …
   c. What happens when things go wrong, or unintentional outcomes or harm is caused? What investigation and accountability occurs?

4. What aspects of national and organisational culture affects attitudes and actions?

The basic distinction is between organisations and acts that are intentionally and unintentionally unethical. The focus is both on the former to support improvements and on the latter so as to reduce incidence of adverse outcomes.

Behavioural science has made much progress in recent decades in identifying human characteristics, cognitive biases and other factors that influence behaviour. The chart below summarises in the column marked 'Risk' the factors identified by behavioural and scientific research that adversely affect unintentional ethical actions. The column marked 'Policy' summarises the approach that would tend to promote maximisation of ethical decisions and outcomes, and to avoid the identified risks. The scientific findings have been grouped into the following categories:
(a) The existence of an ethical basis and purpose for the organisation
(b) The personal characteristics of actors and decision-makers
(c) The decision-making environment and processes
(d) The social environment

| | Risk | Policy |
|---|---|---|
| | Ethical basis | |
| 1 | Lack of consensus on the fundamental ethical principles and values. | Widely consult, debate and agree the fundamental principles and values (of the organisation – in the context of those of the society in which it operates). Ensure new joiners are consistent with these values and that promotion is based on living the values as well as achieving financial results and is perceived to be so. |
| 2 | Absence of a system that supports decisions being made in accordance with those ethical principles and values. | Operate under an EBP framework, including promoting the use of an EDMM in an environment where decisions are |

| | | examined from diverse perspectives. |
|---|---|---|
| 3 | Lack of perception that such a situation is operated. | Regularly assess culture and measure and evaluate EBP. Tolerate feedback to highlight senior leaders leading by example. |
| | **Actors & decision-makers** | |
| 4 | Lack of awareness/consciousness that an ethical issue arises, or that an action is wrong. | Leadership and personal development to promote self-awareness, leadership consciously raising ethical dilemma/aspects and education and scenario-based training, including in business ethics.<br>As part of 'on-boarding' and ongoing as part of normal modus operandi (including risk based CPD). |
| 5 | An individual with lack of emotional or ethical balance. Inability to feel guilt or embarrassment. Lack of mental balance. | Recruitment based upon core values. Screening of hires, allocation of personality types to appropriate jobs. Early intervention where indications of problems arise. Support for people with difficulties. |
| 6 | An individual (or group) with lack of self-belief or motivation. Anxiety or lack of security: emotional (self-esteem, personal problems) or financial. Lack of encouragement or support. Moral disengagement. | Leadership excellence. Leadership and professional development widely available. Feedback and transparency – early intervention where issues exist. Motivate, and support colleagues and staff.<br>Recognise good practice and engagement. Moral disengagement occurs when there is a do/say gap. Foster fairness and leading by example. |
| 7 | Lack of belief that ethical conduct is expected or valued; that what you do does not matter; that what you do will not have any adverse consequences or will not be detected and called out so as to embarrass you. | Wide consultation on values, cultural measurement and assessment to spot issues; demonstrate consistently that ethics is everyone's responsibility, all the time. Leaders and managers raise issues at team meetings and avoid blame, but show that people are accountable – just culture.<br>Have an Integrity Function and a network of ethics ambassadors. |
| | **Decision-making environment and processes** | |
| 8 | Complexity of decision-making in rule dimensions or process. Lack of clarity of the desired purposes/outcomes. | Simplify rules and decision-making processes.<br>Wide consultation to determine intentions and statement of ethical purpose and values. Clarify and communicate expected outcomes consistently. |
| 9 | Lack of perception of fair, predictable and proportionate processes and climate. | Develop and honour fair, predictable, proportionate and transparent processes.<br>Remuneration that is fair intrinsically and by differentiation (limited multiplier between top and bottom). |
| 10 | Crowding out ethics: imposing targets that drive short-term or biased decision-making and goals, e.g. output or financial goals. | Achieve performance management including the how and not just the what, based on stated values. Understanding |

| | | among leadership of how ethical considerations can be crowded out by targets: set realistic targets; review processes for making critical decisions.<br>Pay not based solely on outcome targets. Pay incentives that do not distort consideration of ethical practice. No bonuses based only on individual achievement or share price. |
|---|---|---|
| 11 | Anchoring. Actions influenced by inadequate information. | Institutionalise asking what we don't know and information we don't have. Glorify the 'I don't know zone!' Simple processes for getting information. Structures that are clear, simple, and non-bureaucratic. |
| 12 | Framing of decisions. Decision-making and risk assessment dominated by evaluation of costs and benefits from sole or limited viewpoints (e.g. financial, business or team).<br>Lack of understanding of the impact of adverse consequences. | Institutionalise consideration of decisions from multiple viewpoints: create Ethical Decision Making Models. Especially being aware of an imbalance between loss and gain frames.<br>Undertaking adequately wide impact assessment consultation and modelling. Reduce 'moral distance'. |
| 13 | Lack of time to think, hence acting on impulse. | Prioritise thinking about the long term. Do not foster long hours culture. Work to eliminate unnecessary and low-value work. Create opportunities and physical space for contemplation in tasks.<br>Widely publicise the statements of ethical purpose and goals of the society, organisation and group.<br>Defer and refer decisions that raise difficult ethical issues for wider scrutiny, debate and consensus. |
| 14 | An enclosed, dark physical environment. | A light, open, healthy working environment that encourages interaction between functions, teams, etc. |
| 15 | Lack of ability to ask questions, raise concerns, or object. | Constantly work towards an open culture without blame. Leadership and personal development to support managers and leaders to cope with criticism and divergent views.<br>Any hierarchy should be small and open. |
| 16 | Lack of challenge: availability of challenge; openness to challenge; practical assistance to change. | Leadership and personal development that supports managers and leaders in coping with criticism and divergent views. Encourage error reporting. Operate a supportive open culture. |
| | Social effects | |
| 17 | Lack of respect for leaders or colleagues. Favouritism, over-claiming individual credit for group achievements, over-influence of one or more individuals Lack of cohesion of all individuals in a team or organisation. | Choose leaders in accordance with organisational core values in a transparent process. Leadership and professional development available widely to support healthy secure managers and leaders. Leadership and team coaching as required. |

| 18 | Lack of recognition of escalation (slippery slope) effects and lack of objective construction of ethics and risk depending on remoteness from the actor. | Operate review: persons and teams/organisation, including with external reviewers. Involve diverse perspectives, and regularly apply critical thinking across functions. |
|----|----|----|
| 19 | Lack of visible consequences for unethical behaviour. | Operate a Just Culture policy, openly. Praise and champion ethical behaviour. |

The above findings can be grouped into a list of 'dos' and 'don'ts'. But on the 'do' side, they boil down to operating an open and just culture through an EBP framework.

## 5.1 Establishing an Effective Ethical Culture through EBP

There are countless factors that influence the development of an effective ethical culture. Many organisations will already have aspects of EBP embedded in their culture, though they may have different names or have developed in different ways. There is no one size fits all culture and no one way to proceed. Indeed, every organisation will be starting from a different place. The first step therefore is to begin by understanding the current culture, perhaps through a Cultural Values Assessment (CVA, a Cultural Transformation Tool that is well suited to this task.. A CVA is a simple means to ascertain the view of all employees no matter how large the organisation about the current culture and the desired culture that would increase cultural health and therefore decrease Culture Risk. There are many other ways of measuring culture of course; though in the author's opinion none easier to use or better suited to EBP.

In addition, an organisation should perform an assessment of the presence or absence of the elements of EBP. [37] For example, a belief that ethics is everyone's responsibility is fundamental to developing the attitudes, systems and processes necessary in an effective ethical culture.

One thing is clear. In order to have a values-based culture, the organisation must have identified and described its values and integrated those values into all aspects of their operations. Values provide the nourishment in which an effective ethical culture will grow. Without them, or with the wrong values, the level of culture risk will block healthy growth.

Compliance is all too often mistaken for ethics. Compliance is an outcome of an effective ethical culture; one that achieves a balance between systems and processes and values and culture.

Key lines of inquiry when developing effective ethical cultures based on ethical business practices may include:

- What mechanism exists for identifying the core ethical values?
- Is the compliance function small and decentralized and what is it called?
- What values and behaviours do stakeholders experience in practice when working in or interacting with the organisation?
- How do the actions of leaders contribute to or detract from ethical awareness and the realisation of the organisation's values?
- Do managers regularly discuss ethical issues in meetings?

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[37] These are described in chapters 13 and 14 of C Hodges and R Steinholtz, *Ethical Business Practice and Regulation: A Behavioural and Values-Based Approach to Compliance and Enforcement* (Hart, 2017).

