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The application of legislative decree no. 231/2001 through organizational models: rhetoric or real effectiveness?

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Abstract

The purpose of this paper is to describe the quality of the Italian government strategy for preventing and combating corruption through the application of the Legislative Decree 231 of 2001 and its impact on organizational procedures. We carried out an empirical research on the application of Legislative Decree 231 based on an empirical analysis of more than 500 Italian VET providers. The results depict a controversial situation. A small part of the sample seems to comply with the law, the remaining organizations just comply with the issues of mere form, they "simply" incorporate norms from their institutional environments and thus gain legitimacy, resources and stability. In this way they "institutionalise" compliance with Decree 231. And this, in turn, shows that this illusion of compliance does not coincide with ethics. It is clear that there is a great risk of creating a merely formal paper-based compliance system, which has no real impact on organisational behaviour, despite the fact that compliance is compulsory and anticipated by a law.
The paper provides a starting point, which enables to reflect on the intertwined relationship between ethics and compliance, and to outline the pros and cons of the current applications made by the Italian VET providers.

Kew words: Compliance, Ethics, Organizational models

1. Introduction

Corruption and fraud against public administration in Italy are endemic, as reported in the Transparency International ranking: in 2015, Italy is ranked 61 out of the 168 observed countries on a corruption perception index, which measures the perceived levels of public sector corruption. The Italian Court of Audit has pointed

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out that the total direct cost of corruption amounts to 60 billion euro each year (equivalent to approximately 4% of GDP).

It was in reaction to this situation that Legislative Decree no. 231 was issued in 2001 to implement article 11 of Enabling Act no. 300 of 29 September 2000, whereby the Government was to define a penalties system for the administrative liability of bodies in compliance with the obligations set out by a number of important international acts: the Convention on the protection of the European Communities' financial interests of 26 July 1995, the Convention on the fight against corruption involving officials of the European Communities or officials of Member States of the European Union approved in Brussels on 26 May 1997, and the OECD Convention of 17 September 1997 on the fight against corruption involving foreign public officials in international economic transactions.

This has led to a change in the Italian regulatory system: the Decree provides a new form of liability, which the legislator describes as "administrative", that is independent from the liability of the individual who has actually committed the crime. The Decree covers a large range of felonies that can be committed by persons in the interest or to the advantage of the company, from "white collar crime" against public administrations to environmental crimes, from employment crimes to felonies against industry and commerce.

Hence the need to better define this kind of responsibility, especially in terms of organisational responsibility. In effect, under articles 6 and 7 of the Decree, the company body may be exempted from liability if it can prove it has adopted and effectively implemented an organisational, management and control model designed to prevent said offences. In fact, under paragraph 2 of article 6 and paragraph 4 of article 7 of the decree, the lawmaker establishes that this organisational model must meet the following requirements:

a) the Board of Directors adopted and efficiently enacted, prior to commission of the act, organisational and management models which are capable of preventing offences of the type occurring;

b) the task of overseeing such operations, compliance with the models and seeing to updating of same has been delegated to a Supervisory unit vested with powers to act on its own initiative and conduct monitoring;

c) the persons committed the offence by fraudulently circumventing the organisational and management models;

d) there has been no omission or insufficient oversight on the part of the Supervisory unit referred to in subparagraph b).

That said, problems arise from the vague definition of both the organisational model and supervisory unit. The decree does not explain the managerial and organisational models in detail. In other words, when analysing the decree it becomes evident that the exact specification of the nature and the suitable level of precision in the adoption of the organisational, management and control models and procedures is a complex and wide subject. A second important consideration concerns the identification of the supervisory unit. Here, the focus is on the trade-off between the nature of the agent in charge of the control and the quality and operability of this control. It may appear appropriate and more useful, in order to

achieve a better degree of precision, to give a qualified outsourcing body the responsibility of controlling the adoption and compliance of the organisational models. This is in order to guarantee the organisation's effective independence from possible constraints that may be created by a hierarchy. While a supervisory unit composed of company managers and officers would mean a cost reduction it also means a lack of autonomy and independence of judgement. This implies that the firm faces a dilemma about whether to choose the adoption of sophisticated management models with an independent supervisory unit, or conversely to adopt a strategy of cost saving, based on the probability that the offence may be disclosed and sanctioned ex post.

From these reflections, it raises the central question of our paper that is to describe the quality of the Italian government strategy for preventing and combating corruption through the application of the Legislative Decree 231 of 2001, with special emphasis on the impact on organizational procedures.

