

A critical analysis of whether ethics and compliance functions should be combined or separated in organisations

by
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Abstract

Recent global corporate scandals have demonstrated the importance of strong ethical organisations. Ethics and compliance functions play a critical role in fostering an organisational culture that accentuates ethical conduct. The challenge is how to optimally structure the two functions, given that they are unique but have common goals. The goal of both functions is to embed the ethical culture across an organisation. Compliance however involves following rules and policies to control and monitor unethical behaviour, while ethics involves engendering values and principles to self-regulate behaviour.

The aim of my research is, firstly, to draw on pertinent academic literature exploring the structuring of ethics and compliance functions, notably Painter et al.'s (2019) Values Driven Business Alignment Framework and Mintzberg (1983) approach to grouping functions and aligning processes; and, secondly, to forward an argument for a suitable structuring of the ethics and compliance functions.

Whether to separate, combine or separate-but-collaborate the ethics and compliance functions is influenced by both the regulatory framework of a specific country and the pertinent design principles. Separation or combination of the two functions is based on features of what is called *vertical alignment*, whereas the separate-but-collaborate approach is based on features of *horizontal alignment*. Past research focused on vertical alignment; however, an increasing body of knowledge on horizontal alignment has been produced in recent years. The hybrid model promotes collaboration on common issues while maintaining the independence of each function. The benefits of a hybrid model are fourfold: it improves synergy between the functions, reduces inter-functional tension, prevents silos and expands cooperation.

This study is valuable in that, firstly, it contributes to the debate by providing justification for a hybrid model founded on horizontal alignment and functional design principles. Secondly, the study provides a practical guide on how to implement an appropriate design for value-driven functions in an organization.

Opsomming

Onlangse wêreldwye korporatiewe skandale beklemtoon die belangrikheid van sterk etiese organisasies. Etiek- en nakomingsfunksies speel 'n kritieke rol in die organisasie kultuur deur klem te lê op etiese gedrag. Die uitdaging is om die twee funksies optimaal te struktureer, siende dat beide uniek is, maar het gemeenskaplike doelstellings. Die doelpunt van albei funksies is om 'n etiese kultuur dwars oor die organisasie te vestig. Nakoming behels die onderworpenheid aan reëls en beleide om onetiese gedrag te monitor en te beheer, terwyl etiek die self regulering van waardes en beginsels meebring.

Die doel van my navorsing is om eerstens die toepaslike akademiese literatuur wat die strukturering van etiese- en nakomingsfunksies ondersoek te onttrek, veral Painter et al.'s (2019) se Values Driven Business Alignment Framework en Mintzberg (1983) se benadering tot groeperingsfunksies en aanpassingsprosesse. Tweedens om 'n argument voor te lê vir geskikte strukturering van etiese- en voorkomingsfunksies.

Die reguleringsraamwerk en toepaslike ontwerpbeginsels van 'n spesifieke land sal die vraag van of die etiek-en nakomingsfunksies gekollaboreer, geskei of gekombineer moet word beïnvloed. Kombinasie of skeiding van die twee funksies is gebaseer op die eienskappe van vertikale belyning en kollaborering-en-skeiding op die horisontale belyning. Waar daar in die verlede op vertikale belyning navorsing gefokus was, is daar die afgelope paar jaar toenemende navorsing en kennis oor horisontale belyning geproduseer. Die hibriede model bevorder samewerking tussen algemene kwessies maar handhaaf die onafhanklikheid van die twee funksies. Die voordele van 'n hibriede model is viervoudig: - dit verbeter sinergie tussen die funksies, verminder interfunksionale spanning, voorkom ensilering en skep samewerking.

Hierdie studie bied waarde :- eerstens dra dit by tot die argument vir die regverdiging vir 'n hibriede model, gebaseer op horisontale belyning en funksionele ontwerpbeginsels en, tweedens, bied die studie 'n praktiese gids om 'n geskikte plan vir waardegedrewe funksies in 'n organisasie te implimenteer.

Declaration

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1. Research Proposal

1.1. Background

There is an international trend of corporate scandals involving fraud, corruption and dishonesty as evidenced by cases like Enron, Volkswagen and WorldCom. These scandals and failures put pressure on organisations to ensure that they conduct their businesses in an ethically upright manner and comply with the laws governing their operations. Reacting to this pressure to be compliant to act ethically, the United States instituted laws such as the Sarbanes Oxley Act (SOX) (2002) to govern the management of ethics and compliance. In South Africa, we have followed a self-governing process using the King Report on Corporate Governance, which is known as “King IV” (IoDSA, 2016). The first King Report was published in 1994, followed by the second report in 2002, then the third report in 2009, and lastly the fourth report in 2016.

Consequently, corporate governance has become prominent around the world, however, there is a huge difference in how countries approach it. Rossouw and Van Vuuren argue that the difference in approach revolves around the locus of control. They write,

“when the locus of control resides within the corporation, (with the board of directors and executive management) then the system is one of *internal corporate governance*. When the locus of control is located outside the corporation, (with government and other regulatory institutions) it is a case of *external corporate governance* (Rossouw and Van Vuuren 2017: 210)”.

Further, Rossouw and Van Vuuren (2017) argue that the other distinction in approaches to corporate governance regards whether the companies are compelled to or chose to abide by corporate governance standards. One could say that when companies are compelled to abide by corporate governance standards, they follow a compliance approach and the locus of control is located outside the organisation. However, when companies chose to abide by corporate governance standards, it is a self-regulatory approach and the locus of control is located inside the organisation.

Therefore, compliance aims to eliminate regulatory failures, while self-regulation promotes ethical corporate actions even when not required by legislation. In other words,

compliance focuses on adherence to laws, rules and policies; ethics, on the other hand, involves going beyond what is required by law. Nevertheless, ethics and compliance are closely related as they both serve to prevent misconduct and promote ethical conduct.

In response to the pressure to uphold good corporate governance, organisations have changed how they operate their businesses. They have introduced *ethics and compliance functions* to promote ethical conduct and maintain effective compliance with regulatory requirements. Compliance functions tend to focus on curbing employee misconduct by institutionalising policies and procedures to guide employees' conduct, and misconduct is punished. Conversely, ethics functions promote company values and principles to ensure that values form part of the decision-making process across all levels of the organisation.

Beyond establishing ethics and compliance functions, companies have also ensured proper alignment of these functions. This is done by promoting either *vertical alignment*; a hierarchical structure or *horizontal alignment*; collaboration of activities between complementary functions.

1.2. Problem statement

While organisations acknowledge that it is important to obey both the letter and spirit of the law, there is currently no consensus on what constitutes the optimal way to structure the relationship between the ethics and compliance functions. Even though structuring ethics and compliance functions is context based, there is a persistent question whether they should be combined into one function or not. There is a widespread debate on this question with different researchers holding sometimes decidedly different views. Hoffman et al. (2008), for example, argue that an ethics function should stand alone since this would enhance the independence of ethics officers. The Compliance Institute of Southern Africa's framework (2013) suggests the need for an independent compliance function since this should facilitate formal and structured monitoring of compliance.

Dana (2016) argues that ethics and compliance are mutually reinforcing; true compliance only exists when there is a strong ethical culture; therefore, the two functions must be

combined. Groenenwald and Donde (2017), similarly to Dana (2016), argue that ethics and compliance represent two distinct yet complementary functions. Gnazzo (2011) argues that ethics and compliance should be combined as a single function since the fundamental purpose of both is to train people on what is expected of them and to monitor their conduct. De Klerk (2015) however argues that combining ethics and compliance may negatively influence ethical culture as compliance will likely override ethics.

Dorosz (2019) argues that there are essential elements that an organisation should consider before deciding on how to design the ethics and compliance functions. Moreover, different researchers suggest that there are different ways of structuring (designing) functions. For Kathuria et al. (2007), there is vertical alignment that putatively promotes structural reporting. While for Painter et al. (2019), there is a dyadic horizontal alignment involving collaboration of the two functions.

1.3. Aim of the research

The aim of the research is to investigate how the ethics and compliance functions are structured in organisations so as to forward an argument for the suitable structuring of these two functions.

1.4. Theoretical frameworks

I will enlist Painter et al.'s (2019) Values Driven Business Alignment Framework in order to address the problem statement I have posed in this study. The framework illustrates the process of aligning the ethics and compliance functions in a complementary way so as to create synergy between them. Furthermore, the framework shows the costs of misaligned functions and the benefits of aligned functions. I will also apply Mintzberg's approach to grouping functions by aligning them into units.

1.5. Chapter layout

The chapters in my thesis are as follows:

1.5.1 Chapter 2

This chapter involves a critical literature review of the relevant publications and industry related guidelines on the structure of ethics and compliance functions. I focus on vertical and horizontal alignments of complementary functions given that different organisations follow different approaches. I also focus on the functional design principles of grouping functions. I proceed to discuss the conceptual differences between ethics and compliance. I then highlight the arguments for and against combining the ethics and compliance functions into one function versus keeping them separate but collaborative. Lastly, I explicate the advantages and disadvantages of both these options.

1.5.2 Chapter 3

This chapter discusses the hybrid model as an alternative to the two functions. I focus on the rationale for the hybrid model, and its benefits and requirements. I further discuss how the South African legal and regulatory framework supports the hybrid model. I also deliberate on how The Ethics Institute governance of ethics framework provides a roadmap for the management of ethics in organisations. Lastly, this chapter discusses the practical application of horizontal alignment using Painter et al.'s (2019) horizontal alignment framework.

1.5.3 Chapter 4

In light of the literature review from chapter 2, this chapter will critically analyse and argue for the optimal way to structure the two functions (ethics and compliance). I look at what the relevant theory says about designing complementary functions, and then propose a solution to guide organisational thinking. I conclude by explaining why this solution is the better one.

2. Literature review

2.1 Introduction

This chapter's literature review shows that in recent decades, as scandals in the corporate domain increased, some governments, such as the USA and South Africa, were moved to provide organisations with guidelines to structure effective compliance and ethics functions. The guidelines define requirements for promoting an ethical organisational culture. Different countries introduced various regulations to enforce compliance with the set requirements. To mitigate compliance risks, organisations implemented ethics and compliance functions. The ongoing debate regards what the optimal way is to structure the two functions. Different researchers have different views on the question; some argue that organisations must integrate the two functions into one function while others say that each function should stand-alone. A third school of thought suggests the two functions to be independent but should make a *deliberate effort* to collaborate.

Dana (2016) and Painter et al. (2019) agree that ethics and compliance functions play a vital part in embedding an ethical culture. Although the two functions are essential in promoting the proper conduct, William (2012), De Klerk (2015), and Groenewald and Donde (2017) argue that the two functions involve different approaches and principles when it comes to institutionalising an ethical culture. Drawing on an extensive range of sources, the authors set out the various strategies in which the two functions operate. Groenewald and Donde (2017) argue that compliance focuses on laws and rules, and ethics focuses on values.

When an organisation follows a compliance-based approach to governance, a set of laws, rules or policies of conduct is implemented and enforced. There are penalties in place for anyone who does not comply with these rules. Conversely, with the ethics-based approach, organisations focus on principles and values to guide conduct. Organisations develop their own set of core principles to help employees govern their behaviour according to these principles.

Determining the optimal structuring of the two functions is a challenge. For this reason, this chapter will explore the different ways of structuring the two functions. This literature review narrows the structuring of ethics and compliance functions down to three approaches: (1) The organisation can separate the two functions which then operate as stand-alone functions; (2) integrate the two functions into one function; or (3) the two functions can collaborate in a hybrid model. As we will see, there are advantages and disadvantages to each approach.

Structuring the two functions can be configured using vertical or horizontal alignment design principles. According to Guttman (2006), vertical alignment is the traditional hierarchical business model that involves dividing an organisation into functional silos and that requires multiple decision-making levels.

