

**Self-Regulation: Managing the Business Environment through Compliance**

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## **Abstract**

Modern organizations operate in a progressively complex and global business environment, with long run survival depending upon the ability to conform to normative stakeholder expectations. Organizational strategies that design operations, processes, and products to respond to emerging needs and prevent negative environmental impacts can offer competitive advantage. The ability to shape industry norms, standards, or beliefs, and to reframe public perceptions about the social suitability of certain business practices, is a core dynamic capability adept at achieving competitive advantage. Recognizing that an organization's ability to wield such influence is reliant on its perceived social legitimacy, recent years have witnessed a renewed examination by scholars of industry self-regulatory practices. This study examines the influence of self-regulatory mechanisms on value creation, with the goal of determining whether a compliance and ethics program can assist organizations in obtaining a competitive advantage? The findings indicate that compliance and ethics programs create value and are positively related to several dimensions of social legitimacy and cost savings.

## **Self-Regulation: Managing the Business Environment through Compliance**

There is growing recognition that modern organizations are operating in a progressively complex and global business environment, which inherently levies considerable challenges on organizations seeking to remain competitive (Koehn, 2005; Ramaswami, Srivastava, & Bhargava, 2009). Such heightened complexity rests on a number of factors, including environmental protection, health and safety, technology policy, human rights, legislative politics, activist pressures, media coverage of business, and corporate social responsibility (Aggarwal, 2001). Paralleling the rise in the complexity of organizational challenges is the realization that long run survival depends on an ability to conform to normative expectations rather than simply operating with greater efficiency (Fiss & Zajac, 2006). As such, scholars have stressed the need for research into the connection between changes in the business environment and organizational success (Bowman & Ambrosini, 2003; Zahra, Sapienza & Davidson, 2006; Oliver & Holzinger, 2008).

In response, increased attention is being paid to the ways organizations respond to changes in the business environment in order to create value (Judge & Douglas, 1998; Klassen & Whybark, 1999; Aragon-Correa & Sharma, 2003). As firms are embedded within a societal context that can affect activities in the value chain, competition, and firm resources, long run survival depends on an organization's ability to conform to normative expectations rather than simply operating with greater efficiency (Fiss & Zajac, 2006). Success requires companies to learn how to recognize and respond to changes in the business environment. Thus, it is essential for organizations to adapt their capabilities and align them with changing conditions in the business environment to create value (Bagley, 2008; DiMatteo, 2010; Siedel & Haapio, 2010).

An environmental strategy that anticipates future regulations and social trends and designs operations, processes, and products to respond to emerging needs and prevent negative environmental impacts can offer competitive advantage (Aragon-Correa & Sharma, 2003). The ability to shape the norms, standards, and beliefs of an industry, or to reframe public perceptions about the social suitability of certain business practices, is a core dynamic capability adept at achieving competitive advantage (Oliver & Holzinger, 2008). As an organization's ability to wield institutional influence is critically reliant on its social legitimacy (Jiang & Bansal, 2003; Prakash & Potoski, 2006), rising trends see a renewed emphasis on the study of self-regulation. While scholars have examined the relationship between self-regulation, legal strategy, and the business environment (Omarova, 2010), existing literature has failed to conduct a detailed examination into the potential of using self-regulatory mechanisms to create competitive advantage. Consequently, my primary motivation is to conduct a comprehensive investigation to serve as the basis for guiding future research and practice concerning the capacities needed to develop competitive advantage through self-regulatory policies. Specifically, I hope to answer the following research question: Is a compliance and ethics program a self-regulatory mechanism that can assist organizations in improving financial performance and creating competitive advantage by enhancing social legitimacy?

## **Literature Review**

### **Dynamic Capabilities**

Organizations are embedded within a societal context that dramatically affects firm resources and the competitive environment; long-term success and survival necessitate adapting to normative public expectations, rather than simply seeking to operate with greater efficiency (Fiss & Zajac, 2006). Under the resource-based view, competitive advantage is acquired by effectively developing, merging, and deploying organizational resources in ways that add unique value to the firm (Priem & Butler, 2001; Colbert, 2004). However, this view suffers from a lack of capability evolution, as it fails to grant proper attention to the constant fluctuations of the business environment (Bowman & Ambrosini, 2003). The dynamic capabilities approach is an extension of the resource-based view that attends to this deficiency by recombining and deploying internal competencies (Zahra, Sapienza, & Davidsson, 2006) to address the requirements of rapidly changing environments (Teece, 1997; Baum & Wally, 2003; Jantunen, 2005).

Dynamic capabilities represent a collection of distinguishable organizational processes that are molded by a firm's asset position (Eisenhardt & Martin, 2000) and focus on actualizing strategic change (Helfat & Peteraf, 2003). Dynamic denotes the ability to reevaluate and refurbish competencies with the intention of realizing congruence with a constantly evolving business environment (Teece, 1997). In turn, capabilities represent the capacity to implement a focused and coordinated set of tasks with the goal of achieving a particular outcome (Combe & Greenley, 2004). Dynamic capabilities are essential in turbulent environments (Zollo & Winter, 2002; Helfat, Finkelstein, Mitchell & Peteraf, 2007), as they enable firms to leverage internal assets and influence environmental demands, resulting in greater congruency between firm strengths and operating requirements (Teece, 2007).