- Is there an ethics ambassador or values champion network?
- Is there a Board level ethics/integrity sponsor?
- How much resource is dedicated to developing EBP?
- Is there a clear embodiment and alignment of shared value and social purpose?
- Are leaders supported to develop the skills necessary to promote EBP?
- What level of trust exists between staff and management, and between all other stakeholder groups?
- What evidence is produced to demonstrate and verify the level of trust and existence of a holistic ethical culture?

## 6. A FRAMEWORK FOR REGULATORY AUTHORITIES: THE REGULATORY DELIVERY MODEL

Officials in the UK Office for Product Safety and Standards (OPSS), part of the Department for Business, Energy & Industrial Strategy, have developed a Regulatory Delivery Model (RDM) through working with governments and regulators across the world.[38]

The RDM comprises three *pre-requisites* for regulatory agencies to be able to operate effectively (governance framework, accountability and culture) and three *practices* that agencies need in order to deliver societal outcomes (outcome measurement, risk-based prioritisation and intervention choices). It is not the function of this document to into the RDM in detail but acknowledge it as a foundational framework for EBP and EBR. Instead, this section focuses on providing a broad overview of the RDM and the opportunities within it to create an integrated regulatory framework that is designed to primarily regulating through culture.

These are summarised below.

### A. Pre-Requisites

*Pre-requisites* for regulatory agencies to be able to operate effectively:

1. *Governance Framework* covers the basis on which a regulatory authority is formed, its powers, purpose, structures, the landscape within which it operates, and its powers and responsibilities.

2. *Accountability* covers the relationships and responsibilities of an authority towards its different audiences, what it is accountable for and to whom. It involves transparency and accountability mechanisms.

3. *Culture* covers the culture of the authority, emphasising the shaping features of leadership, values and competency.

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[38] G Russell and C Hodges (eds), *Regulatory Delivery* (Hart, 2019).

## 6.1 RDM Prerequisites – Governance Framework

Governance can be defined as the manner in which control is exercised; the influences over a person or organization; or the ways in which policies are delivered. In the RDM, Governance Frameworks are considered in terms of a regulatory agency's purpose, its structure, its operating landscape, and its powers and responsibilities.

The model set out here recognises that all stakeholders are involved in the governance and operation of the entire system, rather than compliance just being the responsibility of 'regulatees' and enforced by regulators. That shared involvement is illustrated by the figure below, which shows this communal involvement, albeit at differing levels of intensity, illustrated by different shades of blue.[39] The model enables all stakeholders to be involved. Any governance framework set out under this model should be built with this in mind.



Public Risk Management – Multi-Stakeholder Context

NGOs = Nongovernment Organizations
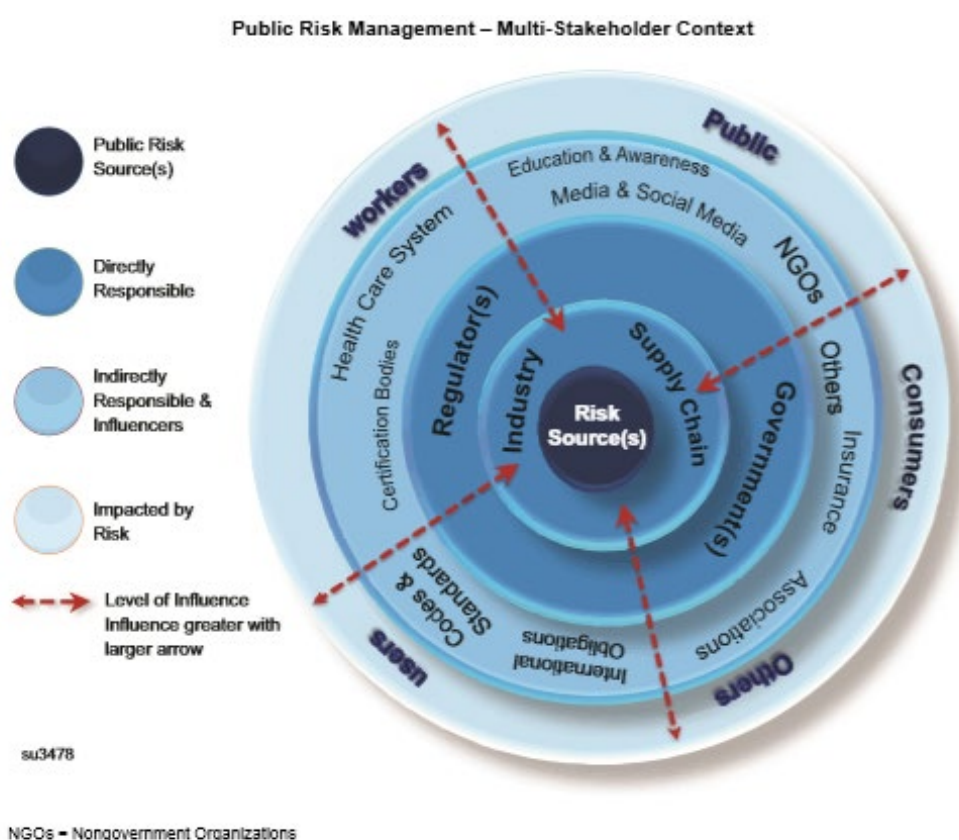
Some key lines of enquiry that should be addressed when building a governance framework would include:

- Clarity and alignment between the regulatory objectives, the purpose of regulatory requirements and of the regulatory agency – The agency should understand and should be able communicate its purpose as not merely being a compliance seeker but a trusted partner and influencer of ethical business practices
- The design and operational structure of the agency – The agency should have decision-making capabilities that are not limited to just inspections and enforcement

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[39] CAN/UL2984:2019 National Standard of Canada: Standard for Management of Public Risks–
Principles and Guidelines (Standards Council of Canada, 2019), Figure 2, p 18.

but include broad range of toolkits that would allow it to become a facilitator of ethical business practices

- Governance landscape – As illustrated in the figure above, the agency should consider the entire system and have a clear understanding of the individual and collective responsibilities of the various actors within the system and especially other regulators
- Powers and responsibilities – The agency should have and be able to use a wide ranging toolkit of regulatory and non-regulatory powers and instruments to primarily facilitate an enabling environment for ethical business practices and with a goal of meeting the set objectives

## 6.2 RDM Prerequisites – Accountability

Accountability is understood within the RDM in terms of the empowerment of stakeholders to participate in the regulatory process and to challenge the regulatory agency. It is seen both as a constraint on the behaviour of the regulatory agency and as an enabler by strengthening the authorising environment through creation of confidence and utilisation of trust. While defining accountability, it is important to consider both what the regulatory agency should be accountable for and to whom they should be accountable. With respect to the latter, the RDM presents a simple representation of the accountability relationships between the key stakeholders of the system as shown in the figure below.
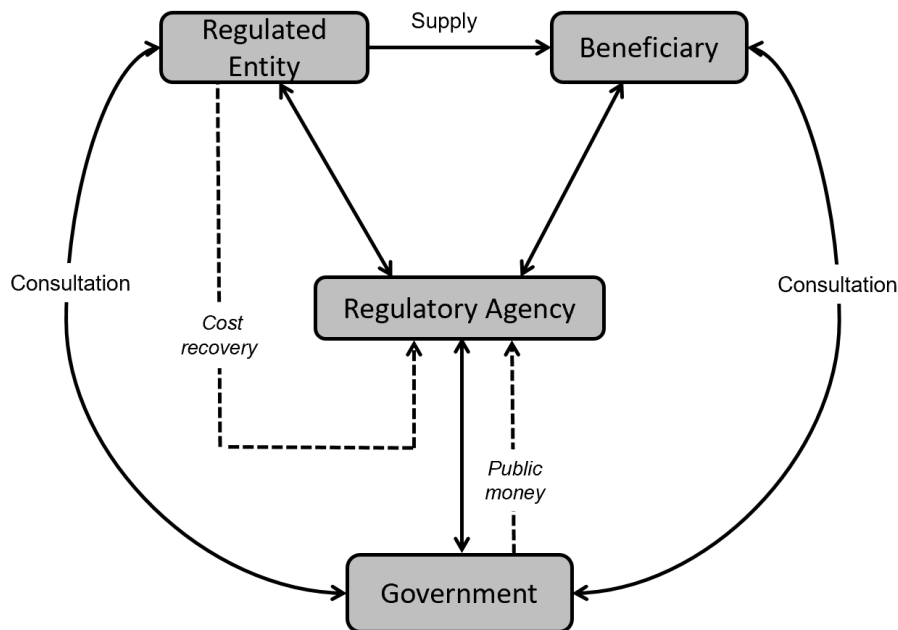


Key lines of inquiry that need to be considered by a regulatory agency while building accountability frameworks in our proposed model include:

- Appropriate measures that demonstrate transparency of its functions and processes and that builds confidence and trust amongst its stakeholders
- Effective mechanisms that enable the regulated entities, governments and other stakeholders of the system to hold the agency accountable

## 6.3 RDM Prerequisites – Culture

Culture is considered within the RDM as a collective understanding and purpose that manifests itself in the visible behaviour of the regulatory agency. It will determine how the regulatory agency will respond to the forces of governance and accountability and support improvement.