Conversely, horizontal alignment is a model that makes a *deliberate effort* to encourage teams to work together and collaborate as peers with equal responsibility for the success of the overall business and with equal power to make decisions (Guttman, 2006). Horizontal alignment promotes cooperation and coordination of efforts and practices to pursue organisational goals across an organisation and transfer knowledge among team members (Kathuria et al, 2017).

This chapter consists of three sections: (1) a comparative analysis of ways of structuring the ethics and compliance functions given the nature of these functions; (2) organisational design principles that impact on the success of these functions; (3) a comparative analysis of ways of structuring the functions given the organisational design principles followed.

2.2 Regulatory overview

In 2002, the US government enacted SOX in direct response to executives' unethical conduct at organisations like Enron and Parmalat (Weber and Wasieleski, 2013). SOX strives to foster an ethical culture in business. Geddes (2017) notes that in 1977 the Securities and Exchange Commission (SEC) investigated several US companies for bribing foreign officials to procure government contracts. Geddes (2017) also argues that

the procurement process lacked transparency when dealing with potential suppliers creating room for unethical conduct. To regulate the procurement process, the US government then passed the Foreign Corrupt Practices Act of 1977 (FCPA) to ensure that, firstly, there are internal controls; secondly, that there is transparency; and, thirdly, that new accounting rules are adopted by companies (Geddes, 2017). That is, the Act was passed to prevent illegal and unethical conduct. Furthermore, Josephson (2014) notes the Defence Industry Pentagon scandal that led to a Blue-Ribbon Presidential Commission appointment as another example. The Commission's main contribution was the recommendation of self-governance. Companies were forced to introduce a code of ethics and go beyond compliance.¹

Painter et al. (2019) point out that in 2004 the Federal Sentencing Commission re-assessed their guidelines and stressed the importance of ethics and compliance functions in promoting the ethical culture and compliance to laws. Josephson (2014) argues that for a programme to be effective, it must embed both ethics and compliance into the 'DNA' of the organisation. The FSGO (1991) views ethics and compliance as a single function thus contributing to the general integration of the two. Like the Compliance and Ethics Leadership Council and Ethics Resource Centre, professional bodies mostly endorse this approach (De Klerk, 2015). However, some researchers – e.g., Hoffman et al. (2008) – question the rationale of collapsing compliance and ethics into a single function and argue that compliance swallows up ethics when doing so. In other words, companies will focus more on compliance to the rules and policies and less on ethics.

Interestingly, this US approach is different to the route followed in South Africa (and in some European countries) where a values-driven ethics management programme is typically followed (De Klerk, 2015). In South Africa, the government introduced legislation such as the Companies Act 71 of 2008 to stipulate requirements for managing ethics. This legislation also required establishing a Social and Ethics committee to monitor

¹ Josephson (2014) notes further that this is why the Federal Sentencing Guidelines for Organisations of 1991 (FSGO) were introduced.

and report ethics-related matters. King Report also circumscribes a corporate governance framework and promotes self-regulation for both ethics and compliance functions.

An overview of the extant literature suggests that the decision to combine or separate the two functions is context dependant and is heavily informed by the regulatory regime of a country. As an alternative to the separation and the integration of the two functions, another school of thought argues that both functions should remain independent (rather than integrated) yet must *intentionally collaborate*. In other words, they follow a *hybrid* model. The hybrid model moves away from traditional functional silos and towards deliberately working together to achieve business results (Guttman, 2006). Borys and Jemison (1989) define a hybrid model as two or more independent functions that collaborate to pursue a common objective.

In response to international government-imposed penalties, some organisations began to pay special attention to how they structure their operations to promote good corporate governance. Organisations created ethics and compliance functions; however, there has been an ongoing debate on how to structure the two functions. This section's background explication of ethics and compliance has set the stage for addressing the conceptual differences between compliance and ethics. These differences will be dealt with next.

2.3 Conceptual differences between compliance and ethics

The development and principles of ethics and compliance functions and the options to structure them have been introduced in the previous sections. This section pays particular attention to the difference between the compliance and ethics functions. The characteristics of the two functions are different.

Groenewald and Donde (2017: 17) argue that compliance is *rule* based whereas ethics is *principle* based. Furthermore, the features are different: compliance is *explicit*, while ethics is *implicit*. Groenewald and Donde (2017) highlight that the two functions have contrasting *roles*. As previously stated, ethics locates the locus of control inside the organisation and compliance locates the locus of control outside the organisation. The ethics function

focuses on promoting principles and a values-based culture; that is, doing what is right. In contrast, the compliance function drives rules thereby promoting a rule-based culture.

In an analysis of compliance, Arjoon (2006), De Klerk (2015), and Geddes (2017) argue that compliance is born out of government regulation in response to illegal acts. In other words, regulation is the foundation of compliance; it enforces required conduct. Hence, Brien (2013) argues that compliance operates from a position of power since it instils fear: comply or face the consequences. Organisations know that failure to meet the regulatory requirements will result in harsh penalties. They therefore promote compliance to mitigate reputational risks, litigation risks, indictment risks and many other financial and operational risks. Arjoon (2006) and Dorosz (2019) argue that compliance is not voluntary; instead, it operates by way of obedience and is therefore easier to implement. Importantly, compliance can lead to the misunderstanding that what is not prohibited is allowed.

As opposed to compliance, ethics is doing the right thing even when not required by law. Gnazzo (2011) defines ethics as the establishment of values and culture in an organisation. In other words, the commitment to establishing ethics sends an internal and external message on how the organisation wants to be perceived. According to William (2012), ethics guides the decision-making process. Further, the other objective of the ethics approach is to prevent unethical conduct. According to Arjoon (2006), ethics builds trust and long-term benefit, such as competitive advantage and encourages investor confidence.

For Dorosz (2019), the ethics-based approach outlines the principles that everyone must own and adhere to. Furthermore, the ethics-based programme encourages accountability, responsibility and proactive reporting of illicit conduct. Arjoon (2006) supports the view that ethics should guide corporate behaviour. Dorosz (2019) argues that ethics-based programmes do not have clear guidelines which presents a challenge during decision making. Two important approaches that emerge from these studies are the *rule-based* approach versus the *principle-based* approach. The rule-based approach focuses on adherence to rules to prevent unethical behaviour and the principle-based focuses on alignment with company values during decision making process (Dorosz, 2019). Understanding this difference will help structure the ethics and compliance functions and

create an ethical culture. This discussion of the conceptual differences between compliance and ethics introduces a debate over how organisations must structure their ethics and compliance functions. This debate will be explored in the next section.

2.4 The current debate on how to structure the ethics and compliance functions

In South Africa and in Europe the idea of integrating the ethics and compliance functions into a single function often provokes lengthy and heated arguments. This section covers the conflicting ideas on structuring ethics and compliance, as well as the influence of regulation when shifting from a compliance to a compliance-and-ethics programme. We will also look at arguments for the combination of the two functions, arguments for their separation and arguments that they remain separate but collaborate.

Brien (2013) argues that both ethics and compliance functions provide a base for human conduct and play a related role in instilling an ethical culture in an organisation. Trevino and Nelson (2010, 25) argue that recent business history has shown that divorcing an organisation from ethics runs considerable risk. However, as stated before, in South Africa and Europe, there are currently conflicting views that concern the structuring of ethics and compliance functions.

Trevino et al. (1999) and Dorosz (2019) hold that the two functions be combined into one function to foster an ethical culture by regulating what is right and wrong. Conversely, De Klerk (2015) argues that the two functions have different roles and that organisations should therefore separate them. Groenewald and Donde (2017) and Blodgett (2011) say that the two functions complement each other; thus, the functions should remain independent but collaborative.

However, as stated before, structuring the ethics and compliance functions is influenced by the country's regulatory framework. Therefore, for any organisation to decide whether to separate, integrate or encourage collaboration between the two functions, management has to consider all elements (including all advantages and disadvantages). The next section will discuss these debates.

2.4.1 Arguments in favour of combining the two functions

Some researchers argue that the separation of compliance and ethics into individual functions does not yield sustainable results. This section reviews the literature in favour of combining ethics and compliance into one function. According to Blodgett (2011), there is a need for the two functions to converge and integrate into one unit. Blodgett (2011;41) says “ethically integrated compliance statements imbued with express ethical perspectives may more effectively guide behaviour than narrow statements of rules and obligations that are juxtaposed with corporate values”. Facilitated by the relevant design principles, integrating the two functions into one function brings about a vertical alignment. In other words, ethics and compliance functions will report to the same hierarchical structure. However, in this alignment the common trend is that compliance swallows up ethics (De Klerk, 2015). The ethics function ends up reporting to the compliance function. Gnazzo (2011) argues that allowing one function to report to the other (separate) function is not ideal as both functions will find it difficult to acknowledge the other function’s contribution.

All the same, Gnazzo (2011) argues that combining ethics and compliance functions gives impetus to and reinforces the idea of going beyond the relevant policy and preserving its values. Weber and Wasieleski (2013) agree that the two functions should be combined into one function. They argue that the integration of the two functions ensures the right conduct and enforcing such behaviour can be centralised. Centralising the functions will encourage consistency in combating and mitigating illicit behaviour. Both engender an organisational culture that says it is ethically correct to comply with all applicable laws.

Weber and Wasieleski (2013) conduct various studies to investigate whether these two functions are linked or not. They highlight that their research outcome confirms that ethics and compliance officers generally have both an ethics and compliance background. That is, they have the skills required for the implementation of both ethics and compliance functions. Therefore, the two functions can be grouped as one function. Kavanagh (2008) argues that there is a tension between the two functions caused by competing available

resources. Therefore, separating the two functions exacerbates internal competition and discourages joint efforts. Kavanagh (2008) concludes that the two functions should be combined and treated as one function. According to Kavanagh (2008), the ethics approach gives compliance “soul” by harnessing internal policies and procedures, whereas the compliance approach can provide ethics with “body”.

ECCI (2015), Blodgett (2011), Brien (2013), and Weber and Wasieleski (2013) thus concur that organisations should combine ethics and compliance functions since the success of their activities and purposes is dependent on each another. However, Geddes (2017) warns that combining the two functions should not involve putting more regulations in place and ignoring ethics. Combining the two functions should not promote a one-sided view of compliance; instead, it should promote a balanced view of both ethics and compliance. This integrated function must provide an overview of both functions features and not just that of compliance or ethics.

In conclusion, the literature reviewed above supports the vertical alignment of the two functions. They must report to one department since they have a common purpose: to embed an ethical culture. Proper compliance is supported if the organisation has a robust ethical culture. However, to structure the two functions optimally, the organisation must follow appropriate design principles as discussed in section 2.5.

2.4.2. Arguments against combining the two functions

It is well established from various studies that the ethics function is responsible for preserving organisational values and ensuring that ethics forms part of the decision-making process across the organisation. In contrast, the compliance function ensures adherence to the operating environment’s laws and regulations. Therefore, the two functions are unique, and operate independently. Hoffman et al. (2008) and the Generally Accepted Compliance Practice Framework of 2013 (GACP) drawn up by the Compliance Institute of South Africa argue that the compliance function should stand alone to enhance independence. The GACP urges the need for an independent compliance function as this will assist compliance officers in performing their responsibilities effectively.

According to Sull et al. (2015), a top-down chain of command is better than cross-functional alignment. Their study suggests that, when functions operate independently, the lines of authority are clear and there is direct supervision. By implication, the separation of compliance and ethics as stand-alone functions introduces vertical alignment where functions operate independently and have different reporting lines.