2. Compliance and organizational models: reality or appearance?

As argued above, it is clear that there is a strong risk of creating a compliance system that is merely formal and paper-based and that has no real impact on organisational behavior, even more so if compliance is required by law. Zbaracki (1998) suggests that this kind of compliance - and this is true for other practices such as total quality management too - implies a technical intervention that can become both ambiguous and sometimes dubious. It is almost as if there are two versions of compliance: a technical version, which incorporates some fairly well-defined organisational interventions and control procedures; and a second more rhetorical version that seems to carry a sort of rhetorical excess (Hackman and Wageman 1995) and ambiguous terms where organisational implications and improvements are unclear. Distinguishing between "a technical organisational model" and a "rhetorical organisational model" recalls a longstanding claim of institutional theory (Powell and DiMaggio 1991), which describes a process whereby the symbolic value of something like the organisational model ultimately supplants its technical value (Bourrier and Bieder, 2013). Using an organisational model pursuant to decree 231 may provide an organisation with little technical benefit, but the claim of using it confers legitimacy on the organisation (Westphal et al. 1997). Consequently, managers will use the "rhetorical 231" largely in a formal and symbolic way to gain legitimacy without necessarily affecting activities at the technical core of the organisation (Meyer and Rowan 1977). Edelman (1992) argues that this poses a dilemma for organisations: they must appear attentive to the law in order to gain legitimacy and public resources and, at the same time, seek to minimize the law's constraints on traditional managerial prerogatives. Hence, organisations respond to this dilemma by creating symbolic structures, which serve as visible efforts to comply with the law. Edelman points out that because the normative value of these structures does not depend on their effectiveness, they do not guarantee substantive change in organisational behaviour.

In effect, our case is a special example of organisational form which can be observed not only as "coercive isomorphism" due to the application of a law, but also as "normative isomorphism" due to guidelines and procedures issued by trade associations and other stakeholders, as well as "mimetic isomorphism" since its application is very specific to industries where organisations work closely together.

Hence, organisations have wide latitude in determining how, if at all, to comply. In this context, the creation of symbolic structures is especially attractive: an organisation can point to structural change as evidence of its compliance, without necessarily creating significant change in behaviour, even though the creation of symbolic structures is only the first stage of organisational response to law. The literature on regulation and on organisational behaviour tends to emphasise the capacity of organisations to resist compliance with law.

To overcome this criticism, Edwards (2003) and Wolfe (2004) define compliance as the adherence by the regulated to rules and regulations laid down by regulators, uniting a rules-based approach – which means adherence to the letter of the law - to a more flexible ethical one which is concerned with adherence to the spirit of the law. And this proposes a link between an ethically correct attitude and the activity of compliance, which has been frequently emphasised and studied by numerous authors (Paine 1994; Laufer and Robertson 1997; Trevino et al. 1999; Jackman 2001; Weber and Fortune 2005), who all stress the importance of supporting compliance programs by a solid orientation towards ethical behavior, and demonstrate that the objective of responsible conduct cannot be achieved solely by imposing from outside what is required but must also appeal to what is desired (Michaelson 2006). They suggest adopting compliance programs that are not oriented toward mere respect of the rules, but to pursuing the creation of a sense of shared values that can help define an ethical role for individuals, a combination of compliance and values approaches is ideal.

There has been the risk of an exclusive orientation to compliance in the US (Weaver and Treviño 1999) with the Sentencing Commission's guidelines for organisational defendants (Dalton et al. 1994; Weaver et al. 1999) that took effect in 1991, and through which organisations that proactively manage legal compliance face significantly reduced fines and sentences if they are caught engaging in misconduct. Therefore, while many companies have taken a legal compliance approach in their programs, this has not avoided unethical and illicit behavior such as Enron and the more recent financial scandals. An illusion of ethical progress has been created which has confused the relationship between ethics and compliance.

This becomes clearer if we compare studies focused on the introduction of a code of ethics, as a written expression of organisational values and beliefs: some studies found that the existence of a corporate code significantly reduced unethical decisions (Hegarty and Sims 1978), while other studies (Laczniak and Inderrieden 1987; Mathews 1987) found that codes have little effect upon decision making or the amount of illegal activity. This demonstrates that a code of ethics is a tool, it is compliance, but it is not the organisational value of the company. Ethical is more than being merely compliant, compliance is ordinarily a necessary but insufficient condition for ethics.