The regulatory agency should, at a minimum, be able to establish, implement and demonstrate all the applicable ethical principles and standards described in the previous section as they pertain to ethical business practices and address the following key lines of inquiry:

- The agency's leadership should demonstrate the competence and capability of not only implementing EBP internally but in administering similar expectation of its regulated entities
- The agency's values are aligned externally with the regulatory objectives and internally with its pre-established principles and standards
- The agency's learning and development strategies are proportional to its purpose and that promotes a culture that focuses on the desired outcomes

### B. Practices

*Practices* that agencies need in order to deliver societal outcomes:

4. *Outcome Measurement* covers the need to identify the outcomes on which the agency is focused and to monitor and report against them.

5. *Risk-based Prioritisation* is the mechanism for allocating (scarce) resources to priority areas at strategic, operational, tactical and targeting levels, using risk as the 'currency of regulation'.

6. *Intervention Choices* involves the ability to select and implement appropriate means to mitigate risks including through understanding of the awareness, capability and motivation of the regulated and of the beneficiaries.

## 6.4 Outcome Measurement

The concept of outcomes has been discussed earlier in the section on "Regulatory Objectives".

Measures such as the number of inspectors; inspection levels or frequencies; the numbers of prosecutions or other sanctions; when taken as proxies for outcomes, have a perverse effect. They encourage a focus on quantity over quality and incentivise poor choices.[40]
The OECD, in its best practice principles for regulatory enforcement,[41] suggests that 'improvements in the number of businesses that are "broadly compliant" with the requirements should be used only as a complement to outcome indicators'.

The UK Office of Product Safety and Standards provides an example of a logic modelling approach for measuring outcomes and impacts as shown in the figure below.

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[40] G Russell and H Kirkman, 'Outcome Measurement' in G Russell and C Hodges (eds), *Regulatory Delivery* (Hart, 2019).
[41] 'Regulatory Enforcement and Inspections, OECD Best Practice Principles for Regulatory Policy' (OECD, 2014).

| Inputs | Activities | Outputs | Outcomes | Impacts |
|---|---|---|---|---|
| Legal mandate: Powers to enforce | Advice and guidance activities | Information and guidance documents | Improved compliance | Stronger market for 'sustainable' timber |
| Competent staff | Developing compliance tools for businesses | Tailored advice delivered | Confidence and certainty in business community | Reduced illegal logging and deforestation |
| Technical expertise | Training businesses | Businesses trained | A level playing field for UK businesses importing timber | Improved governance in timber supplying countries |
| Funding | Verifying licences for timber imports | Licenced timber enters the country | More responsible business practices in sourcing timber | Conservation and safeguarding of biodiversity |
| Data and intelligence | Inspections and other checks on compliance measures | Sanctions for non-compliance | Consumer confidence in UK timber products | Reductions in CO2 emissions |
| | Receiving allegations of non-compliance | Regulatory reports | | |

Australian Regulator Performance Framework key performance indicators:

1. Regulators do not unnecessarily impede the efficient operation of regulated entities
2. Communication with regulated entities is clear, targeted and effective
3. Actions undertaken by regulators are proportionate to the regulatory risk being managed
4. Compliance and monitoring approaches are streamlined and coordinated
5. Regulators are open and transparent in their dealings with regulated entities
6. Regulators actively contribute to the continuous improvement of regulatory frameworks

Whatever be the approach selected by the regulatory agency, the key lines of inquiry should consider:

- Impacts and outcomes that are appropriate for the set regulatory objectives
- Measure the culture of the regulators and regulated entities
- Measure its direct and indirect impact on the performance of the regulated entities
- Reflect the entire regulatory systems

## 6.5 Risk Based Prioritization

Risk is defined as combination of the probability of harm and severity of harm (ISO Guide 51). Regulatory agencies are generally understood to be the overseers and custodians of public risk. Public Risk - the full range of potential public harms, arising from voluntary or involuntary activities, from which the public expects protection (UL 2984).

Private and public assets and/or services (public risk sources) create public good intended to provide benefits. However, they may also pose a risk of causing harm (s) to the public and/or other impacted public risk stakeholders. Public goods provide benefits that are either shared by some or many members of the public or individual organizations. Public risks pose harms to individuals or organizations who may not be the same organizations or individuals who receive the public good. Society acknowledges acceptable public risks and tolerable public risks, based on perceived or actual benefits, while fully knowing that all activities carry some risk. A level of public risk associated with a public harm may be tolerable to society in one context or circumstance, but intolerable in another context or circumstance. The figure below from UL 2984 illustrates this balance.
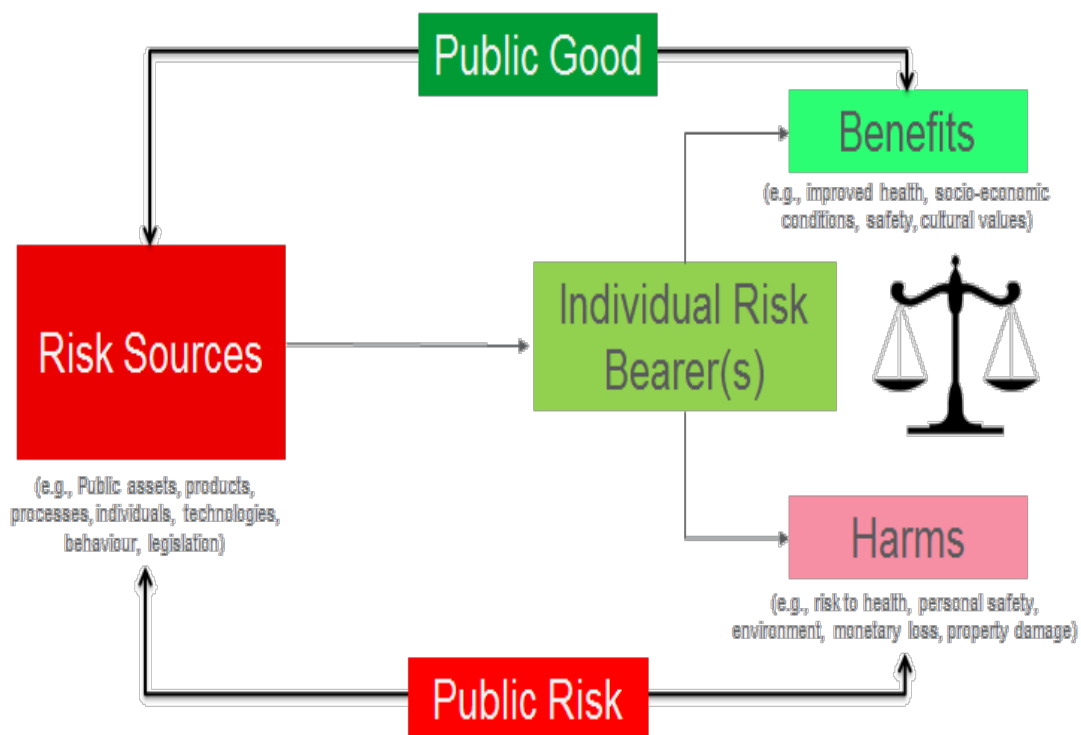


Organizations such as regulatory agencies whose primary responsibility is public risk management should demonstrate that their resources are focused on addressing identified public risks for which they are responsible.

Risk Assessment should be used by regulatory agencies:

   (a) In determining priorities between regulatory areas.
   (b) In determining regulatory priorities within a regulatory area.
   (c) In determining, in relation to the regulatory priorities identified, the individual regulated entities, premises or activities that should be targeted at an operational level.
   (d) In being clear, at the level of an individual regulated entity or premises, where the focus of any checks on compliance should be.

Risk Assessment is fundamentally reliant on the use of good-quality and relevant information. Within RDM, the examination of the practice of risk based prioritization involves a careful consideration of how regulatory agencies are gathering, accessing and analyzing data, information and intelligence in order to make informed assessments of regulatory risk at all levels.