Of particular concern is that combining ethics and compliance might lead to an excessive over-reliance on either one or the other of the functions. Groenewald and Donde (2017) point out that there are risks when combining the two functions as companies tend to focus more on compliance given that there are penalties for non-compliance.² When the two functions are combined, the focus will be on compliance with the law to avoid penalties rather than on self-regulated ethical behaviour.

Groenewald and Donde (2017) also believe that the two functions require different mindsets. Ethics officers may inspire employees to act in a manner that is consistent with organisational values. In contrast, compliance officers insist that there is no grey area when dealing with compliance. The authors state further that ethics and compliance practitioners even use different locutions when engaging with employees. Compliance uses *punitive measures*, while ethics uses *persuasion* to institute an ethical culture.

De Klerk (2015) echoes this viewpoint by arguing that combining the two functions will slowly erode moral thinking. De Klerk concludes that the two functions should not be combined; they have different objectives and approaches, resulting in an uncomfortable pairing. De Klerk argues further that merging the two functions militates against creating an ethical culture. Organisations are incentivised to follow the law while neglecting ethical behaviour. Integrating the two functions thus lowers ethical expectations.

Groenewald and Donde (2017) view the two functions as separate functions given that ethics is more than the law. Moreover, combining the two functions might lead to people

² Despite these risks, Groenewald and Donde (2017) still recognize that the two functions can collaborate and therefore support the hybrid model which will be discussed in sub section 2.4.3.

abdicating their responsibilities. Roberts (2009) explains that reliance on compliance discourages organisations from being ethical. Compliance does not empower people to avoid unethical conduct; instead, it creates fear as the driving motivator for compliance with the law.

De Klerk (2015), the GACP (2013), and Roberts (2009) argue that although the attributes of the two functions overlap to some degree, the two functions require different problem-solving skills and qualifications. Therefore, organisations should keep them separate. Taleb (2018) argues that organisations must separate ethics and compliance because laws come and go while ethics stands the test of time. We can say that ethics starts where the law ends. This section highlights the benefits and the risks of combining ethics and compliance into one function versus treating them as separate. In summary, it has been highlighted that the two functions are fundamentally different and combining them creates disharmony.

2.4.3. The two functions should be separate but collaborate

Paying attention to ethics or compliance creates silos. Alternatively, combining the two dilutes the impact of the ethics function. Thus, there appears to be a need to align and reposition the two functions. Some researchers are of the view that the two functions must be separate but collaborative. This idea is supported by Hoffman and Rowe (2007) who argue that the two functions are unique yet interrelated. This third-way approach combines vertical and horizontal alignment; it is a *hybrid model*. Based on the above statement, I argue that the hybrid model borrows the best features from both the vertical and the horizontal alignments. We can say that the two functions stand independently but operate collaboratively.

Borys and Jemison (1989) define a hybrid arrangement as one in which two or more independent functions or organisations combine to pursue common interests. To do so, the authors argue that it is essential to understand the boundary between the functions and which parts will and which will not belong to the hybrid. Agreeing on the boundaries will assist in defining the rules for collaboration. Borys and Jemison (1989) also argue that the hybrid model embodies a purpose shared by the relevant teams. This will, in turn, help top

management to agree on how much of each team's resources will be utilised in the collaboration.

Borys and Jemison (1989) highlight that the hybrid model creates value in a way that each of the parties alone could not. The hybrid model promotes collaboration and interdependency, and the capabilities of the partners are combined to create synergy. Further, the parties involved share available resources. Therefore, based on the above information, I recommend that alignment must be neither vertical nor horizontal, but rather structured according to the hybrid model.

Subsection 2.4.3 suggests that the two functions are not conflicting but *interdependent*; they need to align horizontally for the two to jointly succeed. Dana (2016) and Painter et al. (2019) agree that ethics and compliance are mutually reinforcing. The ethics and compliance functions must actively collaborate given that they aim for a common goal, namely fostering an ethically desirable culture. Kavanagh (2008) concurs that each role is needed to complete the other.

Arjoon (2016) and Groenewald and Donde (2017) argue that when organisations allow collaboration between ethics and compliance functions, there must be an internal framework that drives the collaboration. The authors point out that collaboration must happen at two levels: the operational level and governance level. At the governance level in South Africa, King IV report states that the Governing Body must ensure effective and ethical leadership. Effective leadership implies enforcing a culture of compliance with the laws and regulations that govern behaviour. Ethical leadership involves setting the tone from the top to instil an ethically upright culture in the organisation. Moreover, Groenewald and Donde (2017) highlight that for ethics and compliance functions to collaborate effectively in an operational way, there must be an agreement on areas of collaboration and there must be a clear definition of each function's role so as to avoid duplication.

Although Groenewald and Donde (2017) point out that ethics is dynamic³ while compliance is static, they agree that both functions have similarities. Dana (2016) argues that proper compliance only exists when there is a strong ethical culture where people want to do the right thing. Groenewald and Donde (2017) argue that, although ethics and compliance represent two distinct functions, they are complementary. Therefore, they should collaborate.

Trevino and Nelson (2010) similarly state that, although organisations generally have formal programmes to manage ethics and compliance, their efforts will not be effective without collaboration. Berenbeim (1991) argues that deliberate collaboration between the ethics and compliance functions enables organisations to have well-structured and targeted programmes. Deliberate collaboration ensures that the organisation's internal messages become standard and that the decision-making process becomes quicker. According to Berenbeim (1991), the partnership between the two functions will make the programme of embedding the ethical culture 'alive' (i.e., dynamic) as each function can capitalise on its strengths to complement the other. Furthermore, the joint effort provides an opportunity to have a systematic approach that engenders consistency to what is 'preached' and to what is practised (Berenbeim, 1991). In other words, collaboration assists in building a sustainable and robust culture in an organisation.

In similar vein, William (2012) acknowledges that, even though ethics and compliance are different, they overlap and should work together. Ethics helps avoid conflict when there is dissonance between values; it helps with decision making. Although the two functions are different, they both seek a common goal: compliance with the laws, policies and procedures and adherence to the organisational values. Therefore, although the two functions are based on different approaches and must be kept separate, one should also create a platform and structure the functions in such a way as to deliberately encourage collaboration.

³ Ethics is about 'walking the talk' (Groenewald and Donde 2017).

Arjoon (2006) argues that a suitable *balance* should be found between the two functions. Organisations should not promote one at the expense of the other. Simply introducing more laws will not transform a business into a more ethically effective entity. According to Arjoon, the benefit of collaboration between rule-based and principle-based approaches is that decision-making processes can be better managed. Furthermore, the author argues that identifying and managing risks proactively is key to the organisation's survival. Therefore, focusing on *both* rule-based and principle-based approaches will foster attempts to identify, measure, monitor, and proactively manage uncertainties.

Customers respect businesses that act responsibly by complying with the laws *viz.* adhering to the principles of a suitable ethical code. Trevino et al. (1999) and Dorosz (2019) argue that both ethics and compliance have advantages and disadvantages when they operate in isolation; therefore, they should collaborate in order to have *impact*. Kathuria et al. (2014) similarly argue that while alignment is essential, the functions should not be coupled so tightly that they cannot adapt to a dynamic external environment. Therefore, the ethics and compliance functions must evolve together, and organisations must create a suitable balance between the two functions. Organisations must have the functions working in tandem when striving to build a suitable ethical culture.

As we have seen, the compliance approach develops and implements sets of rules that guide employees' conduct; however, this approach tends to induce fear rather than aspirations to ethically upright conduct. However, the ethics approach can involve unhelpful talk of values without a clear message of consequence for non-adherence to policy. Trevino et al. (1999) point out that, whether promoting compliance, ethics or the integration of the two, there may be inconsistencies in processes and procedures. Trevino et al. (1999) conclude that for collaboration to be effective, values must be supported by policies and both must align with organisational processes and procedures.

In summary, it has been shown in this subsection that even though the ethics function is different from the compliance function, they have notable similarities. Ethics and compliance both have distinctive roles but can collaborate to create a suitable ethical

culture. They encourage certain behaviours and discourage others. The hybrid model pursues common interests. The horizontal alignment of ethics and compliance will foster collaboration across silos, thereby building a solid ethical foundation

Mintzberg (1983) argues that for grouping functions to be effective, the organisation must follow suitable design principles. We now explore this topic.

2.5 Functional design principles

This section investigates the importance of understanding the principles and patterns of coordinating cross-functional teams' activities into a harmonious relationship. Dorosz (2019) argues that there are essential elements that an organisation must consider before deciding on how to design ethics and compliance functions since the decision will impact the sustainability of the organisation. We can say that structure *affects performance*. Study of the design principles literature indicates that implementing practical ethics and compliance structures can be either facilitated or hindered by the specific functional design. According to Thompson (1967), 'functional structure' refers to a team's internal pattern of relationships, authority, and communication. This structure has three primary dimensions: *centralisation*, *formalisation*, and *complexity* (Mintzberg, 1983). According to Thompson (1967), centralisation refers to the locus of authority and formalisation refers to the rules and procedures used to govern behaviour. Complexity is generated by the interdependency between teams (further contributing factors are how tasks and activities are distributed as well as the relevant management layers) (Mintzberg, 1983).

Blodgett (2011) highlights the importance of understanding which structure is appropriate given the functions' purpose and desired outcomes. Arjoon (2016) and Groenewald and Donde (2017) argue that structuring ethics and compliance functions needs a practical *framework* to guide these two functions' intricate design. This framework ensures that designs are functional and efficient. Van Vuuren and Eiselen (2006) argue that, although the ethics and compliance functions exist, there is still no clear direction of the functional reporting lines.

However, according to King IV and the Companies Act of 2008, the ethics function should report to the ethics committee which is a subcommittee of the governing board. In some instances, the ethics function is allocated to departments such as compliance or human resources as an add-on function. It stands to reason that there should be an analysis of how the two functions are currently designed in big organisations and what process was followed in developing them. The literature on the subject highlights further that design of ethics and compliance functions is influenced by several factors that include – but are not limited to – *context, culture, resources, strategy, size, capacity and maturity*.

Goold and Campbell (2002) and Trevino and Nelson (2010) argue that whether we should centralise versus decentralise the ethics and compliance functions is context dependant. Therefore, it is essential to consider all possible constraints that may hamper the implementation of the design. Similarly, Painter et al. (2019) highlight that specific contextual dynamics influence the two functions' design. For example, some companies may find that it is better to align ethics and compliance horizontally and decentralise the initiative's coordination due to both the company's size and the maturity of the functions. Conversely, some businesses may not have enough capacity and resources to focus on ethics and compliance and may therefore align the functions and centralise the decision-making process.

Burton and Obel (2018) suggest that *team design* influences how teams perform tasks together. According to structural contingency theory, the design must create a fit between structure, contingencies, and coordination needs. For Burton and Obel, structure involves how one breaks the whole into its parts, as well as how one coordinates these parts to make them a whole and thereby achieve an overall purpose. According to Burton and Obel, not only are the tasks coordinated, but they also function interdependently. Recall that ethics and compliance can operate as stand-alone functions, be combined into one function or be independent but collaborate. Burton and Obel further acknowledge that there is no one perfect way of designing an organisation given that the applied design is context-based. Therefore, compliance and ethics functions should be flexible enough to adapt to current and future environments. To this end, Goold and Campbell (2002) suggest that functional

design is all about *who does what, when and how*. The aim is to allocate and coordinate tasks and resources, while acknowledging that designing functions has trade-offs.

For example, if ethics and compliance operate as stand-alone functions, they will be independent; however, due to the resulting high number of management layers in the design, information flow will be slow. Alternatively, if the two are combined into one function, there would be no duplication of efforts. However, as suggested previously, ethics may well be swallowed up by compliance once the two functions are integrated. Our third way, in which functions collaborate deliberately through a hybrid model, may also involve trade-offs. The design could create disharmony between functional units due to the overlapping of functions. This may create unproductive power dynamics and the threat of ‘turf wars.’