Dynamic capabilities affect value and competitive advantage by apportioning significance to organizational resources that improve the organizational capacity to adapt to the business environment. Value can be generated or preserved by grasping opportunities and taking steps to actively influence the business environment (Oliver & Holzinger, 2008). An influence oriented strategy, which relies on externally oriented capabilities to shape public policy requirements to fit organizational needs, is a firm-level action undertaken to marshal support for company interests (Oliver & Holzinger, 2008).

### **Dynamic Capabilities and the Business Environment**

Influence oriented strategies are characterized by attempts to proactively influence the consumer public, legislators, and administrative agencies responsible for shaping industry regulatory structures (Watkins, Edwards & Thakrar, 2001; Gardner, 2003) by proposing favorable rules, lobbying, and engaging in other political activities (Hillman & Hitt, 1999; Aggarwal, 2001; Shaffer, 2009). An environmental strategy that anticipates future regulations and social trends and designs operations, processes, and products to respond to emerging needs and prevent negative environmental impacts can offer competitive advantage (Aragon-Correa & Sharma, 2003). Therefore, the ability to shape the norms, standards, and beliefs of an industry, and

reframe public perceptions about the social suitability of certain business practices, is a core dynamic capability adept at achieving competitive advantage (Oliver & Holzinger, 2008).

Consequently, an organization's ability to wield institutional influence is critically reliant on its social legitimacy. Undertaking activities that enhance social legitimacy can support the development of competitive advantage through heightened brand recognition, increased employee productivity, and reduced regulatory costs (Porter & Kramer, 2006). Research demonstrates a positive long term relationship between corporate social performance and economic performance (Schnietz & Epstein, 2005; Wahba, 2008), as studies indicate that aligning financial performance with high moral culpability and societal expectations yields increased organizational value (Zadek, 2001; Emerson, 2003; Jackson & Nelson, 2004; Arjoon, 2005; George & Sims, 2007). Accordingly, societal conditions constitute a vital part of the competitive landscape and affect the ability to streamline productivity and achieve long-run strategic goals (Porter & Kramer, 2006). As a result, growing recognition of the importance of these conditions has fueled increased research and interest in self-regulation (Jiang & Bansal, 2003; Prakash & Potoski, 2006). Thus, the timing seems propitious to conduct an empirical study examining the role of self-regulatory efforts in driving organizational value and competitive advantage.

### **Self-Regulation**

Organizations in any industry share a common reputation, as many companies suffer when any lone actor engages in undertakings that damage the industry's shared reputation (Barnett & King, 2008). As a result, crisis frequently acts as a catalyst for shifts in stakeholder perceptions of any given industry (Hoffman & Ocasio, 2001; Behr & Witt, 2002). Concerns arising out of the activities of one organization can cause regulators, suppliers, and the general public to revise their beliefs about the reliability of other organizations in the same industry, leading to generalized and undeserved conclusions (Bartley, 2003; Yu, Sengul, & Lester, 2008). As new public trends created by social movement activism can influence organizational responses and behavior (Bartley, 2007; King & Soule, 2007; Reid & Toffel, 2009), a result of the industry commons problem is that crisis causes firms to institute self-regulatory measures (Gunningham & Rees, 1997; Rivera, de Leon, & Koerber, 2006), in an effort to reduce the degree to which transgressions by one organization harm others in the same industry (Barnett & King, 2008).

Proponents of self-regulation assert that it offers significant advantages, as it can be inherently more efficient, cheaper, and less convoluted than direct government regulation (Black, 2001). In addition, advocates emphasize self-regulation's potential for nurturing shared values, cultivating a sense of ownership and participation in decision-making, and facilitating voluntary compliance with resulting rules (Black, 2001; Omarova, 2010). In order to capitalize on these advantages, many U.S. organizations have implemented a variety of self-regulatory measures designed to bring company practices in line with prevailing public sentiments (Fuller, Edelman, & Matusik, 2000; Delmas & Toffel, 2008), including corporate compliance and ethics programs (FitzSimon & McGreal, 2005; McGreal, 2010), codes of ethics (Gaumnitz & Lere, 2002; Kaptein, 2004; Bartley, 2007), employee grievance procedures (Sutton, Dobbin, Meyer, & Scott, 1994), accreditation standards (Gaver & Paterson, 2000; Casile & Davis-Blake, 2002), quality assurance systems, and informational campaigns (King & Lenox, 2000).