6.5.1 Culture Risk

Culture risk is the likelihood that individuals and teams in a business will behave ethically (or not) and as discussed in Section 5 can arise in many ways. This is relevant not just on a daily basis in a 'steady state' but especially when the circumstances give rise to pressures on the humans or organisation involved, such as financial distress or to obtain what is perceived to be a short-term gain at the risk of unethical action and possibly long-term damage.

Several methods for risk assessment are available and are being used by regulatory agencies worldwide but when applying it to the proposed model, some of the key lines of inquiry should:

- Include evidence and data that measures "culture risk" and that reflects the culture and business practices of the regulated entities and their impact on both the components of risk (likelihood and consequence)
- Involve analysis that represents an appropriate balance of compliance risk and culture risk
- Account for the presence and effectiveness of not only its own intervention choices but also those of the regulated entities
- Assess the amount and types of "Cultural Entropy" or dysfunction in the organisation.

## 6.6 Intervention

The regulatory agency, being clear on its outcomes and having decided where to direct its resources, faces a decision on how best to use them. *Intervention choices* involves the ability to select and implement appropriate means to mitigate risks including through understanding of the awareness, capability and motivation of the regulated and of the beneficiaries. Used effectively this enables a new breadth of potential resolutions which empower action and multiply impact.

The task of regulatory agencies, while often expressed in terms of mitigating risk or ensuring compliance with regulation, is fundamentally about *changing the behaviour* of regulated entities. While some agencies do have direct authority to mitigate risks themselves, even in these cases most of their impact is achieved by changing the way others act. Behaviour of regulated entities matters not just because it determines compliance and non-compliance but because it contributes to wider outcomes of reducing regulatory risks.

The primary question for a regulatory agency is therefore what it can do that will be most effective in delivering the desired behaviour change amongst those it regulates. A secondary question of relevance to many regulatory agencies will be what else they can do that will contribute to risk reduction.

A regulate who practices EBP, and relates to the regulatory agency through an EBR relationship, should be motivated to work spontaneously, and with the agency, to do the right thing, so that formal intervention may be unnecessary. The most efficient intervention by an authority is where a business volunteers, or agrees, to make changes to prevent occurrence of harm and to reduce future risk. This spontaneous behaviour can be incentivised and

encouraged by an agency adopting policies based on cooperation and ethical behaviour, such as making clear in a published enforcement policy that certain behaviour will be considered as mitigating factors (or conversely, aggravating factors) in considering interventions and sanctions. It can also be institutionalised in relationships and agreements, such as under the Primary Authority scheme discussed below.[42]

An important issue to determine is the reason for non-compliance as this will drive selection or design interventions that are appropriate to the circumstances. An example of reasons and relevant interventions is:
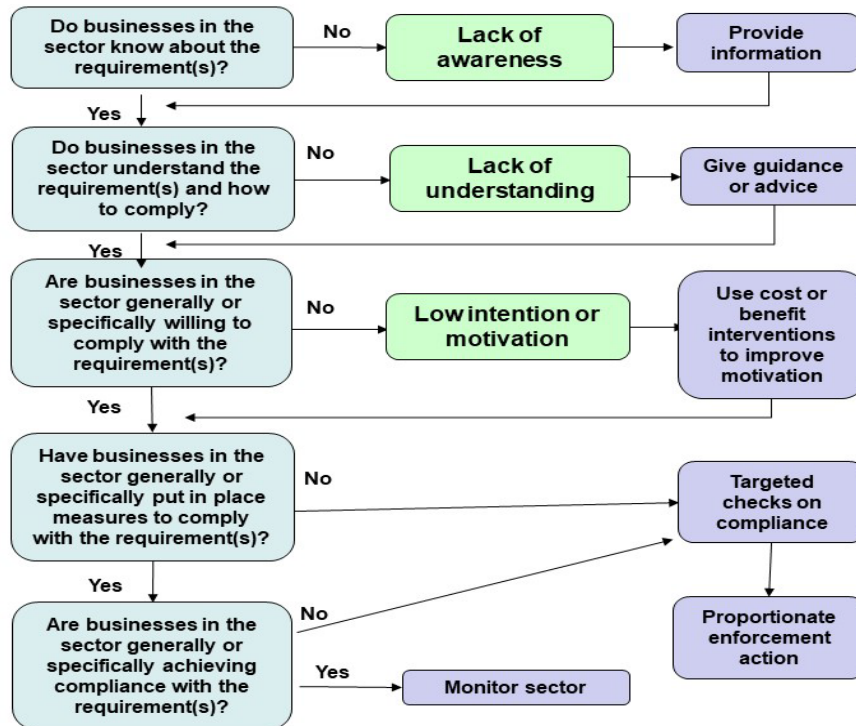


Some lines of inquiry are set out above under each of the six elements.

The following sections of this paper describe an approach to creating an integrated RDM that achieves the defined regulatory objectives by regulating through culture and by using principles of EBP and EBR.

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# 7. AN INTEGRATED FRAMEWORK FOR REGULATING THROUGH CULTURE: ETHICAL BUSINESS REGULATION (EBR)

On the basis that *both* businesses and regulators have accepted the need for them to operate their organisations on an ethical (EBP) basis, how should they inter-relate? A framework for 'regulating through culture' on the basis of the Ethical Business Regulation (EBR) model is as follows.

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**Ethical Business Regulation**

A relationship between a business, or a group of businesses, and a regulator, or group of regulators, in which the business produces evidence of its on-going commitment to Ethical Business Practice and the regulator recognises and encourages that commitment.

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EBR is an open relationship of trust between businesses and regulators built on evidence that both sides can be trusted and that each will, unless evidence to the contrary occurs, treat each other with respect in openly and fully cooperating to regulate risk and commercial behaviour in accordance with the fair rules of their society.

What evidence should such a relationship be based on? *Both* sides should produce adequate and ongoing evidence of their intentions, activities and outcomes. The nature of such evidence will differ from sector to sector and as organisations mature.

The essence is for parties to 'Do the right thing' and demonstrate that they intend this, are capable of doing this, and achieve it. The approach is based on creating an effective ethical culture based upon values and consistently reinforcing and applying those values.

The model moves beyond demonstrating compliance solely with regulatory rules. The requirement is for all parties to achieve compliance with *ethical* requirements. Legal regulatory requirements might not cover everything, or may give rise to inconsistencies, or even be unethical themselves.

Determining what the 'right thing to do' is in a particular situation requires constructive inquiry and debate through open conversations between all stakeholders. This will involve fair, honest and open feedback, without seeking to impose blame for actions, but where consequences follow identification of problems.

The ideal is for the regulator to adopt the RDM based on ethical values, and for the commercial organisation(s) to adopt EBP. As discussed above, the RDM comprises three *pre-requisites* for regulatory agencies to be able to operate effectively (governance framework, accountability and culture) and three *practices* that agencies need in order to deliver societal outcomes (outcome measurement, risk-based prioritisation and intervention choices). The same pre-requisites should apply to businesses, as should the three practices, suitably modified.

The components are to establish relationships based on trust through the following characteristics:

- *A shared commitment to ethical values*. The overwhelming motivation of a public official should be to achieve outcomes that secure the general public good. That of businesses

should be to serve a societal purpose and to do so ethically: that involves a shift away from an idea that the sole goal of corporations is to maximise shareholder value.

- *A healthy organisational culture.* A culture where individuals can thrive, bring their ethical values to work and feel pride in their work and that of their organisation in alignment with its societal purpose.

- *Evidence.* Both regulators and businesses need to produce convincing evidence that they can be trusted, consisting not just of claims to that effect but of evidence of their actions and behaviour. In companies, this has to demonstrate that shared ethical values are placed above short-term profit maximisation and that the manner in which results are achieved is as important as the results themselves in evaluating performance.

- *Constructive engagement.* Regulators and businesses that operate on this basis have to work together within the relationship of trust in resolving problems—especially difficult ones. This involves sharing information and issues within the regulatory relationship, so that potential problems may be discussed *ex ante* and problems that have emerged be fairly resolved *ex post*. It must be a relationship that involves an open and full flow of information. If that is to be sustainable, the relationship has to avoid blaming each other, as has been found to be essential in civil aviation safety. However, it also must be based on mutual respect, such as for the authority of the regulator and the expertise of both sides. The regulator retains ultimate authority as representative of the people and public good, and may challenge commercial actions. Particular issues should ideally be resolved by discussion, based on the shared values, principles and objectives, and solutions published as guidance (thereby in due course enabling unnecessary legal rules to be thinned out and replaced by guidance that can be developed and fine-tuned more quickly).