Goold and Campbell (2002) argue that sometimes management allows the design to evolve over time which can result in designs with no clearly assigned roles and responsibilities. Potentially, this lack of clarity on roles and responsibilities between ethics and compliance introduces tensions and abuses of power between the two functions. For Goold and Campbell, the design must therefore outline clear roles and responsibilities. There must also be accountability and adequate controls to remedy power abuses in decentralised functions. That being the case, Goold and Campbell argue further that there are two tests organisations should conduct to ensure that the design is fit for purpose; these are “fit” tests and “good design” tests. According to the authors, the fit tests assess whether the function’s design supports its strategy, the talent pool and the situation. The good design tests can facilitate the balance between hierarchy, control and process. The purpose of the tests is thus to identify and assess potential problem areas and *proactively* address these.

Mintzberg (1983), like Burton and Obel (2018), argues that for an organisational structure to be effective, there are two fundamental requirements: *division of labour into distinct tasks* and *coordination among these tasks*. Mintzberg (1983) also believes that tasks can be designed into two specialised dimensions: *horizontal specialisation*, and *vertical specialisation*. Horizontal specialisation involves functional teams and cross-functional

teams collaborating and sharing their knowledge and skills. The design allows for the increase of knowledge in disciplines learning from complementary functions. Teams are grouped based on their skills, knowledge and/or expertise in their relevant function. This design encourages experts to work together to enhance knowledge and skills, as well as promoting understanding of the function.⁴ In contrast, vertical differentiation refers to the number of hierarchical levels in an organisation. Vertical differentiation can make the flow of information difficult given that the information has to pass through many layers. This can result in potential distortions of information (Mintzberg, 1983).

Mintzberg (1983) argues that designing functions involves grouping functions in a way that encourages them to operate as a *system*. Using Mintzberg's (1983) typology, there are six factors to consider when designing functions; we will however focus on the two most relevant of these.⁵ The first strategy is to group functions based on *work output*. Since ethics and compliance functions have a common goal of creating an ethical culture, they can be grouped. The second strategy is to group functions based on the specialised *skills and knowledge* they together require. Functions are grouped according to the level of exposure and training received.⁶ Painter et al. (2019) thus argue that one must consider aligning functions in a way that fosters complementary skills and competencies. Mintzberg (1983) similarly contends that for grouping of functions to be effective, the organisation must follow specific criteria: there must be efficient workflow management, a well-mapped process and scale of economies.

Turkulainen and Ketokivi (2013) highlight the importance of managing the collaboration of cross-functional units and functional interfaces with a specific focus on *organisational complexity* and *task complexity*. The authors define 'collaboration' as a process where

⁴ According to Hall (1977), job specialisation is considered a good indicator of horizontal differentiation.

⁵ According to Mintzberg (1983), functions could also be grouped by the type of work process and function, the time when the work is done, types of clients and the geographical location in which the organization is operating.

⁶ William (2012) notes that ethics officers are trained to handle conflicting positions, while compliance officers are not.

different teams work together to coordinate their activities to achieve a common goal. They define ‘organisational complexity’ as the challenges involved when functions with different sets of competencies must work together. Lastly, they define ‘task complexity’ as the operational requirements of various jobs depending on what the jobs aim to achieve.

In summary, there are important factors to consider when designing a function because design affects how teams function. Therefore, for ethics and compliance design to be efficient and effective, organisations must follow a structured and systematic approach based on relevant models or theories.⁷ As previously stated, ethics and compliance can be designed vertically or horizontally. We now turn to this topic.

2.5.1. Functional design principles on alignment

In the comprehensive literature on the subject, various authors develop ways to design functions. The research generally suggests that developing functions must follow a *systematic* approach. However, each design has particular benefits and inherent trade-offs.

According to Mintzberg (1983) and Burton and Obel (2018), certain key factors need to be considered when aligning functions: *the company’s size*, *the maturity of functions* and *the nature of the relevant industry*. Firstly, some organisations are small and to save costs and resources, they combine ethics and compliance functions into one function. Conversely, large organisations can afford to separate the two functions and make them independent functions. In terms of the second factor – maturity of the functions – if ethics and compliance functions are well established, they can be separated and operate independently. However, if the maturity level is low, the organisation should integrate the functions to allow for growth and development. The third factor is the nature of the industry. If their industry is highly regulated, compliance and ethics functions can be resourced to operate at an optimal level as independent functions.

⁷ Relevant theories include Structural Contingency Theory, wherein design is theorised to be context dependent (Donaldson, 2001) and Institutional Theory, which places institutions at the centre of the analysis of designs and conduct (Berthod, 2018).

As mentioned, there are two ways to drive alignment between ethics and compliance functions: vertical or horizontal. Vertical alignment operates within the specialised functional areas which are hierarchically structured. Vertical alignment thus creates functional specialists with clear roles and responsibilities. Mintzberg (1983) highlights that stand-alone functions are vertically aligned and have separate reporting lines. When compliance or ethics is treated as a stand-alone function, there are independent and objective criteria for monitoring the activities' implementation. There are proper checks and balances to ensure that each function's mandate is achieved; the hierarchy is evident.

As mentioned earlier, another school of thought argues that when combining ethics and compliance, compliance gets more attention since non-compliance (to regulatory requirements) results in stiff penalties. Ultimately there may be an inherent conflict between ethics and compliance priorities.

Vertical alignment promotes autonomy and independence, but – above all – it is centred around power and control within functional units. The functional reporting structure is clear and easy to manage. The scope of control and management is centralised at the top and is well defined. Vertical alignment facilitates more effective checks and balances, as well as implementable structures to deliver specific goals and objectives.

Vertical alignment has notable disadvantages. According to Guttman (2006), vertically aligned functions tend to focus more on what they need to deliver as a function and ignore how they fit into the organisation's bigger delivery plan. They end up outside the organisation's overall strategy. The functional teams may lose out on important activities and decisions because they are isolated. Moreover, vertically aligned functions can be inflexible; the sharing of information and decision-making is often slow (Guttman, 2006).

Horizontal alignment involves alignment between functions; the focus is on cooperating and coordinating efforts. Guttman (2006), Kathuria et al. (2017), and Painter et al. (2019) note that horizontal alignment concerns cross-functional alignment and collaboration. Cross-functional alignment promotes consistency, complementarity, and support of

functions. Horizontal alignment encourages the *distribution of power* between functions. In other words, the teams have the license to participate in making decisions about their work. There is a sense of *respect* for the knowledge and skills in each function. A notable benefit of horizontal design is that it creates a decentralised division of labour to respond quickly to business challenges. Unlike vertical alignment, the horizontal design focuses on working together on everyday activities across functions. The alignment takes advantage of coordinated tasks between functional units.

The disadvantage of the horizontal alignment is that it can create disharmony between functional units due to the risk of overlapping functions. The teams may end up competing amongst themselves for power and control. Unlike vertical alignment, horizontal alignment means cross-functional teams operate according to a clearly defined set of decision-making protocols; people are accountable and ‘own’ their results (Guttman 2006). However, Kathuria et al. (2014) argue that there must be shared goals and objectives across various levels and within hierarchical units for any alignment to perform effectively in the organisation. The authors argue that horizontal alignment improves inter-functional synergy and coordination.

Kathuria et al. (2014) and Painter et al. (2019) note that most past studies have focused on aligning ethics and compliance functions vertically. Painter et al. (2019) argue however that current researchers should pay serious attention to the horizontal alignment option. I now conclude by summing up this chapter.

2.6 Conclusion

Organisations have created ethics and compliance functions to help embed an ethical culture. However, since the introduction of ethics and compliance functions in companies, there is an ongoing debate over whether to promote integration or separation of the two. Some organisations separate the compliance function from the ethics function while others combine them into one function. A third way is to allow the two functions to operate independently while concurrently enabling them to collaborate. Currently, there is still little uniformity on how organisations should structure the ethics and compliance functions.

There are a range of different arguments for and against combining ethics and compliance functions. Some researchers argue that since ethics and compliance's sole purposes are to foster ethical culture, the two should be combined into one function. Conversely, other researchers argue that organisations should separate the two functions given that they apply different approaches to matters of concern. Thus, the organisation can align the ethics and compliance functions vertically and centralise power, thereby allowing each function to operate independently. Alternatively, the organisation can integrate the two functions into one function; this involves aligning the two functions horizontally allowing distribution of power and collaboration across functions.

However, this literature review demonstrates that the decision to either combine or separate the two functions is context dependent. Above all else, a decision on how to structure the two functions must be guided by a *systematic organisational design approach*. There are different organisation design theories one can apply. However, the common theme is that the design must be *adaptable* to handle current and future opportunities. The failure to design the two functions effectively can be attributed to structural arrangements and risks. This literature review highlighted that horizontal functional designs encourage collaboration, while vertical designs encourage independence. However, the study suggests that there is an alternative alignment to vertical or horizontal alignment. This is a promising third-way approach: the *hybrid model*. The hybrid approach takes the best of both vertical and horizontal alignments. Also, the hybrid approach ensures that there is a *shared purpose*, that there are *clear boundaries* and that there is *value in collaborating*.

The arguments considered in this chapter contribute to the ongoing debate on how to structure ethics and compliance functions. The next chapter will motivate why the hybrid model is the most desirable way to structure the two functions and also provide a practical guide to implementation of this approach.

3. Towards a hybrid model

3.1 Introduction

The literature review in chapter 2 has shown that both ethics and compliance functions have the shared goal of embedding an ethical culture in organisations. However, opinions differ on how these functions should be structured. As stated in the previous chapter, the design of ethics and compliance is influenced by a regulatory framework. We now consider how the ethics and compliance functions should be structured in light of South Africa's legal framework and regulations. This approach's practical implications will be illustrated at the hands of Painter et al.'s (2019) *values-driven business alignment framework*. This chapter is structured into three main sections which will be discussed in the following order: (1) the rationale for the ethics and compliance hybrid model; (2) South Africa's regulatory and legal framework (including The Governance of Ethics and Ethics Management Framework); and (3) the practical application of the hybrid model (as illustrated in the Painter et al.'s (2019) values-driven business alignment framework). The following section deals with the rationale for the ethics and compliance hybrid model we are favouring in this thesis.

3.2 The rationale for ethics and compliance hybrid model

The ethics and compliance functions are intricately linked in the institutionalisation of an ethics and compliance culture throughout an organisation. It is therefore crucial that they be properly aligned.

3.3 Background

Although the successful implementation of a suitable organisational culture is dependent on the reinforcement of ethics and compliance across the organisation, weaving them together can be challenging (Kral, 2018). The literature review in chapter 2 explicated three options for structuring the two functions; these are now briefly summarised.

Firstly, De Klerk (2015) argues that the two functions should separate. Therefore, they must be treated as standalone functions each having a separate reporting line. Each function has its structure that focuses on its deliverables. Ethics or compliance managers assume responsibility for their team's deliverables. Thus, supervision of output is specific to a function, and the two functions are regarded as specialised.

Secondly, as Kavanagh (2008) and Gnazzo (2011) argue, the two functions can be combined into one function having one reporting line. This arrangement introduces a structure where ethics and compliance report to one department and their activities are integrated into one plan. Authority is centralised at the top, and management is responsible for producing a single combined function. Thus, the two functions are interdependent. As stated in the previous chapter, according to the principles of functional design, this option involves vertical alignment. Guttman defines vertical alignment as the traditional hierarchical business model involving divided functional silos requiring multiple approval levels before decisions can be made.