However, critics of self-regulation (Rivera, de Leon, & Koerber, 2006), view it as little more than a smokescreen intended to create an illusion of regulation (van Tulder & Kolk, 2001; Schwartz, 2004), citing a lack of effective enforcement capabilities, an inability to maintain legitimacy, and an overarching failure of accountability (Omarova, 2010). These concerns may have merit, as numerous factors affect the selection, design, implementation, and success of self-regulatory mechanisms. For example, the level of legal regulation present in an industry is a significant indicator of whether organizations will implement the self-regulatory commitments they symbolically adopt (Benabou & Tirole, 2006; Short & Toffel, 2010). In addition, successful implementation depends on the presence of self-regulatory routines designed to develop the organization's capacity to comply with existing legal obligations (Short & Toffel, 2010). Research has shown that self-regulatory initiatives tend to fail in the absence of external deterrence pressures, such as the possibility of fines, sanctions and other penalties (McCaffrey & Hart, 1998; King & Lenox, 2000; Parker, 2002; Short & Toffel, 2010). Moreover, if competitive advantage is to be achieved, the benefits yielded by self-regulation must be particular to a specific organization. An organization cannot hope to achieve a competitive advantage if the benefits of its actions are dispersed among other firms in an industry, or if its actions are easily replicated by competitors.

Thus, the question becomes whether self-regulatory measures can address both the legitimacy concerns raised by skeptics and create value unique to the organization? In the next section, I will provide a brief overview of how compliance and ethics programs can assist organizations in accomplishing both of these objectives.

### **Self-Regulation through Compliance and Ethics Programs**

Compliance and ethics programs are fundamentally a response by the business community to the provisions of the U.S. Federal Organizational Sentencing Guidelines consulted by the Courts in determining proper sentences for companies convicted of a crime. Under the guidelines, legal fines and penalties are based on a calculation that takes organizational size, extent of senior management involvement in criminal activity, existence of prior criminal violations, and prior obstructions of justice into account. However, a reduction in fines is permitted for companies that have effective compliance and ethics programs in place at the time of the legal violation (Oakes, 1999; McKendall, DeMarr, & Jones-Rikkens, 2002). Organizations that are able to design and implement such programs have the potential to drastically reduce their legal fines and penalties (Moeller, 2004; Green, 2005; Rezaee, 2007).

An effective compliance program consists of seven elements. First, standards and procedures designed to prevent and detect illegal conduct by company employees must be established. Second, top management must be knowledgeable about program content, undertake reasonable supervision of program implementation, and designate high-level individuals with responsibility for program management. Third, reasonable efforts must be used to ensure discretionary authority over the program is not given to anyone that has engaged in illegal activities or other conduct inconsistent with the program's goals. Fourth, reasonable measures must be employed to periodically publicize program standards and procedures via efficient training programs and broadcasting of appropriate information. Fifth, reasonable steps must be taken to ensure program observance, periodically evaluate program efficacy, and establish a means through which

guidance on advice can be sought. Sixth, program standards must be consistently enforced using suitable incentives and appropriate disciplinary measures. Finally, organizations must respond appropriately to discovered unlawful conduct and take any necessary measures to prevent similar conduct from occurring again in the future (McKendall et al., 2002).

By their nature and composition, compliance and ethics programs have the potential to address some of the implementation and efficacy concerns regarding self-regulatory mechanisms. First, such programs assist in facilitating self-regulatory routines, as they lay out clear organizational procedures for recognizing, addressing, and preventing legal and ethical violations within the company. Second, compliance programs are driven by factors both inside and outside the organization. Third, these programs incorporate deterrence pressures and punitive enforcement procedures into their overall strategic processes. In addition, unlike other self-regulatory mechanisms that are more likely to benefit an entire industry, a greater portion of the benefits obtained through compliance and ethics programs remain within a specific organization. Compliance programs incorporate the ideas and concepts behind self-regulatory practices into actual company processes and procedures, increasing the potential for efficiency and cost savings. As a result of these unique characteristics, it's my belief that compliance and ethics programs are the self-regulatory measure best suited for obtaining competitive advantage. Therefore, this study will advance and test multiple hypotheses in support of this contention.

## **Theory and Hypothesis**

### **Costs of Compliance**

Organizations in diverse industries routinely view legal fees as costs to be minimized (Kaplan, 2007), with scholars maintaining that the costs associated with supporting legal programs, such as technology investment, increased training, audits, and incident management, force firms to improperly allocate limited resources to the compliance process (Pelliccioni, 2002; Bowman, 2004; FitzSimon & McGreal, 2005; Langevoort, 2006). However, viewing legal costs in this fashion miscalculates the level and severity of the costs that can result (Baucus & Baucus, 1997). The costs that result when organizations fail to comply with legal obligations can include direct costs like fines, lawsuits, governmental investigations, jail time, and employee grievances. Indirect costs, which will be examined in later sections, can include reputation damage, decreased sales, and productivity losses (Hasl-Kelchner, 2006; Bagley, 2008).