- *Understanding.* Each side—both business and regulators—needs to understand the context in which each operates and *how* each other works. This should cover an appreciation of what problems each faces in practice, and how improvements are to be made. It responds to realities. It is not possible to solve all problems instantly. A direction of travel needs to be set, and evidence of movement in addressing challenges has to be shown. A regulator who never talks to or visits companies to see how they operate will not be able to understand what is possible nor will it be able to avoid unintended consequences. Mere inspection here does not go far enough. The dialogue has to be open and full on both sides if real challenges are to be identified, so that they can be discussed and addressed.

- *Transparency.* The actions and outcomes of both regulators and those subject to regulation must be open to scrutiny by the communities that they serve. This is to guard against arbitrariness, capture, corruption and a disengagement of the internal deliberations from the ethical consensus of the wider community. Mechanisms of governance, contribution to ethical debate, scrutiny and societal supervision are necessary.

It can be seen that those public authorities that consider themselves only to have enforcement functions, rather than being regulatory authorities, will face a more difficult challenge in optimising the number of successful outcomes. This is for two reasons: first, the enforcement mode is likely to be a traditional approach based on sanctions and deterrence; second, they face difficulties in building relationships with those whose behaviour they seek to influence (and may not see the need to do so). Two strategies may assist here: first, the adoption of EBP by both authorities and businesses and, second, piggy-backing onto an EBR relationship established with businesses by one or more other key regulators.

**7.1 An Example of a Structure: The Primary Authority Model**

Examples of successful regulator-regulatee relationships can be seen in many sectors. Each have individual characteristics. One example of a highly successful approach is the UK Primary Authority (PA) scheme. [43] This provides a structure for formal cooperation agreements between businesses, Local Authorities and some national regulatory authorities. It provides channels of communication between the contracting parties to identify and resolve issues of uncertainty over law or compliance.

The PA scheme includes the following elements:
1. formal agreements between a lead authority (the Primary Authority) and a business (or trade body);
2. a mechanism for any local authority to raise an issue of compliance or breach first with the PA and then for the PA to raise this with the business, rather than every local authority starting enforcement action itself;
3. a mechanism for the business to raise any issue of interpretation or compliance with the PA, and to receive 'assured advice' with which it should comply, with low risk of being prosecuted.

An illustration of the PA structure is:



THE PRIMARY AUTHORITY SCHEME - DEVELOPED
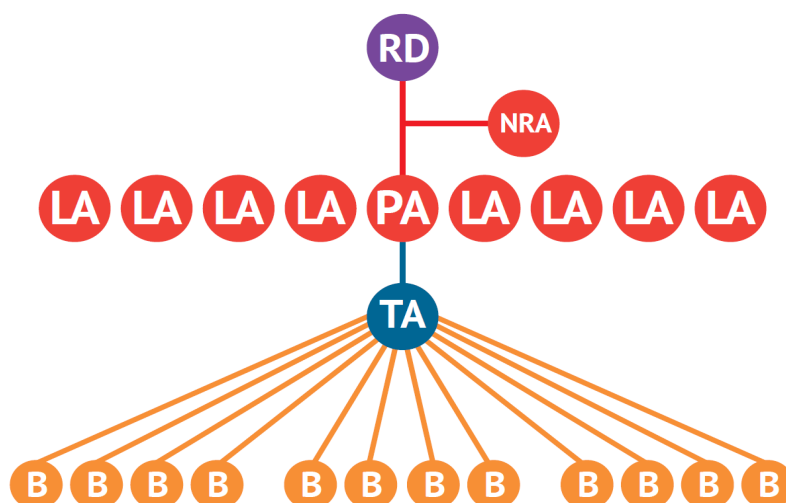
RD   = the Department for Business, which exercises overall supervision of the scheme.
NRA  = a national regulatory authority that is part of the scheme
LA   = a Local Authority
PA   = the Primary (local) Authority for the relevant business
TA   = the national headquarters of the business, or a trade association or other partner
B    = local outlet of the business or trade association

This model encourages responsible businesses to 'do the right thing' in all their activities. If they are unsure or identify a problem, they should raise it (for which they will be given credit in the Regulator's response).

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[43] *Primary Authority Overview* (Department for Business, Energy & Industrial Strategy, 2019), at www.gov.uk/government/publications/primary-authority-overview.

It has been said:[44]

Numerous local authority-led projects in the UK over the past 20 years have demonstrated the potential benefits of a supportive approach. In an early example, a 2004 collaboration between Bolton Metropolitan Borough Council and Salford University aimed at improving food hygiene standards in ethnic catering businesses demonstrated that directed training support to businesses that had not previously responded well to a traditional inspection regime was very effective in raising compliance levels: 65 per cent of the premises targeted in the first phase of the project showed significant improvement.[45]

The Primary Authority like approach can also be applied in other jurisdiction where a national/sub-national regulator (e.g., energy) can be designated as the lead contact who would coordinate other regulators (eg health and safety, revenue, environment) with whom the business has to inter-relate.

## 7.2 The Better Business for All Example

The Primary Authority scheme has been developed in a related model for partnership working between regulatory services and local businesses, called the 'Better Business *for* All' partnership (BB*f*A).[46] BB*f*A is a principles-based programme, meaning that can be adapted to local circumstances.  Its five principles are summarised below.

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**The 5 Principles of BB*f*A partnerships for local regulatory delivery**
**Strategic**
BB*f*A partnerships consider what is needed, wanted and valued in a locality and consider how expertise and resources can be shared and allocated to ensure that demand can be met
**Local**
BB*f*A partnerships seek to address how services are delivered at a local level and make changes that suit local circumstances.  The programme brings together relevant stakeholders in a defined geographical area. It focuses on '*how do we do things around here*'
**Collaborative**
BB*f*A partnerships bring together those services that have an impact on the way business operates. They also bring business organisations to the table, involving them as equal partners, as well as Local Enterprise Partnerships and Growth Hubs.
**Practical**
BB*f*A partnerships are designed to ensure any changes made benefit all those involved.  They are not a talking shop but are action focused. Action plans are developed based on local evidence for change or activity to support local priorities
**Growth Focused**
The focus of BB*f*A partnerships is to help support business to survive, prosper and grow.  All improvements and changes made through the programme have this focus in mind.  Linking the programme into the LEPs strategic priorities helps to keep the programme focused on growth.
*Extracted from training materials used by the Office for Product Safety and Standards*

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A Local Enterprise Partnership is typically the basis of governance arrangements, involving a local Board of relevant businesses, recognising the role that regulatory services are playing in supporting local growth. Local action plans provide the detail as to how the objectives will be

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[44] G Russell and H Kirkman, 'Outcome Measurement' in G Russell and C Hodges (eds), *Regulatory Delivery* (Hart, 2019).
[45] Improving the Public Image and Risk Assessment of Ethnic Minority Food Retail Businesses – the 'Bolt 'Project'. Presentation to Food Standards Agency workshop, 2004 (unpublished)
[46] Martin Traynor and Kathryn Preece, 'Better Business for All, an Approach to Building Local Capacity for Collaboration and Accountability' in G Russell and C Hodges (eds), *Regulatory Delivery* (Hart, 2019).

achieved. Most local programmes have developed strands of activity around these key objectives which generally reflect the following:

- Accessible advice and support
- Culture and competence of officers
- Coordination and communication across the local system

The objectives of BB*f*A are:

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**BB*f*A Key Objectives**
1. Simplifying the local regulatory system and processes
2. Providing advice and support to business
3. Increasing the business awareness of regulatory officers
4. Effective coordination across the regulatory system
5. Establishing an ongoing dialogue between regulatory services and local business
6. Supporting national and local priorities
7. Building trust through transparency and accountability

*Extracted from training materials used by the Office for Product Safety and Standards*

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Key lines of inquiry when developing the framework would include:

- Have the regulator and businesses committed to EBP?
- Have the regulator and businesses produced evidence that they operate on the basis of a holistic ethical culture?
- What level of trust exists publicly and between the organisations?
- What evidence should be produced that would demonstrate the existence and level of trust (transparently, privately, through third parties such as ombudsmen or audit)?
- Should the basis of agreement, and/or of particular aspects or next steps, be in a Memorandum of Understanding or similar document?
- Does the level of trust need to be improved? How could this be achieved?
- What changes should be made in the mechanisms to support trust or to produce relevant evidence?