What is shared between the two designs is that both approaches follow a hierarchical structure; they operate in silos and authority is centralised at the top of the organisation. The unintended consequence of centralised authority is that there are multiple management layers. Information flow is slow due to multiple layers; the information gets distorted and decision-making processes are slow. An advantage however is that the lines of authority and accountability are clear. Moreover, teams have specialised skill sets and can therefore operate independently.

The third option is to align the two functions to be independent but collaborative. This involves the two teams having separate reporting structures but also coordinating and collaborating on pertinent tasks and activities. Dana (2016) and Painter et al. (2019) argue that they must actively collaborate since they aim for the same goal; they need each other to exist. According to the principles of functional design, this alignment that promotes collaboration between functions is horizontal. Horizontal alignment encourages the two

functions to be independent but collaborative. This is our preferred hybrid model, which we turn to next.

3.4 The hybrid model: benefits and requirements

As stated in the previous chapter, both combining and separating the two functions has advantages and disadvantages. Bearing in mind the positives and negatives of vertical versus horizontal alignment, we now turn to the argument for why a hybrid model is the best approach to aligning the ethics and compliance functions. The inherent challenges involved in vertical alignment and the benefits involved in horizontal alignment serve as the impetus for the hybrid model.

Borys and Jemison (1989) argue that the hybrid model promotes a *common purpose* for two or more functions. The authors highlight that for the hybrid model to yield results, breadth of purpose, boundary determination, value creation and stability mechanisms must be at the centre of arrangements. Breadth of purpose creates a platform for sharing a common purpose and reducing uncertainties. Common purpose also clarifies the expectations of each team. According to Borys and Jemison (1989), since both functions have their deliverables, teams must have a well-articulated boundary where the hybrid begins and where it ends. Without well-specified boundaries, teams tend to attach some of their obligations to the hybrid process thus lowering hybrid performance. Value creation centres around the quality of reciprocal interdependence relationships. Lastly, the two functions must maintain performance stability by instituting rules, procedures and roles that create expectations of dependability among members.

Fostering the hybrid model *prevents silos and expands cooperation and collaboration*. The horizontal alignment can help the ethics and compliance functions look beyond their immediate function and recognise that they are, in fact, interdependent. The two functions should not be inward-looking. Instead, they should ‘see the bigger picture’: their work directly impacts the broader organisation. Borys and Jemison (1989) argue that a lack of common purpose and information sharing prevents cooperation and collaboration. The

ethics and compliance functions must join efforts to embed a suitable organisational culture by making ethics and compliance part of the organisation's critical processes. In other words, the hybrid model ensures that there are no inter-functional barriers. The ethics and compliance teams consistently coordinating efforts to institutionalise an ethical and compliant culture. The literature suggests that proper compliance can be achieved if there is a robust ethical culture where people want to adhere to values of the organisation.

When implementing the hybrid model, potential tensions between the two functions should be prevented. Kavanagh (2008) argues that the source of tension between the ethics and compliance functions is *internal resources*. The organisation may not have enough resources to accommodate both ethics and compliance activities and is then forced to choose between them. Alternatively, the two functions may not have enough resources to deploy in achieving a common goal. According to Borys and Jemison (1989), decisions must be made about how much of each team's resources can be claimed in the hybrid model. To respond to this challenge, ethics and compliance must identify the resources that are (or are not) part of the collaboration process. The goal is not to compete over resources but instead to share available resources to build an ethical culture.

Although the hybrid alignment intentionally promotes the collaboration of the ethics and compliance functions in matters of common interests like training and awareness campaigns, it also allows that the two functions operate independently. Independence will allow the two functions to discharge their respective responsibilities without overt interference. Independence also allows for the segregation of power between ethics and compliance to mitigate potential conflict. However, independence must not weaken the working relationship between the two functions. The hybrid model *manages* the tension between independence and collaboration. Hybridisation combined with distinctive duality creates a desirable balance between collaboration and independence.

For Kavanagh (2008), when ethics and compliance are not equally promoted, compliance squeezes out ethics due to so-called organisational span of control. That is, the functional design will support the compliance function, and there is a danger that compliance can

become merely a ‘box-ticking’ exercise (Dana 2016). The hybrid model therefore encourages organisations to give equal attention to ethics and compliance. There should not be over-reliance on one function. Instead, there should be exchange of complementary skills between the two functions to assist in embedding an ethical culture. Each function contributes equally.

The coexistence of the two functions promotes an efficient and effective way of solving ethical challenges. Unlike vertical alignment, horizontal alignment ensures that information flow is fast because there is no hierarchy involving different management levels. Consequently, the decision-making process is efficient because of the absence of multiple levels of decision-makers (as in vertical alignment). Moreover, the decision-making protocols are clearly defined and synchronised. Furthermore, coexistence encourages different but complementary perspectives to help address ethical problems. In contrast, when functions are integrated into one function or operating completely independently, they fail to achieve an optimal balance; the focus is one-sided.

Compared to vertical alignment, the hybrid model helps the two functions recognise duplication of efforts and proactively correct them when their performances overlap. In other words, the two functions have *proactive inter-functional communication channels*. Ultimately, a well-structured and targeted approach will help the two functions create *synergy* when delivering messages about suitable conduct while also holding employees *accountable* when they are noncompliant with policies.

The design of the ethics and compliance functions must also be aligned with the organisational strategy and be congruent with the regulatory framework. The following section will examine South Africa’s regulatory and legal framework and its contribution to structuring relevant ethics and compliance functions.

3.5 South Africa's regulatory and legal framework

The hybrid model also finds support in the South African legal and regulatory framework.⁸ Naidoo (2009) and Wiese (2014) notes that in South Africa, the regulatory framework governing companies consists of the Companies Act 71 of 2008, the Company Regulations of 2011, common law, the King IV Report, incorporation of King IV in the Johannesburg Stock Exchange (JSE) listing requirements and other legislation that directly or indirectly imposes certain governance obligations (e.g., the Competition Act 89 of 1998).

The framework reinforces self-regulation via the principles of King IV Report. King Report's recommendations are incorporated into legislation through the Companies Act 2008 and Johannesburg Stock Exchange listing requirements. The South African framework endorses a voluntary, principle-based approach (as in King IV) but also stipulates legal requirements (via the Companies Act, the Companies Regulations and listing requirements).

Andreasson (2011) argues that because of the challenges associated with the transition from apartheid and concomitant reintegration into a competitive world economy, South Africa is better at maintaining the principle-based approach. This is due to the adoption of the Bill of Rights contained in the South African Constitution and the laws that have been enacted to give effect to the principles and rights contained therein.

Post-apartheid South Africa's regulatory landscape has changed fundamentally; hence there has been a need to review company law and align it with the Constitution and the Bill of Rights (Wiese, 2014). Rossouw et al. (2002) argue that to participate in the global economy, South African corporations must meet international corporate governance

⁸ The regulatory framework of a country influences the ethics and compliance structural alignment. Kral (2018) notes that the US Sentencing Guidelines have served as corporate America's blueprint in structuring effective programmes to prevent and detect violations of the law. This explains why ethics and compliance are integrated into one function in the US.

standards without neglecting domestic challenges. According to Wiese (2014), the question driving the New Companies Act of 2008 was in whose interest a company should be run? The question concerns whether a company should adopt the *stakeholder model* or the *shareholder model*.

Evan and Freeman (1993) define stakeholders as all parties that (to some extent) rely on, interact with or are affected by the operation of the company; shareholders are those with a direct financial stake in the company's profits or losses. The shareholder model holds that the corporation is an extension of its owners and ultimately responsible to these owners; conversely, the stakeholder model understands the corporation as a social entity responsible and accountable to a broader set of actors (Andreasson, 2011). According to Wiese (2014), the new company law guidelines suggest that – considering the South African context and the country's constitution – companies should serve the need of *both* the shareholders and the stakeholders.

The King IV Report also stipulates that companies must not serve only their shareholders' interests; they have a responsibility towards all the stakeholders (to varying degrees). Essentially, shareholders are classified as part of the broader stakeholder community; thus, there must be a *balanced* approach to meeting *all* stakeholders' interests. For business operations to succeed, there also needs to be concern for non-financial factors such as surrounding social and environmental domains. In this case, the South African legal and regulatory framework integrates the law and values to build compliance and ethical cultures.

Andreasson (2011) argues convincingly that to balance shareholders' interests and rights with the needs and demands of a broader range of stakeholders in society, we need to adopt the hybrid model. This is because the prosperity of the business and that of society is interdependent. Principle 3 of King IV states that the organisation is – and should be seen to be – a responsible corporate citizen. In other words, companies should not only serve shareholders' needs, but should address the social and economic benefits to the society they are operating in. Equally important, King IV focuses on the ethics of governance (Van

Vuuren 2018). The ethics of governance demands an *inclusive stakeholder ethos*. That is, the organisation must not focus on one or a few stakeholder's needs and ignore the rest of the stakeholders. Furthermore, the organisation must be transparent when dealing with all stakeholders not just with shareholders.

To ensure an effective application of the law, the South African government delegated some control over companies to regulatory bodies, agencies and authorities that deal with specific crimes (Naidoo, 2009). These delegated control functions ensure that companies are well managed and that there are consequences for non-compliance with regulations. To avoid penalties, the board must oversee that the company complies with set regulations.⁹

Furthermore, principle 2 of King IV (IoDSA, 2016) states that the board, as a governing body, is not just accountable for compliance with laws, but also responsible for the establishment of an ethical culture. To ensure good corporate governance, South Africa follows King IV's self-regulatory system of good practice. King IV provides guidelines for company practise; however, the guidelines are voluntary. According to (King IV) (IoDSA, 2016), the legal status of King IV is that of a set of voluntary principles and therefore lacks legal enforcement. King IV stipulates the standards of good governance. South African companies are encouraged to apply the principles and practices of the King Report to mitigate the risk. If companies fail to apply these principles, they are expected to explain why.

Lastly, listing of companies on the JSE – a licensed exchange under the Securities Act (2004) – is granted subject to compliance with the principles set out in King IV and with specific corporate governance requirements. Some elements of King IV have been incorporated into the JSE listing requirements. Therefore, listed companies must comply

⁹ Over and above the stated regulations, certain customs and court decisions attain law-status even when they are not specifically written as legislation (these are known as common laws). To enforce common law principles in South Africa, the common law provisions are reflected in the Companies Act (2008). For example, the Act stipulates that directors and officers have a fiduciary duty to act in good faith and in a company's best interests.

with King IV's provision, and failure to comply requires an explanation. There are sanctions for non-compliance with listing governance requirements.

As demonstrated above, the regulatory framework in South Africa is consistent with the hybrid model. This means that it adopts the rules-based approach where corporate governance is legally enforceable through the laws and regulations but also follows the principles-based approach through the codes of fair practice. Furthermore, some of King IV principles are incorporated into the JSE listing requirements. The South African regulatory framework advocates *compliance and ethics*. This is consistent with the hybrid model in that the interdependency of the *legal and ethical* functions is recognised whilst safeguarding the autonomy of each function.

Finally, The Ethics Institute developed the Governance of Ethics and Ethics Management Framework to assist organisations in managing ethics. Although The Ethics Institute's Governance Framework does not form part of hard regulations, that is compliance, it is part of the soft regulatory roadmap for ethics management in South Africa.

In conclusion, the characteristics of mandatory laws and discretionary principles support the notion that South Africa's regulatory and legal framework is consistent with the hybrid model. Furthermore, the hybrid model's rationale lays a foundation for examining the framework applicable to corporate ethics.

The following section will examine The Ethics Institute Governance Framework.