While compliance programs cannot completely eliminate the legal costs associated with doing business, they can assist in limiting the damages that result from legal crisis. Compliance and ethics programs allow organizations to respond to discovered unlawful conduct within the organization in a faster and more organized manner. As this can translate into quicker resolution, there is less time for the legal problem to go unchecked and cause prolonged damage (McKendall et al., 2002). In addition, improved response to legal crisis enables organizations to bring relevant issues to the attention of governmental agencies, assist with governmental investigations, and provide compensation to affected parties. Not only can these actions reduce the impact and severity of the harm on the environment, general public, or shareholders, but they can also reduce the level of governmental fines and penalties through the mitigation provisions of the Sentencing Guidelines. In contrast, other methods of self-regulation do not receive the

benefit of similar legislative provisions, are less focused on direct cost reduction, and are less likely to be directly tied to core operating processes and procedures. Based on the above literature, the implications that can be drawn lead to the following hypotheses:

*Hypothesis 1: There is a negative relationship between the investment in compliance programs and the direct costs of non-compliance.*

*Hypothesis 2: Given the potential negative relationship between the investment in compliance programs and the direct costs of non-compliance, there is a positive relationship between the investment in compliance programs and overall compliance savings.*

*Hypothesis 3: There is a greater negative relationship between the direct costs of non-compliance and compliance programs than between the direct costs of non-compliance and collaborative agreements, disclosure standards, ethical codes, informational campaigns, and quality assurance systems.*

### **Crisis Prevention Productivity**

The concept of process efficiency is a key component of competitive advantage (Porter & Kramer, 2006). Legal strategy and business strategy are necessary complements that must be tied together (Bagley, 2010; DiMatteo, 2010), as most business decisions involve legal and non-legal factors, requiring simultaneous examination by an organization's legal and business risk management teams (Sharer, Mauk, & Day, 2007; D'Aversa, 2008). Given the competitive advantage that can result through well-organized and resourceful management of the legal process, organizations are beginning to regularly incorporate compliance programs and other legal considerations into the strategic planning process.

Organizations that make a commitment to self-regulation must select an appropriate framework that will guide that self-regulatory commitment. Compliance and ethics programs sketch suitable action steps for implementing this strategy, as they establish formulas for establishing organizational processes and procedures. The heavy reliance placed upon the Sentencing Guidelines by the courts (Sheyn, 2010) opens up a source of value for organizations able to create mechanisms that respond appropriately to their specifications (Wells, 2001). As such, the specifications imposed by the guidelines act as a blueprint for modifying organizational processes and procedures to accommodate self-regulation. It is this coordination of business units and integration with overall business goals that sets compliance and ethics programs apart from other self-regulatory mechanisms and allows organizations to create value and obtain a competitive advantage. Compliance and ethics programs reduce the negative effects that often accompany legal crisis, such as disbelief, panic and indecision, by incorporating required responses into an overall self-regulatory plan. In contrast, other stand-alone forms of self-regulation do not offer this level of integration. Based on the above literature, the next set of hypotheses are as follows:

*Hypothesis 4: Investment in compliance programs is positively related to improved employee morale during a legal crisis, and negatively related to panic and indecision.*



*Hypothesis 5: There is no relationship between employee morale, panic, or indecision during a legal crisis and collaborative agreements, disclosure standards, ethical codes, informational campaigns, and quality assurance systems.*

### **Favorable Legislation and Public Image**

Legal standards and obligations are a primary driver for achieving socially responsible behavior (Seeger & Hipfel, 2007), as laws guide the competitive environment by changing in response to the ebb and flow of public sentiments concerning firm policies, products, and activities (Bagley, 2010). Scholars have argued that without an interlocking body of treaties, statutes, regulations and other laws, the evolution of responsible corporate behavior may advance at glacial speeds (Saxe, 1990; Shum & Yam, 2011). However, the line between voluntary and mandatory law is thin (Martin, 2005). Laws are often outdated, inapposite, and poorly defined, creating an ambiguous zone between clearly obligatory and clearly discretionary practices (Lundblad, 2005; Glinski, 2007).

To cope with such uncertainty, organizations perform socially responsible activities that move beyond the letter of the law (Martin, 2005; Zerk, 2006; Conrad, & Abbot, 2007; Shum & Yam, 2011). Organizations have responded by exercising greater legal responsibility and implementing programs to manage health, safety, social, and environmental activities (MacLean & Nalinakurnari, 2004). Studies have indicated that self-regulation can mitigate, quash, and even reverse growing public support for formal legislative, regulatory, or judicial intervention in business affairs. By alleviating public apprehensions and nurturing doubts about amplified governmental involvement in business regulation, self-regulatory efforts can diminish public receptivity to legal changes (Silverstein, 1999; Bowman & Ambrosini, 2003).