# 8.  NEW APPROACHES TO INTERVENTION

Regulating through culture involves regulators treating ethical businesses in ways that differ from traditional approaches—and vice versa. The treatment of individuals or organisations that deliberately break the law remains similar to traditional approaches and involves familiar tools, although the language no longer uses the terminology of 'deterrence' but of protecting society and achieving regulatory objectives.

## 8.1 Principles for Regulatory Intervention

It was said above that the relationship between citizens (including commercial organisations) and the society (represented by public bodies and including individuals working in them) should be one of common engagement based on shared ethical principles and goals, and relationships based on evidence that all can be trusted. This section develops that paradigm in relation to how a state body should respond where a regulatee infringes the society's ethical principles or rules. The basic distinction, of course, is between those who aim to behave ethically and those who do not.

The following principles should apply to regulatory intervention by a public authority.

1. Force can only legitimately be used by a duly constituted legitimate authority to protect the ethical values of society.
2. Force may not be legitimately used with the aim of inflicting harm on others. The purpose and effect of use of force must be to provide protection, not to punish.
3. Any measures taken must be proportionate to the need to protect society.
4. Any measures taken must be based on the best available scientific evidence of their effectiveness in reducing the incidence of future risk of unacceptable harm.
5. Measures should also be taken to make good any harm caused.

This marks an evolution from a State reserving to itself a monopoly of use of force on its citizens and justifying such use when its rules are broken. First, the State must itself be ethical and have ethical objectives, procedures and actions. It is not ethical for a State to seek to rule its citizens through fear (which is the basis of deterrence). Second, the criterion for use of force should not be breach of a rule but protection of ethical society. That goal can justify use of considerable force when it is required, but it moves beyond a notion of a State punishing people, as use of punitive force sets one actor (the State) above all others in a situation of moral superiority that is not justified in a democracy where all citizens are to be treated equally and with respect.

Justifying intervention in response to intentional harm is relatively unproblematic, but there still remains the issue of whether an intervention will be effective in reducing future risk. It is no longer acceptable to impose a sanction on the basis of retribution, punishment or 'just desert'. Protection of society, however, may require strong intervention, such as removal of liberty or licence, and of the ability to qualify as a director or perform certain activities, or to remove illicit or unexplained assets. The principle of proportionality should also apply to the intervention selected. But the principal focus is now on *protection and prevention* rather than on punishing. Most of this paper concerns interventions that are not obviously intentionally unethical, but can be categorised as errors, mistakes, products of lack of full attention or over-concentration on other goals, and so on. The purposive approach requires a focus reducing future incidence and risk, and hence on how change is to be achieved.

Of course, there are some (hopefully a minority) whose intention is criminal. They need and deserve to be dealt with in a traditional manner involving protection of society (traditionally described as 'punishment' but now justifiable as proportionate protection). Thus,

proportionate sanctions should not be used in response to non-compliance that passes evidential and public interest tests.[47] Use of 'hard enforcement' sanctions should be targeted on those who consciously intend to break the law, or who do not take their general responsibilities seriously enough.

## 8.2 A Change of Approach

The traditional approach has been based on assumptions from legal philosophy and classical economics, that the way to provide protection is through a legal system that operates on a model of identifying breaches and imposing enforcement sanctions for those breaches that are identified, on the *theory* that enforcement will act as a deterrent to all future breaches.

That theoretical assumption has been wholly undermined by the science of behavioural psychology and empirical evidence into the causes of errors and of the success of new approaches.[48] This evidence-based approach establishes the following propositions:

    (e) There is little evidence to suggest that the theory of deterrence has much effect on behaviour – and certainly not the detailed effects that are desired. A strategy of imposing more or higher fines on companies will *not* in fact produce greater compliance.

    (f) Many humans do not make decisions or take actions based on rational thought, but act automatically and subsequently justify their actions to themselves. It is advantageous to provide opportunities for time to reflect on actions before taking them and for challenge to thinking.

    (g) Use of excessive force on people who think they are trying to obey the law has been shown to reduce general willingness to comply with any rules in future.

    (h) Adopting an evidence-based scientific approach to understanding and affecting human actions will be a more effective strategy than imposing sanctions after-the-event. Many individuals and (especially small) businesses may not be able to focus on requirements or compliance, may misunderstand or not be aware of what they need to do, or not have the resources to comply. It is often the case that well-intentioned people lose sight of ethical issues when they are crowded out by other priorities (e.g. meeting targets or maintaining the success of their group).

    (i) The culture of an organisation (especially whether it is ethical, open and transparent, listening and responsive) has a major impact on behaviour and decisions. Approaching behaviour through culture rather than through trying to ensure compliance is far more effective.

The concepts of *enforcement* and *deterrence* are outdated as mechanisms and those words should usually be avoided as they carry confusing connotations. The transformation that is needed is from thinking that the State may exert force on citizens based on breaches of law, and that such use of force is the mechanism that will achieve cessation of future wrongdoing (in other words, it will deter future breaches or risky activity, or will achieve change that will do so). The scientific and empirical evidence shows that those propositions are no longer sound. The key question is: How can future behaviour be affected? In answering that question, an understanding of the reasons why things happen (root cause analysis, motivations and impediments) will be essential, and the RDM's concept of selecting the right intervention choices will be relevant.

An example of the traditional rules-breach-sanction-deterrence concept of enforcement is the EU's approach. The EU principles of subsidiarity and procedural autonomy mean that

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[47] *Code for Crown Prosecutors* (Crown Prosecution Service, 2018).

[48] C Hodges, *Law and Corporate Behaviour: Integrating Theories of Regulation, Enforcement, Culture and Ethics* (Hart Publishing, 2015).

Member States' arrangements and practices of enforcement have not been harmonised, or even considered on a comparative basis between different States or sectors. EU case law has merely developed requirements that national sanctions must be 'effective, proportionate and dissuasive'.[49] That mantra is repeated in many EU legislative texts, but it has developed on a piecemeal basis, has never been subjected to systematic research or review, and does not amount to a principled enforcement policy or one that has been subjected to empirical evaluation.

At a more fundamental level, the question is not why people breach rules but: What affects behaviour, decisions, actions and culture? The answer to that question will come from scientific study of human behaviour and actions. It will not come from theories of economics or legal philosophy.[50] The answer (or series of answers) drives understanding of how people are influenced by particular, or competing, incentives, influences, 'controls' or interventions, whether these are in individuals' minds or inside or outside their groups or organisations. It also provides the opportunity to enlist organisational culture as a powerful regulatory tool.

By basing our regulatory designs and responses on how human beings make decisions and behave, individually and in organised groups, we are now able to be much more focused in achieving change and reducing risk. The approach necessarily involves some humility in the extent to which, and whether, any external actor (such as an authority or inspector) is able to affect the behaviour of others.[51]

The critical concept is that of *intervention*. A public authority (regulator, police, court) may intervene in the activities of citizens and organisations in accordance with the Principles set out above. It is significant the RDM does not talk of 'enforcement' but of 'regulatory intervention' and regulators making *intervention choices*. The policy is based on the science-based insights into the reasons for non-compliance and how best to address the behaviour of individuals in regulated entities and the cultures of such entities.

Thus, the rationale for the new approach rests on philosophical, political and empirical foundations. The empirical foundation is that the use of disproportionate force on humans and the use of force with the aim of deterring future behaviour are largely ineffective in affecting the root causes of why behaviour that is socially unacceptable (an infringement) either historically or, more importantly, in future. The political and philosophical foundation rests on the understanding that all human beings have fundamental rights and freedoms and deserve to be treated with respect but they equally have obligations to respect others in the society in which they live.

Individuals should observe the rules of the society in which they live, but only if such rules are based on ethical foundations of mutual respect and support. In return, the society, acting through its properly authorised authorities, may take action to support the observance of its ethical rules, including action against the individual freedoms and rights of its citizens to

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[49] Case 68/88 *Commission v. Greece* [1989] ECR 2965 paras 22-7; Case C-326/88 *Anklagemyndighedem v. Hansen & Sons I/S* [1990] I ECR 2911; Case C-36/94 *Siesse v. Director da Alfandega de Alcantara* [1995] ECR I-3573 paras 19-21; Case C-83/94 *Leifer* [1995] ECR I-3231 paras 32-41; Case C-341/94 *Allain* [1996] ECR I-4631 para 24; Case C-29/95 *Pastoors v. Belgium* [1997] ECR I-285 paras 24-26.

[50] A theory that decisions will be made on the basis of an evaluation of benefits exceed costs presupposes that that is the mechanism by which humans reach decisions (whether all or some decisions), and that all actions are based on rational analysis of available evidence. Much behavioural science establishes that human mechanisms for acting are frequently neither rational nor involve cost-benefit analysis.