3.6 The Governance of Ethics and Ethics Management Framework

Implementing sound corporate governance poses some challenges within companies as it requires a change to standard operating procedures. Therefore, to assist South African companies in embedding an ethical culture, the Ethics Institute developed The Governance of Ethics and Ethics Management Framework (Van Vuuren, 2018). South African companies are aware that they require proper governance of ethics as stated in principle 2 of King IV. This principle states that the governing body should govern the ethics of the company in a way that supports the establishment of an ethical culture. However, the

challenge lies in *operationalising* this task.¹⁰ Figure 1 shows the four stages in the Governance of Ethics and Ethics Management framework.



Figure 1: The Governance of Ethics and Ethics Management Framework (Van Vuuren, 2018).

The Governance of Ethics and Ethics Management Framework consists of: (1) leadership commitment, (2) establishment of the governance structures, (3) ethics management and (4) external assessment. Let us discuss these in turn.

3.6.1 Leadership commitment

Van Vuuren (2018) makes a distinction between the governance of ethics and ethics management. The governance of ethics is the establishment of governance structures to govern ethics activities. The Governance of Ethics and Ethics Management Framework

¹⁰ The Governance of Ethics and Ethics Management Framework promotes an ethical culture through the management of ethics.

empowers the ethics office to manage ethics in a logical and structured manner (Van Vuuren, 2018). To give effect to leadership commitment, as stated in the Institute's framework, King IV's principle 1 (IoD, 2016) states that the governing body should provide effective and ethical leadership. The Governance of Ethics and Ethics Management Framework states that leaders must show proper commitment by ensuring that their organisation is, in fact, led in an ethically responsible way. Thus, the tone is set at the top, and ethics and compliance principles are ingrained in a top-down fashion.

3.6.2 Governance structures

The Governance of Ethics and Ethics Management Framework encourages organisations to implement governance structures such as ethics ambassadors,¹¹ ethics offices and so-called ethics champions.¹² Furthermore, the Companies Act (2008) section 72 (4) stipulates that the organisations must establish a Social and Ethics Committee to monitor and report ethics-related matters. Similarly, King IV principle 8 states that the Social and Ethics Committee's responsibility should include its statutory duties and any other responsibilities delegated to it by the governing body.

3.6.3 Ethics management

Moreover, the Governance of Ethics and Ethics Management Framework stresses that an organisation must conduct ethics risk and opportunity assessments as part of ethics management. The outcomes of the assessments should help the ethics team to understand the organisation's risk profile. Based on the risk profile, the organisation should decide on the appropriate ethics management strategy with clear management plans to mitigate identified risks. In return, the organisation's ethics strategy and types of risks will inform its code of ethics and ethics-related policies. The company can follow the principles-based approach, the rules-based approach or a combination of both (a hybrid approach), to

¹¹ Ambassadors could be utilized for their personal integrity and credibility; they are often respected members of the organisation (Rossouw and Van Vuuren, 2017).

¹² An ethics champion has an instrumental role as the catalyst for the ethics management initiative. The role of ethics champion should ideally be taken up by the CEO (Rossouw and Van Vuuren, 2017).

develop the suitable code of ethics. The risk profile will also dictate the type of policies to prioritise. Upon completing the ethics strategy, the ethics-related policies and the code of ethics, the ethics team should consider the most effective way to create awareness of the organisation's documented outcomes. The ethics team should implement pro-active initiatives like awareness campaigns, ethics help desks and reactive interventions like disciplinary procedures. Lastly, to manage ethics risks, both teams should report the performance of the organisation to all relevant stakeholders.

3.6.4 Independent assessment

Lastly, the Governance of Ethics and Ethics Management Framework states that a governing body must consider the need to receive periodic independent assurance of risk management's effectiveness. In other words, the governing body should allow an independent assessment by internal audit to evaluate the adherence to the organisational ethical standards. In support, King IV principle 11 (IoDSA, 2016) likewise suggests that there should be independent assessment of the organisation's ethics performance that looks to objectively monitor for good governance.

In summary, to establish an excellent corporate culture, the Governance of Ethics and Ethics Management Framework follows the hybrid model. It combines King IV's principles of good governance and the Companies Act's standards (2008). The former representing work of an ethics function, and the latter of a compliance function.

To conclude, in South Africa – like in many other countries – corporate governance has risen to prominence. The governance is not done in isolation from the broader background of the country's legal and social context. An effective governance framework is dependent on a robust legal framework in the country. The South African regulatory framework aligns mandatory regulation and self-regulation approaches. Furthermore, South Africa's corporate governance is characterised by focusing on satisfying the interests of both the shareholders and the stakeholders. A framework opts for an inclusive stakeholder approach. Andreasson (2011) refers to this approach as a hybrid model because organisations need to engage with all stakeholders (not just shareholders) in a meaningful

and strategic way. To implement the hybrid model, there must be a practical guide to assist organisations. The next section covers the hybrid model's practical application.

3.7 Practical application of the hybrid model

As previously highlighted, the ethics and compliance functions must be independent but collaborative to achieve common goals. This section will cover the practical framework to guide the hybrid model's application through the horizontal alignment of the ethics and compliance functions. The research will apply Painter et al.'s (2019) values-driven business alignment framework principles. These are supported by Guttman's (2006) work on building horizontal organisations; Berenbeim's (2010) work on utilising Human Resources, ethics, and compliance collaboration to instil ethics; and Borys and Jemison's (1989) work on hybrid arrangements as strategic alliances. According to Painter et al.'s (2019) framework, the practical application of aligning the two functions has five stages. These are illustrated in the diagram below and can serve to promote hybrid horizontal alignment within organisations. We will apply the five stages of Painter et al.'s (2019) framework to align the ethics and compliance functions practically.

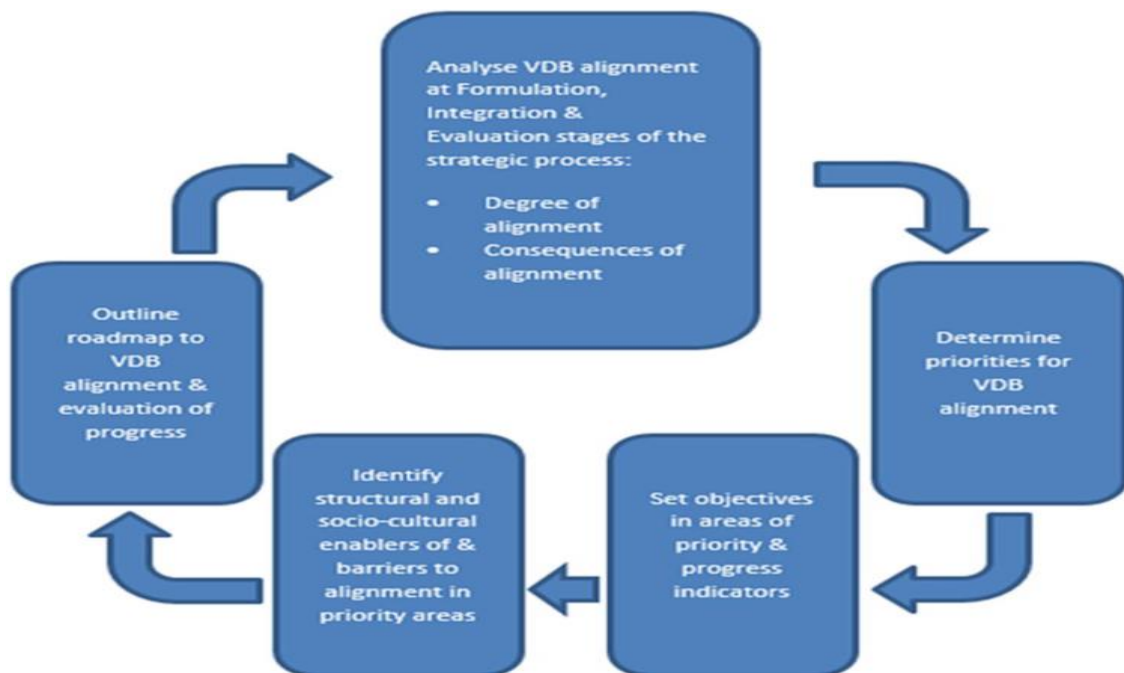


Figure 2: Values-driven business alignment framework (Painter et al. 2019)

The five phases to follow when aligning functions horizontally in this framework are: (1) determine the degree of alignment in values-driven functions, (2) determine priorities for alignment, (3) set objectives in priority areas, (4) identify structural and socio-cultural enablers or barriers and (5) outline the road map and evaluate progress. Let us explore these in turn.

3.7.1 Determine the degree of alignment

According to Painter et al.'s (2019) values-driven business alignment framework, the first phase allows representatives of the two functions to identify areas that hinder alignment versus opportunities for alignment and creating synergy. At this stage, context plays an important role; the representatives must consider the internal factors that could potentially promote or hinder collaboration. The size of the organisation, levels of competence, available budget and organisational ethics management maturity levels encourage or hinder alignment (Van Vuuren, 2018). The functional design literature moreover suggests that implementing a hybrid model can be facilitated or hindered by its structural design. Thompson (1967) defines 'structure' as an organisation's internal pattern of relationships, authority and communication. Thompson (1967) argues that there are certain dimensions to consider when structuring functions; these include centralisation or decentralisation of the locus of authority and decision making. Painter et. al. (2019) argue that a values-driven business alignment framework encourages the decentralisation of decision-making processes at the operational level. Decentralisation of power and authority promotes collaboration between the two functions and improves the decision-making process.

Painter et al.'s (2019) values-driven business alignment framework acknowledges that the ethics and compliance functions play various roles. To allow the two teams to align and function at an optimal level, there must be adequate allocation of resources for both ethics and compliance. Burton and Obel (2018) argue that there must be clarity on resource allocation for the design framework to be effective. Borys and Jamison (1989) highlight that in a hybrid arrangement where the stated purpose is not aligned with the actual activities, resources are likely to be affected.

Furthermore, the successful implementation of horizontal alignment requires senior management's involvement and support. Management's role in embedding an ethical culture is crucial. Therefore, senior management must actively support the effort to adhere to ethical standards. As stipulated in King IV, the "tone from the top" influences how the company is lead and managed. Buy-in from the top managers will show strength and sincerity about doing the 'right thing'.¹³ Verschoor's (2017) study however shows that only 16% of employees view the CEO as the champion of compliance and ethics.

The ethics and compliance functions have the task to provide support to top management by equipping them with skills to exemplify the organisational values and handle unethical conduct. The ethics and compliance officers also need to organise executive coaching to assist leaders with ethical conduct. Ongoing leadership development training would assist leadership in making ethics part of the organisation. Ethics and compliance officers must also create a system for top management to continuously communicate the importance of both 'living the values' and of the consequences for non-compliance to all employees. Verschoor's (2017) study shows that 82% of senior leaders communicate the importance of having a strong ethics and compliance culture. Open communication by top management on zero-tolerance for unethical conduct and non-compliance with the laws will send the message that living the values is non-negotiable. Frequent and consistent communication – particularly face-to-face events like conferences, team meetings and 'town halls' – will also reinforce compliance and ethical culture.

3.7.2 Determine priorities

According to Thompson (1967), the second dimension to consider when structuring the hybrid function is *formalisation*. This involves establishing rules and procedures to govern behaviour. Painter et al.'s (2019) values-driven business alignment framework suggests that to embed an ethical and compliant culture, the ethics and compliance functions need

¹³ Line managers also play a crucial role in institutionalising ethics (Van Vuuren, 2018). Guttman (2006) argues that a champion is needed at the executive level to demonstrate total commitment during this phase.

to prioritise the design of policies, the code of ethics and the code of conduct. Regarding the code of ethics and the code of conduct, Brien (2013) argues that the two codes can be complementary. Therefore, ethics and compliance officers must ensure that the two codes reference and complement each other. The code of ethics or the code of conduct standing alone cannot block illicit behaviour (Brien, 2013). Promotion of the code of ethics will not just happen unsolicited; there must be a coordinated effort to encourage it (Brien, 2013).