Compliance programs are more likely to result in less stringent government regulation, and increased public image, as they represent actual implementation of compliance efforts. For example, by requiring standards and procedures designed to prevent illegal conduct, compliance programs incorporate the benefits of a code of ethics by creating processes to implement that code. In contrast, other self-regulatory mechanisms, such as disclosure standards and informational campaigns, risk characterization as window dressing initiatives, based on the absence of a clearly identifiable link to organizational activity. As a result, the general public and governmental policymakers may be more skeptical of such efforts. Based on the above literature, the final set of hypotheses are as follows:

*Hypothesis 6: Investment in compliance programs is positively related to improved public image and negatively related to increased legislative oversight.*

*Hypothesis 7: There is a greater positive relationship between improved public image and compliance programs than between improved public image and collaborative agreements, disclosure standards, ethical codes, informational campaigns, and quality assurance systems.*

*Hypothesis 8: There is a greater negative relationship between increased legislative oversight and compliance programs than between increased legislative oversight and collaborative*

*agreements, disclosure standards, ethical codes, informational campaigns, and quality assurance systems.*

## **Methods**

### **Sample and Data Collection**

Using Ward's Business Directory of U.S. Private and Public Companies, a convenience sample of companies in the United States was selected. The United States was selected for this study as this paper looks at the effects of compliance and ethics programs and self-regulation in the American business environment. Instead of comparing firms from different areas of the world where with varied legal systems and ethical norms, looking only at U.S. firms ensures that all firms sampled share the same cultural context. As result, all firms contained in the sample are likely to face similar levels of scrutiny from the public and government agencies. Although this sample is limited, the companies included are representative of a broad range of industries. Each company included in this sample is publicly traded and engages in self-regulation to one degree or another.

A standardized written survey was conducted. A focused questionnaire about self-regulatory practices used by the company was sent to the legal/compliance department of each organization. Informants were instructed to the survey to another person if appropriate. Although the use of self-reported data can raise concerns about reliability, the survey questions used in this study were specific and addressed factual information. In addition, a cover letter sent with each survey indicated only that the survey was investigating the effectiveness of self-regulatory measures in organizations; it did not ask any questions about specific personal behavior, ethical problems, or legal violations. The survey was confidential, decreasing the likelihood of responses based on a social desirability bias. Respondents were ensured that responses would not be associated with the organization in any way, thereby reducing the inducement to embellish and exaggerate. In order to increase the response rate, follow up phone calls and email reminders were used where appropriate. A total of 205 surveys were sent to companies in various industries. 85 surveys were returned, of which 79 were usable, for an overall response rate of 38%. Every item on the survey questionnaire was formulated as a statement that the respondent had to evaluate on a scale from 1 equals "strongly disagree" to 5 equals "strongly agree."

Of the respondents, a varied range of business sectors were represented: Healthcare (15%), Automotive (7%), Defense (5%), Electronics (8%), Banking and Finance (21%), Pharmaceuticals (13%), Communications (9%), Insurance (7%), Power and Utilities (5%), Real Estate (7%), and Oil and Gas (3%). As to geographic region, 27% of respondents were from the Northeast, 18% from the Midwest, 24% from the South, and 31% from the West. As for organizational size, 25% of respondents worked for an organization of 200–1000 employees, 11% of 1000–4000 employees, 10% of 4000–6000 employees, 13% of 6000–10,000 employees, and 41% of more than 10,000 employees. With regard to organizational age, 8% of organizations had been in business for less than a year, 12% between 1 and 2 years, 15% between 3 and 5 years, 10% between 6 and 10 years, 37% between 11 and 20 years, and 18% over 20 years. As for hierarchical level, 55% of the respondents held a managerial position, 17% worked as supervisor, 19% as mid-level manager, 5% as senior manager or junior executive, and 4% as senior executive or director. With respect to program age, 8% of organizations had a

compliance and ethics program in place for less than a year, 12% between 1 and 2 years, 15% between 2 and 5 years, 18% between 5 and 10 years, 37% between 10 and 15 years, and 10% over 15 years. In regards to program resource allocation, 21% reported annual funding of less than \$20,000, 14% reported between \$20,000 and \$40,000, 11% reported between \$40,000 and \$75,000, 18% reported between \$75,000 and \$100,000, and 36% reported more than \$100,000.

## Measures

**Dependent variables.** The five dependent variables provide indicators of the success of compliance and ethics programs. Legislative oversight denotes trends in the law that reduce the severity of existing legal requirements placed on organizations. Public image refers to the reputation of the organization in the public eye. Non-compliance costs encompass the direct costs of compliance noted above, such as lawsuits, employee grievances, fines, and any government investigations. Legal crisis morale, panic, and indecision focus on the amount of chaos and tension caused by legal problems. Compliance expenditure savings focuses on the reduction in costs associated with resolving legal crises, and does not include the costs associated with implementing compliance and ethics programs.

**Independent variables.** The independent variables included collaborative agreements, compliance and ethics programs, disclosure standards, ethical codes, informational campaigns, and quality assurance systems. In contrast to self-regulatory measures at the industry-level, these specific measures were chosen in order to better assess the benefits provided by self-regulatory measures at the firm-level.

**Control variables.** Several variables were included to control for market and organizational characteristics. I controlled for industry (banking versus others), as banking is overrepresented in the sample. I controlled for workforce size as larger establishments may have more full-scale compliance programs. I also controlled for the age of compliance and ethics programs, as older programs may be more entrenched in organizational culture. Controls were also included for compliance program age and resource allocation, as well as hierarchical level.

## Results

Table I presents the means, standard deviations, and correlations for the research variables. The hypotheses were tested using structural equation modeling. Tables II and III depict the results.