[51] The contemporary example of sentencing terrorists to prison and then releasing them at the end of their sentence, or earlier on parole, has highlighted the ineffectiveness of that form of 'punishment' in changing ideological or obsessive beliefs that drive dangerous behaviour.

promote observance of its rules, but only where the rules and the actions are in accordance with ethical principles, are based on the best available scientific evidence as to their effectiveness, and are proportionate.

Organisations do not have human personality and do not 'make' decisions or have emotions. There is no logical sense to anthropomorphise an organisation (i.e. treat it as if it were human). Hence, the effectiveness imposing punishment or sanctions on an organisation needs to be unpicked into confirmation that such actions will affect the behaviour and culture of the key human actors within it. The rationale for imposing constraints on an organisation for the *protection* of society is, however, less problematic.

## 8.3 Responsibility and Accountability

Accountability has prospective and retrospective elements. These terms have a number of meanings, which mask the ongoing confusion between the two Models. Given that the objective is to affect the policy outcomes of protection and business growth,[52] the following possible aspects:

 a) Allocating responsibility for particular roles or achieving certain tasks;
 b) Accepting responsibility for fulfilling a role or achieving certain tasks;
 c) Delivery of tasks, targets, outputs, outcomes and impacts (role performance);
 d) Evaluation of the achievement of role, tasks, outcomes
 e) Giving an account of the extent of such performance and delivery, including what was done or not done, and the extent to which unintended, especially adverse, outcomes occurred;
 f) Imposing consequences for the success or failure of such delivery.

The first two aspects are prospective, requiring systems, functions, roles, tasks or outcomes to be allocated to particular individuals, so that the delivery of those objectives and outcomes is effectively overseen and more likely to be achieved. Choices must be made as to how this is done. One approach is to define and attribute a role, which was a central reason for introducing a Senior Managers Regime in financial services. A different approach is to set performance targets, on the mantra 'what gets measured, get's done'. However, a targets regime, especially if linked to reward through remuneration, can incentivise focus solely on their achievement, at the expense of other desired achievements, such as balanced ethical outcomes.

The last three aspects are retrospective. Giving an account of what happened is the literal meaning of accountability. It is a communication function, requiring honestly, accuracy and completeness. The final aspect features strongly in popular parlance after things are perceived to have gone wrong. 'Who is accountable?' here means 'Who is going to be blamed?' and 'Who is going to be punished?' The feelings underlying those responses are desires for protection and retribution, as blame and punishment of an individual. However, those responses tend to undermine, rather than support, an ethical cooperative culture.

There needs, of course, to be a clear response where people deliberately break rules, internally and externally. The underlying points are not that the rule was broken but why, and whether those who were instigators have abused others' trust. A 'just culture' means that people know that a root cause analysis will determine why things happened, that people will be treated fairly (and so encouraged to speak up without being unfairly blamed), but that a 'level playing

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[52] *Regulators' Code* (Department for Business, Innovation & Skills, 2014).

field' will be maintained for everyone, that will include serious sanctions on people who acted criminally and cannot be trusted.

## 8.4 Segmentation by Ethical Culture

Businesses that adopt EBP and engage in EBR partnerships with regulators provide a basis for market segmentation between them and those businesses that do not demonstrate either an intention to, or a verified history of, 'doing the right thing'. That segmentation will have direct consequences where regulatory responses to non-compliance or harm occur. It will also enable culture-compliant businesses to be considered as low cultural risk, effectively partners in self-regulating through culture and the constant production of verifiable evidence of such culture, and hence to require less resource in inspections or other surveillance activities.

## 8.5 Using EBR to Affect Behaviour

Regulating through Culture, with EBR, provides a significantly enhanced means of changing behaviour and reducing risk. An EBP business should represent lower intrinsic risk than non-EBP businesses as a result of its consistent culture of commitment to 'doing the right thing'. In particular, an EBP business should be able to raise a problem at an early stage, cooperate in analysing the root cause of a problem and in risk-assessment, and in implementing corrective action to reduce future risk and to take restorative action to mend retrospective harm. The basic distinction is between acts that are intentionally and unintentionally ethical.

## 8.6 Intervention Policies

Intervention policies (traditionally known as enforcement policies) should distinguish between entities that demonstrate evidence that they can be trusted and take their responsibilities seriously, and those that do not.  An intervention policy should that list the types of aggravating and mitigating factors that they will take into account in deciding what level of enforcement response they should take to infringements and what seriousness of sanction might be appropriate. In some cases, a business that takes all of the above steps and, for example, voluntarily makes redress payments to customers, staff or suppliers, or to repair the environment, has been considered to deserve no extra financial sanction. Implementation will, of course, be monitored and breach at that stage can be regarded as serious.

If the motivation for the harm is intentional (i.e. the wrongdoing is criminal) then strong public sanctions will be entirely appropriate. That is clearly now a rare occurrence in aviation safety. In other situations, it is important for responses by regulatory authorities, employers, professional bodies, the public and the media accurately distinguish between ethical and unethical motivations in responding to harm, and do not seek to blame, or impose deterrent punishment on people who were trying to do the right thing.

Sophisticated regulators select relevant responses to those who break the rules based on identifying whether the people who caused the offence were intending to act ethically or not. Motivation drives segmentation. The regulator has to possess an enforcement toolbox that contains a wide range of powers, and the discretion to select the tools that are appropriate and proportionate for the task. The powers can start with the ability to obtain information (investigation, review of data from and systems of businesses), require certain actions to be implemented (make improvements, make redress), and end with imposing fines, imprisonment or removal of licence to operate. The statement of what is in the toolbox is simple. What is far more important is to know which tools should be used in what circumstances. Here, there has been a change in understanding and practice. The classical binary model mandates a particular penalty as a response to a particular offence. It is a robotic

system, leaving no discretion to the enforcer to respond to the situation, intent or history of the infringer.

To guard against arbitrariness, capture or corruption, this flexibility has to be governed by safeguards, such as a written enforcement policy that states the objectives of enforcement (achieving compliance or imposing punishment), fair processes, aggravating or mitigating factors that will be taken into account as (e.g. that evidence of ethical motivation and steps to minimise the risk, to make reparation and to prevent future risk) and public transparency and oversight. UK regulators typically possess a wide range of civil and criminal sanctions, hence with some being reserved for courts. In selecting the response to breaches, an example of a simple segmentation approach to individuals is that of the Scottish Environmental Protection Agency, as shown in the figure below. One would now expand that classification into considering the historical evidence of ethical culture or its absence in an organisation, as outlined in this document.

Segmentation of offenders: spectrum of compliance the Scottish Environmental Protection Agency



**When things go wrong**

An ethical operation (business or government) will seek to identify and respond to a regulatory problem (whether it has led to non-compliance or not) by taking the following steps (not necessarily in this order):

1.  Constantly monitor all relevant sources of information to identify problems. This includes aggregated data fed back from staff, customers, suppliers, regulators, consumer groups, communities, investors and others.
2.  React to information indicating the possibility of a problem in an immediate, risk-based and proportionate manner. Facts and issues will not be ignored, buried or denied.
3.  Stop any continuing harm.
4.  Apologise and explain the cause and the corrective steps taken to those affected.
5.  Investigate the root cause of the problem, involving and cooperating with internal, external and regulatory expertise. The urge to ask 'who's to blame?' will be firmly resisted.
6.  Implement steps to prevent recurrence (reduce future risk).
7.  Rectify any harm caused (redress or repair).
8.  Agree any proportionate sanctions with regulators.
9.  Monitor the situation to see if further modifications are needed.

A regulator will need powers to achieve all these functions and outcomes. It will need an extensive toolbox of powers and tools. However, a business that seeks to be trusted as ethical

and EBP-compliant will take these steps spontaneously, or in cooperation with the regulator, without being compelled to do so.


## 8.7 Policy on Interventions

It is axiomatic that the response of a regulator to an EBP business that breaches rules unintentionally and reacts in the ethical manner set out above will be supportive rather than punitive. The imposition of disproportionate sanctions against people who think that they are trying to do the right thing has been shown to provoke lower ongoing willingness to act ethically. The preferred mode for resolution of formal issues between Regulator and traders should be by *agreement* between business and regulator holistically on *all* relevant issues as a combined package, including cessation, actions to reduce risk and change culture, making redress or repair, and any penalties.[53]

Regulators should seek to engage businesses in EBR partnerships that specify expectations on ethical behaviour, and should issue Intervention Policies that make clear that acting in an ethical way when harm or breaches occur will be regarded as deserving of supportive responses (mitigating factors) whereas the converse will prompt more severe responses (aggravating factors).