According to Blodgett (2011), for the code of conduct to be implemented successfully there must be a strong belief and buy-in that the codes must be obeyed. This may be accompanied by making explicit to employees what the measures are. The code of conduct must be used as a reactive tool by evaluating past performance and applying disciplinary measures to deter unethical conduct (Brien, 2013). The code of ethics must be used as a proactive tool to create awareness of what behaviour is expected and can be used as a guide for decision making (Brien, 2013). Furthermore, both codes must support the company's values by guiding employees on compliance with the organisation's standards and on how to resist unethical conduct (Thompson, 1967). However, for the codes to be helpful, they must incorporate both the expected behaviour and the sanctions for non-compliance.

Furthermore, the ethics and compliance-related policies must outline the obligations of the employer and employee. Thompson (1967) notes that compliance policies highlight the rules around conduct and applicable sanctions for non-compliance. As mentioned, the Governance of Ethics and Ethics Management Framework states that the ethics strategy of the organisation should inform the ethics policies of the organisation. For example, suppose the company's strategy is to promote zero-tolerance for corruption and bribery. In such a case, the compliance and ethics functions will prioritise developing anti-bribery and corruption policies

Upon completing the codes and policies, the ethics and compliance functions must collaborate to educate the organisation about these codes and policies. However, the compliance function must ensure that their intervention does not involve educating employees on compliance with rules only. They also need to raise awareness around doing

the right thing. Conjunctively, the ethics team needs to educate employees on how to act ethically and comply with the rules. The training content must cover ethics and compliance, and scenarios must be based on actual situations that employees experience (Kavanagh, 2008).

3.7.3 Setting objectives and progress indicators

It has been noted that leadership must take responsibility for setting a strategic organisational direction. Painter et al.'s (2019) values-driven business alignment framework highlights that the ethics and compliance functions must also play a crucial role in the formulation of the strategy and objectives. Furthermore, the literature suggests that to have a sustainable business, a company's strategy must be grounded in ethical values and not just financial performance. Therefore, the company's strategy must reflect its values. To focus on the alignment between strategy and values, the ethics and compliance functions must be central to the strategy formulation and speak with one voice (Painter et al, 2019). Verschoor (2017) notes that the PwC State of Compliance Study of 2016 (based on information gathered from 600 global executives in large companies) finds that only 36% of the executive surveyed believe compliance officers "play a key role" in strategic planning. Therefore, the two functions' involvement is crucial to ensure that the discussion is steered towards achieving an ethical strategy.

Verschoor (2017) notes that companies could improve compliance and ethics by integrating operations and strategy efforts. The input of the two functions in strategy formulation should thus consider the execution of the strategy. For example, if the organisation sets unrealistic targets based on the strategy, then ethics and compliance must highlight the ethical and compliance risks of these unrealistic targets. These unrealistic targets risk unethical conduct because they further an organisational strategy that is inconsistent with company values. The ethics and compliance officers' involvement will ensure that the company strategy is built on an ethical foundation. This is done by implementing and institutionalizing policies and procedures that reduce the occurrence of unethical activities.

Once the company's strategy is formulated and communicated, the ethics and compliance teams must identify and prioritise factors that aid the organisation to achieve its strategy. The two functions must conduct an inclusive and structured risk assessment to identify high-risk areas within the organisation. As stated previously, King IV principle 11 stipulates that the governing body should govern risk in a way that supports the organisation in setting and achieving its strategic objectives.

Furthermore, The Governance of Ethics and Ethics Management Framework states that the organisation must conduct a formal ethics risk and opportunity assessment. The identified risks and opportunities must be managed and monitored. Rossouw and Van Vuuren (2017:252) highlight that many organisations appoint an operational ethics committee.¹⁴ The operational ethics committee monitors how material ethics risks are managed (Rossouw and Van Vuuren, 2017). Further, Rossouw and Van Vuuren (2017:252) say "the operational committee implements the ethics strategy". In other words, the committee converts the ethics strategy into an ethics management plan and reports on the progress of the implementation of the management plans. In order to promote good corporate governance, the committee should ideally meet on a quarterly basis (Rossouw and Van Vuuren, 2017).

Additionally, Painter et al. (2019) argue that the ethics and compliance functions must act as an independent voice to provide feedback on how the organisation should maintain profit-growing objectives while also instilling an ethical approach within the organisation. This independent voice is an effective way to infuse standards of ethics and compliance into business objectives (Painter et al, 2019).

Considering the above statement that the two functions must act as an independent voice, I recommend that the ethics and compliance officers must provide guidelines to help employees with decision-making when they are confronted with ethical dilemmas. Employees must have the ability to check if their decisions and actions are acceptable, i.e.

¹⁴ This operational committee should also include team members from other risk functions.

whether they support the organisational strategy. They need to have a clear understanding of what is acceptable and who they can contact when in doubt.

King IV principle 16 highlights that stakeholder inclusivity is key to an organisation's long-term success. Therefore, the organisation needs to understand its stakeholders' interests, concerns and expectations. The ethics and compliance teams need to help facilitate stakeholder engagement to get feedback on ethical and compliance challenges and to guide the company on how best to address these. However, the teams must consider their own capacity and available resources. They can then agree on how best to conduct stakeholder reviews so as to avoid resource constraints and duplication of efforts. Borys and Jamison (1989) highlight the importance of setting boundaries when collaborating; the two functions must make clear which resources form part of the collaboration.

In terms of progress indicators, the ethics and compliance functions must develop critical metrics against which to measure both success in building an ethical culture and the impact of their collaboration on the profitability of the organisation. However, as recommended by the Governance of Ethics and Ethics Management Framework, an independent function must assess the efficacy of ethics initiatives.

3.7.4 Identify structural and socio-cultural enablers or barriers

Structurally, some existing channels and processes act as enablers or hindrances in embedding an ethical culture. The ethics and compliance teams must identify enablers and barriers to aligning their two functions. (the size of the organisation can be a hindrance for example). Van Vuuren (2018) argues that if an organisation is small in size, the two functions can be integrated into one function due to resource constraints. Conversely, when an organisation is very big and complex, the ethics and compliance functions may find it difficult to coordinate their activities within the organisation.

However, proximity can enable the two functions to monitor each other's work and adjust accordingly. The principle of accountability in the hybrid model creates an enabling environment. Guttman (2006) notes that team members hold each other accountable by

consistently asking the right questions such as “how far are you with your deliverable?”, “do you need any help?” or “are you comfortable that you will meet your deadline?”. Furthermore, each functional team is interested in achieving best results because they feel their contribution is part of the overall output.

The existing reactive and proactive Human Resource processes could enable collaboration of the ethics and compliance functions. Processes, like the onboarding of new employees and training, can offer consistent ethics and compliance messages about what the organisational values and what the rules are.

3.7.5 Set up a roadmap

The last phase of Painter et al.’s (2019) values-driven business alignment framework involves designing a strategic plan that outlines what is required, why it is required and how to deliver the desired outcome. According to Guttman (2006), the roadmap must set operating objectives for aligning the two functions. Furthermore, the roadmap must create shared understandings of what needs to be delivered and the process for delivery. That is, the road map must help create a shared view of what the goal is for both functions. This process consists of three steps: (1) planning phase, (2) implementation phase and (3) post-implementation and monitoring phase.

3.7.5.1 Planning phase

The plan should include specific steps and milestones to reach a desired goal as well as measurement to monitor progress. That is, each milestone has an expected timeframe to achieve the desired state, and there must be a charter to outline the decision-making ground rules and rules of engagement. This is because where there are rules, teams find it easier to communicate with each other and conflict is easily managed (Guttman, 2006). One must plan for how ethics or compliance initiatives are going to be conducted across the organisation. One must ask, for example, “what structures are the two functions going to use to facilitate training?”, “whose responsibility is it to reward good behaviour and punish bad behaviour?”, “what do we do when the ethics and compliance functions overlap?” and

“how do we hold each other accountable for results?” Burton and Obel (2018) argue that for the framework to be helpful, there must be clarity on *who does what, when and how*.

3.7.5.2 Implementation phase

As previously highlighted, ethics and compliance functions must be independent but collaborative in matters of common interests. In the process of implementation, the two teams must employ the agreed upon initiatives and processes with the view to create synergy between functions through collaboration. For instance, the ethics office should manage the reported cases independently by screening them and allocating them to the correct department to intervene. The compliance office should independently ensure that investigations are conducted, and that so-called consequence management is implemented; this ensures that all transgressions are dealt with swiftly and decisively. According to Guttman (2006), cross-functional team members (both individually and collectively) share in the trials and triumphs during the implementation phase. In other words, they are jointly responsible and accountable since power and responsibility are decentralised.

Guttman (2006) argues that it is one thing to lead vertically aligned teams, another to lead across horizontal alignment. According to Guttman (2006), vertically aligned teams have a similar knowledge base and are accustomed to reporting to the same line manager, while horizontally aligned teams have different skills and separate reporting lines. Therefore, horizontal alignment requires a ‘mind shift’ from team members. According to Berenbeim (2010), promoting and enhancing collaboration between ethics and compliance demands leadership to display apt competencies and attributes. Therefore, to successfully implement collaboration between the two functions, the leadership of each team must be provided with the relevant skills to handle the specific challenges of horizontal alignment.

The ethics and compliance team members must also understand how to facilitate the intentional collaboration of the two functions successfully and be empowered to do so.

3.7.5.3 Post implementation and monitoring

Painter et al.'s (2019) values-driven business alignment framework highlights the importance of continuous evaluation and monitoring of the teams' work. Taking the above into consideration, I thus conclude that the ethics and compliance officers should continuously check their progress against their set goals. That is, the teams should compare what was planned with what was delivered to generate feedback on their performance. According to Painter et al. (2019), this phase identifies successes and failures so that the two teams can improve. We can say that the focus should be on what they need to stop doing, start doing or continue doing.

Guttman (2006) argues that the comparison should be based on the agreed charter, and must include factors contributing to the project's successes, failures and improvement areas. Notably, I conclude that the teams must do interviews with diverse stakeholders to assess the effectiveness of the two functions' collaboration. There should be engagement with senior management to understand if the collaboration helps achieve the business' core objectives. There should also be feedback from employees to determine whether the collaboration empowers their day-to-day decision-making. Berenbeim (2010) argues that it difficult to demonstrate that the collaboration of the two functions contributes to the 'bottom line'; however, it is easier to show that successful implementation of the collaborative efforts reduces reputational risk.

Based on all stakeholders' feedback, the ethics and compliance teams must make practical recommendations to improve the hybrid model's operation. According to Guttman (2006), cross-functional teams learn best from their own experience provided they self-monitor. Based on this feedback, the ethics and compliance teams can report to senior management and the board on the effectiveness and efficiency of the hybrid model. They should also highlight the challenges they faced along with solutions to address these. Importantly, the feedback should stress *what it takes to implement distinctive but collaborative work successfully*.

In summary, Painter et al.'s (2019) values-driven business alignment framework promotes horizontal alignment associated with the coordination of unique but interdependent functions. To practically implement the hybrid model, there must be a tool to guide organisations on how to plan. Moreover, there must be agreement on the way to assess the effectiveness of the project.

3.7.6 Conclusion

Weaving the ethics and compliance functions into the organisational culture to instil ethical conduct while also enforcing compliance remains challenging. Although the literature review suggested that the ethics and compliance functions have common goals, the challenge is coordinating their often-fragmented work. The two functions' design is influenced by the organisation's size and the maturity of the two functions. Another factor that influences the design of the two functions is the relevant country's regulatory and legal framework.