As expected, investment in compliance programs was negatively related to direct costs of non-compliance, legislative crackdowns, as well as panic and indecision during a legal crisis. Investment in compliance programs was positively related to public image and overall cost savings. In addition, there was a greater negative relationship between the direct costs of non-compliance and compliance programs than between the direct costs of non-compliance and collaborative agreements, disclosure standards, ethical codes, informational campaigns, and quality assurance systems. Results also indicated a greater positive relationship between improved public image and compliance programs than between improved public image and collaborative agreements, disclosure standards, ethical codes, informational campaigns, and quality assurance systems. There was no relationship between employee morale during a legal

crisis and collaborative agreements, disclosure standards, and informational campaigns. Similarly, there was a greater negative relationship between increased legislative oversight and compliance programs than between increased legislative oversight and collaborative agreements, disclosure standards, ethical codes, informational campaigns, and quality assurance systems. Finally, there was no relationship between collaborative agreements, disclosure standards, ethical codes, and informational campaigns and panic or indecision during a legal crisis.

Contrary to expectations, there was no relationship between compliance programs and employee morale during a crisis. There was a positive relationship between ethical codes and quality assurance systems and employee morale during a legal crisis. In addition, there was not a greater positive relationship between improved public image and compliance programs than between improved public image and collaborative agreements, disclosure standards, ethical codes, informational campaigns, and quality assurance systems. There was a negative relationship between quality assurance systems and panic and indecision during a legal crisis, whereas there was no relationship between quality assurance systems and improved public image. There was no relationship between direct costs of non-compliance and collaborative agreements, disclosure standards, or informational campaigns. Finally, there was a positive relationship between ethical codes and quality assurance systems and employee morale during a legal crisis.

## **Discussion**

### **Contributions Overview and Implications**

This study examined the influence of self-regulatory mechanisms on organizational value creation. The effects of compliance and ethics programs were compared to those of five other self-regulatory mechanisms used by organizations. Overall, the results suggest that firm engagement in self-regulatory activities, together with the use of a compliance and ethics program, is value enhancing. The findings corroborate most of the hypotheses advanced in this study. Hypotheses 1,2,3,6 and 8 were totally supported.

With respect to Hypothesis 4, results indicated that there was no relationship between compliance and ethics programs and employee morale during a legal crisis, whereas a positive relationship was expected. One possible explanation for this finding is that although compliance and ethics programs provide a plan that may mitigate indecision and avoid total panic during a legal crisis, such events still cause a fair degree of stress that can have an adverse effect on company morale. An alternative explanation could be that there is a tendency to blame compliance and ethics programs for failing to prevent the legal crisis in the first instance.

Regarding Hypothesis 5, a positive relationship was discovered between the other self-regulatory measures examined in this study and employee morale during a legal crisis. A possible explanation is that as employees may blame the compliance and ethics program for failing to prevent legal crisis, it is easier to look to other measures, such as ethical codes, for inspiration and guidance. Further research could examine the explanation for this finding in greater depth.

TABLE I

Means, standard deviations, correlations, and scale reliabilities for dependent and independent variables