The approach identified here is now fundamental to most UK regulatory authorities, under the Regulators Code.[54]

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**The Principles of The Regulators Code** (emphasis added)

1. Regulators should carry out their activities in a way that *supports* those they regulate to *comply and grow*.
2. Regulators should provide simple and straightforward ways to *engage* with those they regulate and hear their views.
3. Regulators should base their regulatory activities on risk.
4. Regulators should share information about compliance and risk.
5. Regulators should ensure *clear information, guidance and advice* is available to *help those they regulate meet their responsibilities to comply*.
6. Regulators should ensure that their approach to their regulatory activities is *transparent*.

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UK regulatory authorities subject to the Regulators' Code are required to publish Enforcement Policies [sic], and these typically contain lists of mitigating and aggravating factors that are taken into account in determining responses and sanctions.

Some lines of inquiry are:

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[53] This function is typically more swift, efficient and cheap than courts. Relegating private redress to private litigation, on the other hand, is ineffective and inefficient: see C Hodges and S Voet, *Delivering Collective Redress: New Technologies* (Hart, 2018); C Hodges, 'Collective Redress: The Need for New Technologies' *Journal of Consumer Policy* (2019) 42:59–90. There is provision for the central role of a public body in the CPC Regulation: Regulation (EU) 2017/2394 of the European Parliament and of the Council of 12 December 2017 on cooperation between national authorities responsible for the enforcement of consumer protection laws and repealing Regulation (EC) No 2006/2004, art 9.4(c) giving a power 'to seek to obtain or to accept commitments from the trader responsible for the infringement covered by this Regulation to cease that infringement'.
[54] www.assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/300126/14-705-regulators-code.pdf

- What is the regulatory agency's policy on use of its powers?
- Is it based on imposing sanctions for infringements or on solving problems so as to maximise outcomes and impacts in accordance with its regulatory objectives?
- Is it based on protecting society or on deterring breaches?
- Has it published a regulatory policy on how it seeks to achieve its objectives that includes its approach to how it intervenes when things go wrong?
- How does the regulator approach accountability?
- Does its policy and practice differentiate between individuals and businesses who intend to act unethically and those who try to do the right thing, such as by adopting EBP and seeking to reduce future risk and improve their culture and behaviour?

More specific suggestions on establishing EBR Protocols across business and the regulatory community are in the following Annex.[55]

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[55] Updated from Appendix 2 of C Hodges and R Steinholtz, *Ethical Business Practice and Regulation: A Behavioural and Values-Based Approach to Compliance and Enforcement* (Hart, 2017).

## ANNEX A: PRACTICAL STEPS THAT MAYBE TAKEN BY PUBLIC BODIES TO CREATE AND SUPPORT EBR

### A.1 Actions by regulatory and enforcement bodies

1. Regulatory and enforcement authorities should review their objectives and enforcement strategies and policies to enable individual businesses to engage the entire regulatory community on an EBR Protocol.

2. Businesses should be able to individually commit to an EBR Protocol with all regulatory authorities, including their stakeholders, that is 'recognised' by an external body such as under the Primary Authority scheme, and that includes agreement on which regulatory control activities and systems will be performed by which tier, and the evidence that will demonstrate their ongoing adherence to ethical commerce.

3. EBR Protocols should cover joint:
    a. Commitment to supporting ethical behaviour.
    b. Commitment to work collaboratively.
    c. Details on how outputs are to be delivered and monitored.
    d. Means of visible compliance.
    e. Means of monitoring performance, including facility for receiving and demonstrating response to complaints.
    f. Protocols on approach to identification of problems, and means of agreement of holistic responses to addressing problems.
    g. Commitment to identifying causes of unethical behaviour and implementing means of supporting rectification and redress.

4. Demonstrable achievement of EBP should be encouraged and rewarded by regulators. Hence, Enforcement Policies and Sentencing Guidelines should be revised and specify an appropriate collaborative response to those who demonstrably observe EBP and EBR Protocols.

5. In order to ensure a consistent and proportionate response to business and to similar behaviours, there should be a mechanism for harmonisation of approach between different regulators and enforcers.

6. Sufficiently wide adherence to EBP, since it would justify a reliable co-regulatory approach, should trigger a comprehensive Better Regulation review of the regulatory system, so as to reallocate responsibilities to the appropriate level of actor, whilst ensuring transparency and verification of practice.

7. Bodies responsible for enforcement should have a wide-ranging toolbox of powers, including inspecting, verifying, obtaining relevant information, initiating and approving actions aimed at reducing future risk and making redress for harm caused, and initiation of the imposition of proportionate sanctions.

8. The response to adverse events should, where proportionate, focus on identifying the root cause of the problem, identifying an effective means of reducing the risk of reoccurrence, making demonstrably fair remedial and redress measures, and finally considering what marking or sanctioning should apply.

9. In imposing sanctions, the behaviour of individuals and the systems and controls of an organisation should be considered separately, and in context. Thus, individuals' actions

may be seen to be perhaps either a mistake or criminal, and be viewed in the context of what the organisation has done to support individuals to operate in a compliant way.

10. The approach to enforcement strategy should:
    a) Set out the objectives of intervention.
    b) Set out the circumstances in which powers will or will not be considered for use.
    c) Be based on principles of predictability, fairness, proportionality, reducing risk, and encouraging improved performance.
    d) Investigate the causes of serious or potentially systemic non-compliance, so that potential options for reducing the risk of reoccurrence of non-compliance, whether by an infringer or others, can be decided upon, and implemented.
    e) Evaluate the impact on victims, so that risk-based remedial action can be identified and taken.
    f) Encourage those businesses and individuals who have demonstrated their trustworthiness to continue to operate in a fair, no blame environment.
    g) Recognise that individuals are the root cause of both good and bad behaviour, whilst the behaviour of individuals and groups can be influenced by external factors such as incentives, group culture, level of support, education, reminders, …
    h) Support a virtuous business ethic.
    i) Give fair incentives to infringers to avoid, reduce, acknowledge, redress and mitigate the harm they cause.
    j) Recognise that problems will occur, irrespective of blame, and that most people in most businesses wish to do the right thing most of the time, and hence support them.
    k) But distinguish those whose motivations and actions are ethically unacceptable, to be sanctioned proportionately.
    l) Evaluate the moral seriousness of the motivation, actions and outcomes of actors who have broken the rules, and impose proportionate sanctions appropriately.

## A.2 Actions by Government

1. Political leadership should explain and endorse the concept of EBP and empower official bodies to support it in practice, including through arrangements to incentivise businesses to adopt EBR and to remove barriers to its achievement and recognition.

2. There should be a consistent approach by all public regulators to recognising ethical practice by firms, whether or not formal arrangements exist. That would involve review and alignment of a Regulators' Code (which would be made applicable to all enforcers) and of all relevant policy documents, including enforcers' Mission Statements and Enforcement Policies and the courts' Sentencing Guidelines, so as to ensure a consistent approach.

3. All regulatory and enforcement bodies should be able to encourage adoption of EBP on the part of those they regulate, to support pilot schemes, and to enter protocol arrangements, including adding an ethical component within arrangements such as a Primary Authority scheme in its original or modified form where acceptable evidence supported this in particular cases.

4. There should be recognition that regulatory and business compliance systems should function as a more integrated system. Hence, the collaborative approach illustrated by the Primary Authority scheme should be extended to as many areas of business and regulated sectors as possible.

5. Government should facilitate a permanent forum for discussion involving representatives of all regulators, enforcers, firms and other stakeholders on what constitutes best practice

in EBP (which may vary depending on sector or circumstances) and how arrangements should evolve.

6. Government should take steps to facilitate the spread of ethical values, and discussion on their content and how they apply in practical situations. This would involve inclusion of ethics in formal educational and skills teaching, accreditation, and trading, provided by educational, commercial and professional organisations.

7. Political statements and information on EBP will be necessary to explain the rationale for not responding to every adverse event with a punitive response ('Who is to blame? Who is going to be punished?') if lessons are to be learned and applied and improvements in performance and reduction of risk are to be achieved.

8. Government should review the statutory basis and mandates of regulators to ensure they can and do encourage EBP and recognition. This would involve:
   - Revision of competency provisions (training and assessment) to ensure frontline officials are equipped professionally and culturally to support EBP.
   - Ensuring performance of regulation is based on how far they recognise and respond to variation in demonstrated compliance e.g. through EBP.
   - Reviewing resources and intra-regulatory cooperation, including cross government leadership.

9. Government should consider if adoption of EBP might be encouraged under public procurement arrangements.