In South Africa, the legal and regulatory framework follows the hybrid model. The framework enforces implicit standards through King IV, the Companies Act of 2008 and the JSE listing requirements. Also, to assist South African companies in embedding an ethical culture, The Ethics Institute developed the Governance of Ethics and Ethics Management Framework. In a quest to institutionalise an ethical culture, the framework recommends that the ethics function should make ethics part of the decision-making process. However, according to The Ethics Institute's Governance Of Ethics Management Framework, the ethics function and other risk management functions, like the compliance function, should collaborate to embed a strong ethical culture in an organisation. Thus, the hybrid model seems to offer the most suitable approach to ethics and compliance function design.

The rationale for a hybrid model is that functions combine to pursue common interests (Borys and Jemison, 1989). According to Painter et al. (2019), the hybrid model allows that the ethics and compliance functions play mutually supportive yet distinctive roles. Taking into consideration the above statements, I then argue that the two functions need to

work closely together to assist each other in proactively detecting unethical conduct and in preventing the reoccurrence of such conduct. Furthermore, the hybrid model develops a platform that enables ethics and compliance to be, in a sense, both separate and together. For instance, the ethics office independently manages the reported cases by screening them and allocating them to the correct department to intervene. The compliance office will independently ensure that investigations are conducted, and that so-called consequence management is implemented; this ensures that all transgressions must be dealt with swiftly and decisively. Then both functions must jointly provide feedback on the findings and make recommendations to share with relevant stakeholders.

Allowing the two functions to draw on each other's knowledge and skills helps create synergies between them. This means that ethics and compliance get equal attention. When the two functions diverge, they operate in silos and their efforts are disjointed. The unintended consequence of operating in silos is that functions focus only on immediate tasks and not on the 'bigger picture'. Conversely, when the two functions are combined into one function, researchers argue that compliance overpowers ethics. However, the hybrid model promotes coordination and collaboration of the activities of the two functions.

To operationalise the hybrid model successfully, the ethics and compliance functions must identify collaboration areas and collectively draw up a plan with clear roles and responsibilities, and they must prioritise activities to avoid duplicated efforts. Moreover, the two functions must identify activities that will enable versus hinder their alignment. Lastly, there must be a way to evaluate the programme's efficacy. This involves three stages: the planning stage, the implementation stage and then post-implementation and monitoring.

4. Summary and Recommendations

4.1 Introduction

My thesis set out to ask whether the ethics and compliance functions should be combined or separated in organisations. Furthermore, the thesis compared the optimal way of structuring the ethics and compliance functions in organisations. Currently, there is no consensus on the two functions' optimal structuring. This research reviewed the different ways to do so. The literature shows that, in the past, research focused on the vertical alignment of the two functions. However, an increasing body of knowledge on horizontal alignment of the two functions has been produced in recent years.

4.2 Discussion

Vertical alignment is the traditional hierarchical business model. As we have seen, it involves functional silos and different organisation levels (similarity of work determines the alignment of functions and goals). Conversely, the horizontal alignment model supports functional teams to work more collaboratively. Horizontal alignment happens between functions and vertical alignment within a function. However, the vertical alignment is dominated by a single chain of command, and there are multiple management layers. As a third way, there is another approach: the hybrid model.

The hybrid approach borrows the best features from both vertical and horizontal alignment. For example, the hybrid model blends the chain-of-command of the vertical alignment with the complementarity or synergy of horizontal alignment. The two functions combine their effort to pursue a common objective while maintaining their independence. This thesis has discussed three ways of structuring ethics and compliance functions and the design principles that guide the two functions' structuring. The discussion has centred on vertical alignment, horizontal alignment and the hybrid model.

Whenever there is a corporate scandal in the headlines, the debate on structuring the two functions is revived. The result of these developments is generally either the tightening of

compliance or the introduction of ethics to govern corporate behaviour. However, this thesis demonstrated that focusing on either compliance or ethics does not produce results.

Compliance and ethics are conceptually different. Compliance focuses on obeying the rules and ensuring that conduct aligns with set rules, whereas ethics focuses on principles, values and the law. Compliance can instil fear and punishment, while ethics encourages adherence to ethical standards. However, even though the two concepts are different, they have a common goal: to embed ethical conduct within an organisation. This necessitates cooperation between the two functions as developed in the hybrid model. The two functions promote different, but complementary cultures.

While appreciating the need to have the ethics and compliance functions, companies are struggling to configure the optimal working relationship between them. This thesis shows that organisations should follow a systematic – i.e. hybrid – way of aligning functions. Furthermore, due to the complexity of how teams are connected and interdependent, organisations should follow suitable design principles when structuring functions.

The literature review in chapter 2 unpacked three options that companies can follow to structure the two functions: (1) they can be combined as one function and have one reporting line, (2) they can be separated as standalone functions and be independent or (3) be separated as independent functions but intentionally operate in a collaborative relationship. The research in chapter 3 highlighted the debate between those advocating for and against the separation of functions versus those who allow them to operate independently but collaborate. We saw that each design option has upsides and downsides.

The choice between integration, separation or separation-but-collaboration of ethics and compliance functions is subject to many influences in the macro-environment. The regulatory and legal frameworks of a country influence the design of the two functions. For instance, the discussion on integration of the two functions showed the influence of regulation in countries like the US. The US corporate governance model is rule-based; for instance, SOX encourages the integration of ethics and compliance functions. SOX is

crucial in regulating corporate conduct. Therefore, organisations comply with this regulation and integrate the two functions into one function.

This thesis positions South Africa as unique in several ways. South Africa has many sources that influence its regulatory framework on corporate governance. The regulatory sources of corporate governance include legislation, regulation, good practice codes, common law and the JSE listing requirements. The Companies Act converted some common law principles into legislation. The King IV Report is a principle-based guideline for good corporate governance; it advocates for an inclusive stakeholder orientation. Thus, South Africa's regulatory environment combines statutory regulation and self-regulation. This combination of statutory regulation and self-regulation reflects the hybrid approach as these two tasks mutually support and reinforce each other; the two functions are unique but also interdependent.

The other factor that influences the alignment of functions is the design principles of those functions. The factors influencing the design include – but are not limited to – the size of the organisation, maturity of the functions and overall structure. For example, in small organisations, ethics and compliance may be integrated due to resource constraints. Whereas in big organisations, the functions may be separated. Similarly, mature functions can be separated because they are already efficient, while immature functions need integration for growth and development. Lastly, the type of organisation influences the alignment of the two functions.

Moreover, according to principles of functional design, functions are grouped according to specialised skills and knowledge as well as the coordination of tasks between them. Other principles deal with who has the authority to make decisions. The centralisation versus decentralisation of decision making affects the functional design. Decentralisation of power improves the decision-making process, while centralisation delays the decision-making process but improves accountability. Furthermore, reporting relationships have a significant influence on how functions are structured.

In chapters 2 and 3, we discussed each of the models' advantages and disadvantages as well as the practical application of horizontal alignment. Those advocating integration emphasise the benefit of synergy that eliminates competition and tensions. Despite this, some researchers fear that compliance will swallow up ethics when the two are integrated into one function. Conversely, those who advocate for separation of functions emphasise the disadvantages of an integrated design. We also noted the advantages of the two functions being independent. However, there are downsides to operating independently: independence creates hierarchy and there is duplication of efforts. The common feature of both models (standalone and integration) is that they are vertically aligned and therefore hierarchical. Power and authority are centralised at the top, and this alignment creates silos that can negatively impact decision-making processes. The literature review also highlighted that aligning the ethics and compliance functions vertically creates operational inefficiency.

Finally, based on the advantages and disadvantages of combination versus separation and the apparent strengths of interdependence, this thesis explored an alternative model. This is the hybrid model explicated in chapter 3 that is based on horizontal alignment. This thesis has forwarded an argument for application of the hybrid model when seeking the optimal relationship between the ethics and compliance functions.

As discussed in chapter 3, South Africa's legal and regulatory framework supports the hybrid model. The hybrid model maintains independence while promoting collaboration between the two functions. The model treats the two functions equally and prevents the possibility of one function swallowing the other. The benefits of the hybrid model are that it coordinates activities between the two functions and creates a well-structured, systematic approach to institutionalise ethical conduct. Coordination of activities promotes the collaboration of different functions to accomplish a collective set of tasks; and it allows functions to deliver on their core purposes. In other words, the hybrid model balances a degree of independence to operate as standalones with a degree of flexibility to collaborate on issues of mutual concern.

Moreover, the hybrid model enables decentralised decision-making and harnesses diverse skills and mindsets. The hybrid model enables complementary functions to optimise effort and input. This thesis applied Painter et al.'s (2019) alignment framework to align the two functions horizontally. It provides a mechanism for ethics and compliance to collaborate on activities and tasks while maintaining independence. The framework seeks to answer questions concerning which functions need to be aligned, why these functions should be aligned and how we should align them.

Chapter 3 also outlined the five stages to follow in applying the horizontal alignment of functions. In this framework, the focus is on the mechanisms and activities that ease collaboration while the two functions retain a degree of independence. The first step is for the two functions to identify areas of common interest and agree on how they will collaborate. The aim of the exercise is to guarantee that there is proper coordination of efforts. Once they have agreed on the type of activities that need collaboration, the second step is to prioritise these activities. Thirdly, they develop a plan while defining objectives and indicators to measure progress. Fourthly, they identify structural and socio-cultural enablers or barriers. Lastly, the ethics and compliance functions must develop a road map. This involves evaluating the efficacy of past and current alignments and planning to improve future alignments.

4.3 Conclusion

This thesis supports the conclusion that the ethics and compliance functions are unique but complementary. In other words, the characteristics of the two approaches are different yet synergistic. The enforceability, motivation and objectives are not the same. However, the two functions need to be independent but collaborative since they have a common goal: to embed an ethical culture. We also saw that structuring the ethics and compliance functions is best served by the hybrid model. The hybrid model allows the two functions to aim at a common goal and not just towards their immediate deliverables. The hybrid approach suggests that this common purpose is broader than individual activities. The advantage of this model is that ethics and compliance's combined capabilities create more value than

when they operate as standalone functions. Furthermore, the hybrid model creates reciprocal interdependence among the two functions.

We also saw how past research focused mainly on vertical alignment of the two functions instead of on horizontal alignment. This thesis' contribution to the literature is therefore significant. Furthermore, factors like a country's legal and regulatory framework and design principles influence the structuring of functions. Therefore, it is vital to have a systematic and structured approach when designing functions.

We also used Painter et al.'s (2019) horizontal alignment framework that guides organisations on aligning the two functions horizontally. The framework focuses on teams that drive behaviours grounded in ethical values and not in fear of punishment. The framework includes five phases that enable ethics and compliance to contribute effectively to the company's vision, strategy and ethical conduct. The framework includes the two functions in the formulation of strategy, integration of values in the strategy and the evaluation and monitoring of the alignment's implementation.

Although this thesis applied the work done by Painter et al. (2019) on horizontal alignment of values-driven functions, the thesis was in the end dyadic. It focused on the horizontal alignment of ethics and compliance only. Therefore, future work should involve conducting empirical research to establish how the ethics and compliance functions in organisations could align with other value-driven functions, e.g. internal audit, forensics and risk management (functions that encourage behaviour grounded in ethical values).

In sum, my thesis demonstrated that for the compliance and ethics functions to align optimally, the organisation should apply a hybrid approach. Furthermore, for the two functions to complement each other, the organisation should follow the design principles on how to structure functions within organisations. We engaged in an in-depth review of the literature on the different models: the vertical alignment, horizontal alignment and hybrid model. We noted the importance of creating an optimal balance between rules-based and principles-based approaches. Organisations should avoid over-reliance on one function

and resolve potential tensions between ethics and compliance functions over internal resources. This thesis can contribute in assisting organisations to follow a systematic process and apply design principles when aligning the two functions according to the hybrid model.

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