| Variables                      | M    | SD    | 1     | 2     | 3     | 4     | 5     | 6     | 7     | 8     | 9    | 10    | 11   | 12   | 13   | 14   | 15   | 16   | 17   |
|--------------------------------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|------|-------|------|------|------|------|------|------|------|
| Legislative oversight          | 4.23 | 1.89  |       |       |       |       |       |       |       |       |      |       |      |      |      |      |      |      |      |
| Public image                   | 3.3  | 2.12  | -0.04 |       |       |       |       |       |       |       |      |       |      |      |      |      |      |      |      |
| Non-compliance costs           | 1.21 | 0.92  | -0.34 | 0.17  |       |       |       |       |       |       |      |       |      |      |      |      |      |      |      |
| Legal crisis morale            | 3.46 | 1.53  | -0.2  | 0.4   | 0.34  |       |       |       |       |       |      |       |      |      |      |      |      |      |      |
| Legal crisis panic/indecision  | 2.23 | 1.17  | 0.23  | -0.1  | -0.13 | 0.11  |       |       |       |       |      |       |      |      |      |      |      |      |      |
| Compliance expenditure savings | 2.54 | 0.7   | 0.01  | 0.08  | -0.05 | -0.79 | 0.15  |       |       |       |      |       |      |      |      |      |      |      |      |
| Collaborative agreement        | 1.62 | 0.89  | 0.1   | 0.03  | 0.04  | -0.04 | -0.03 | 0.12  |       |       |      |       |      |      |      |      |      |      |      |
| Compliance and ethics program  | 33.7 | 11.51 | -0.15 | 0.1   | -0.03 | 0.02  | -0.19 | 0.05  | 0.23  |       |      |       |      |      |      |      |      |      |      |
| Disclosure standards           | 1.49 | 1.32  | -0.13 | 0     | 0.14  | 0.05  | -0.04 | 0.2   | 0.11  | 0.05  |      |       |      |      |      |      |      |      |      |
| Ethical code                   | 3.67 | 2.23  | 0.04  | -0.02 | -0.02 | 0.16  | -0.04 | 0.04  | 0.02  | 0.13  | 0.03 |       |      |      |      |      |      |      |      |
| Informational campaign         | 2.41 | 1.01  | -0.04 | 0.36  | 0.19  | -0.25 | -0.09 | 0.04  | -0.03 | 0.04  | 0.17 | 0.1   |      |      |      |      |      |      |      |
| Quality assurance system       | 3.65 | 0.79  | -0.23 | 0.37  | 0.17  | 0.21  | -0.23 | -0.03 | 0.04  | 0.06  | 0.16 | 0.05  | 0.21 |      |      |      |      |      |      |
| Industry                       | 4.1  | 0.83  | -0.26 | 0.44  | -0.13 | 0.28  | -0.23 | 0.05  | 0.01  | -0.03 | 0.13 | 0.04  | 0.93 | 0.6  |      |      |      |      |      |
| Organizational size            | 3.53 | 0.62  | -0.14 | -0.21 | -0.11 | 0.22  | 0.11  | -0.02 | -0.01 | -0.05 | 0.04 | -0.02 | 0.54 | 0.45 | 0.43 |      |      |      |      |
| Organizational age             | 3.92 | 0.82  | -0.22 | 0.34  | 0.16  | 0.22  | -0.17 | -0.03 | 0.05  | -0.01 | 0.12 | 0.08  | 0.37 | 0.62 | 0.54 | 0.44 |      |      |      |
| Hierarchical level             | 3.74 | 0.95  | 0.16  | 0.13  | 0.35  | 0.23  | -0.13 | -0.04 | 0.03  | -0.03 | 0.14 | 0.01  | 0.52 | 0.57 | 0.56 | 0.53 | 0.64 |      |      |
| Program age                    | 3.47 | 0.81  | -0.21 | 0.1   | 0.42  | 0.24  | -0.13 | -0.04 | -0.01 | -0.04 | 0.12 | 0.03  | 0.25 | 0.79 | 0.48 | 0.6  | 0.61 | 0.65 |      |
| Program resource allocation    | 2.45 | 0.61  | -0.17 | 0.1   | 0.24  | 0.13  | -0.06 | -0.01 | 0.1   | -0.01 | 0.09 | 0.04  | 0.12 | 0.81 | 0.65 | 0.2  | 0.72 | 0.47 | 0.53 |

| Variables                     | Legislative oversight | Public image | Non-compliance costs | Legal crisis morale | Legal crisis panic/indecision | Compliance expenditure savings |
|-------------------------------|-----------------------|--------------|----------------------|---------------------|-------------------------------|--------------------------------|
| Industry                      | -0.04                 | 0.19         | -0.1                 | -0.15               | 0.02                          | -0.1                           |
| Organizational size           | 0.04                  | 0.22         | 0                    | -0.01               | -0.02                         | 0                              |
| Organizational age            | 0                     | 0.01         | -0.18                | 0.05                | 0                             | -0.03                          |
| Hierarchical level            | 0.03                  | 0.17         | 0.04                 | 0                   | -0.05                         | 0.05                           |
| Program age                   | -0.21                 | -0.05        | 0                    | 0.12                | -0.11                         | 0                              |
| Program resource allocation   | -0.17                 | 0.01         | -0.13                | 0.12                | -0.07                         | 0.12                           |
| Collaborative agreement       | -0.01                 | 0.02         | -0.03                | 0.01                | -0.02                         | -0.06                          |
| Compliance and ethics program | -0.26                 | 0.13         | -0.21                | 0.02                | -0.12                         | 0.11                           |
| Disclosure standards          | -0.14                 | 0.09         | -0.02                | -0.01               | -0.01                         | 0.02                           |
| Ethical code                  | -0.11                 | 0.18         | -0.08                | 0.08                | 0.02                          | -0.05                          |
| Informational campaign        | -0.03                 | 0.06         | 0.02                 | 0.01                | -0.01                         | -0.06                          |
| Quality assurance system      | -0.01                 | -0.01        | -0.06                | 0.09                | -0.07                         | -0.1                           |

| Variables                     | Legislative oversight | Public image | Non-compliance costs | Legal crisis morale | Legal crisis panic/indecision | Compliance expenditure savings |
|-------------------------------|-----------------------|--------------|----------------------|---------------------|-------------------------------|--------------------------------|
| Collaborative Agreement       | neg/no                | pos/no       | neg/no               | no/no               | no/no                         | neg/neg                        |
| Compliance and Ethics Program | neg/neg               | pos/pos      | neg/neg              | pos/no              | neg/neg                       | pos/pos                        |
| Disclosure Standards          | neg/neg               | pos/pos      | neg/no               | no/no               | no/no                         | no/no                          |
| Ethical Code                  | neg/neg               | pos/pos      | neg/neg              | no/pos              | no/no                         | neg/neg                        |
| Informational Campaign        | neg/no                | pos/pos      | neg/no               | no/no               | no/no                         | neg/neg                        |
| Quality Assurance System      | neg/no                | pos/no       | neg/neg              | no/pos              | no/neg                        | neg/neg                        |
| <i>Note: Expected/Results</i> |                       |              |                      |                     |                               |                                |

For Hypothesis 7, a greater positive relationship between compliance programs and improved public image was expected than between the other self-regulatory mechanisms examined and improved public image. However, contrary to expectations, there was a greater positive relationship between other self-regulatory mechanisms and improved public image than between compliance programs and improved public image. This finding might be explained by some of the limitations in the methodology employed in this study, which are discussed in next section.

A possible explanation for this result could be that compliance and ethics programs are less recognizable to the public, as their primary emphasis does not focus on promotion and advertising of organizational activities. As such, these results could signify an indication that the public is less aware of compliance programs than other more publicized mechanisms.

This study provides important implications for both researchers and practitioners. Previous research has demonstrated that legal strategy can be used for competitive advantage (Siedel, 2002; Siedel (2010), Bagley (2008); DiMatteo (2010). Although researchers argue that proactive strategies, like self-regulation, can improve financial performance and lead to competitive advantage (Judge & Douglas, 1998; Klassen & Whybark, 1999; Aragon-Correa & Sharma, 2003), little research has examined which mechanisms are most effective in creating value in a turbulent business environment. However, the significant interaction in this study between the different self-regulatory mechanisms and the resulting effect on costs suggests the importance of investigating the circumstances surrounding the effectiveness of each mechanism. Organizations that recognize the costs and benefits associated with implementing compliance and ethics programs will be in a better position to increase effectiveness and reduce costs, thereby leading to improved financial performance and competitive advantage.

## **Limitations**

As with any study, there are limitations that should be acknowledged. First, the research design of this study does not allow the drawing of exact conclusions, due to the cross-sectional nature of the data. In addition, the sample only had a response rate of 38%. Since the response rate is not perfect, there is a possibility that non-response may have been systematic as opposed to random in nature. As a result, some degree of sampling bias may have influenced the results in this study.

In addition, this study covered only one segment in the organizational hierarchy, i.e. the legal and compliance departments. Differences in organizational structure and composition may have contributed to certain answers. For example, questionnaire responses from the legal department in a particular organization may differ from questionnaire responses given by the public relations department in that same organization. Given that only legal and compliance departments were surveyed and that responses were not measured across organizational levels, it is appropriate to exercise caution when generalizing these results.

Another limitation was that the data was self-reported. As self-regulatory mechanism success and effectiveness was measured through self-report, common method variance (CMV) may have artificially inflated the relationships between the mechanisms and outcomes. For instance, in survey studies where the same rater responds to items in a single questionnaire at the same point in time, data are potentially susceptible to CMV (Lindell & Whitney, 2001). CMV can be a cause for concern, (Woszczyński & Whitman, 2004), as sources like social desirability, instrument ambiguity, and scale length can influence rater responses to questions, thereby resulting in method biases (Tourangeau, Rips, & Rasinski, 2000). However, there is increasing evidence that concerns over CMV may be exaggerated (Spector, 2006). In addition, steps were taken to reassure raters of their anonymity, as well as to increase instrument clarity.

This study opens several avenues for future research. First, researchers may find it useful to further theorize and test the effects between other self-regulatory mechanisms and value creation. As the results of this and other studies suggest, multiple factors go into determining whether legal strategy can create value. Therefore, incorporating additional considerations of the market environment and future research models may help to predict various outcomes not limited to mechanism effectiveness.

In addition, future research can explore in more detail the effects that self-regulatory mechanisms have on an organization's bottom line, using this study as a foundation. Specifically this study establishes that compliance and ethics programs, when compared to other forms of self-regulation, have a stronger effect on productivity during a legal crisis, legal cost expenditures, and the number of violations, lawsuits, and complaints that an organization receives. It has also indicated the financial benefits of using self-regulatory mechanisms to respond to changes in business environment. Future research could examine in greater detail the intricacies, benefits, and drawbacks of using self-regulatory mechanisms to create value.

### **Conclusion**

Past research has highlighted the importance that self-regulation can have on market position. However, little research has examined the effects of different methods of self-regulation on overall organizational success and competitive advantage. Drawing on the existing literature, the purpose of this study was to examine the impact of compliance and ethics programs on value creation, as compared to other methods of self-regulation. The results suggest that firm engagement in self-regulatory activities is value enhancing. Accordingly, in support of my hypotheses, the results suggest that compliance and ethics programs are the self-regulatory mechanism with the greatest potential for achieving competitive advantage in a turbulent business environment. Finally, I discussed the implications of these findings for both research and practice.

In spite of some limitations, the conclusions that can be drawn from this study are still important to researchers and organizations. Specifically, findings indicate that organizations that implement compliance and ethics programs best meet business needs and experience reduced legal violations and increased savings. Organizations must continue to develop strategies that respond to changes in legal environment. Therefore, focusing on the proper mechanisms to respond to environmental changes seems critical for organizations that wish to remain competitive in an increasingly costly and unforgiving business environment.



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