Citing several case histories, Paine (1994) found that ethics programs can emphasise values, or can emphasise legal compliance, control and discipline. She argued that programs emphasising values and responsible conduct and following an integrity strategy are likely to have more desirable and long-lasting impacts than programs founded on rule-compliance. This means combining a concern for the law with an emphasis on managerial responsibility for ethical behavior. Therefore she rejects two simpler formulations of the ethics–compliance relationship, what she calls the "correspondence and separate realms views". The correspondence view suggests that ethics and law are more or less coextensive. If it is legal, it is ethical, so compliance is sufficient for ethics. Conversely, the separate realms view insists on the strict separation of law and ethics and the prioritisation of one over the other (law is prior in the eyes of lawyers, and ethics in the eyes of ethicists). Paine discredits both views by citing several management examples in which law is an important but insufficient guide to ethical conduct, and concludes that the relationship between law and ethics is much more complex than either view, Paine proposes instead the ''organisational integrity'' thesis, which goes beyond the other views by positioning a class of compliant behaviors as part of a class of ethical behaviors. The strategies too are very different: the compliance strategy has as its objective the prevention of criminal misconduct, it's based on conformity with externally imposed standards, lawyer driven, and it implies implementing activities such as developing compliance standards, training and communication, handling reports of misconduct, conducting investigations, overseeing compliance audits, and enforcing standards; the integrity strategy aims to enable responsible conduct and is based on self-governance according to chosen standards, management driven with the aid of lawyer and human resources, and it implies implementing activities such as leading company development through values and standards, training and communication, assessing values performance, identifying and resolving problems, and overseeing compliance activities.

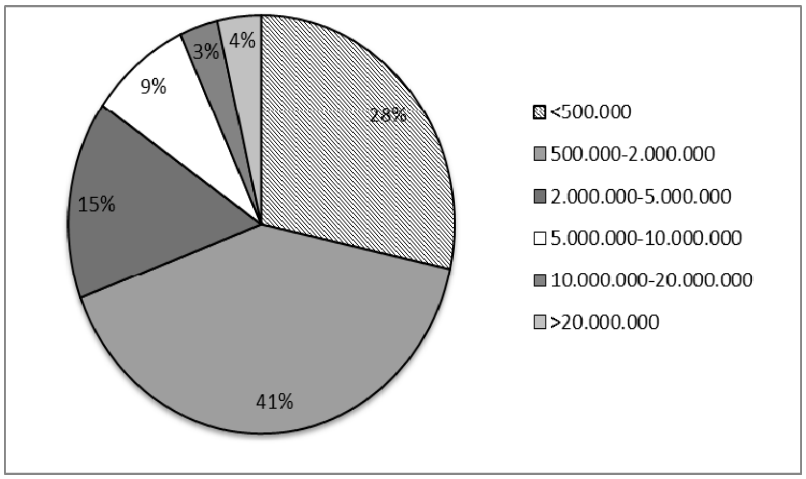
Thus, these reflections suggest that it is not optimal to merely establish and enforce the rules. In this context, the creation of symbolic structures is especially attractive: an organisation can point to structural change as evidence of its compliance, without necessarily creating significant change in behaviour, even though the creation of symbolic structures is only the first stage of organisational response to law. Rather, managers need to create a sense of shared values that can help define an ethical role identity for employees, and set forth organisational support for employees as an ideal. This needs a continuous effort to incorporate ethics into business, integrating ethics into all daily decision making and work practices for all employees; Purcell (1977) and Weber (1981) called this "*the institutionalization of ethics into business*".

3. Research methodology

Our analysis represents an application of an innovative accreditation standard in the Italian VET sector; the introduction of an organisational model pursuant to Decree 231 as a compulsory requisite to gaining accreditation and being able to access public funds. The data reported are the results of research based on an empirical analysis of VET (vocational educational and training) providers in the Lombardy Region. Lombardy was chosen because it is compulsory for VET providers in this region to adopt Decree 231.

The sample consisted of 529 providers, out of a total of about 700 providers in Lombardy Region, most of whom are small to medium enterprises: 28% have a revenue below 500.000 euro a year, 41% have a revenue between 500.000 and 2 million euro, and the remainder of the observed companies have a revenue ranging from 2 million to 10 million euro, just 7% of the sample have a revenue over 10 million euro (figure 1).

Figure n. 1 – Composition of the sample by revenue



Our analysis was developed through the tracing and study of all the documentation concerning the organisational models of the providers, their financial statements, the supervisory unit's reports and minutes, and their codes of ethics. The study of the abovementioned documentation was made possible through a questionnaire submitted to the general management of the providers. The questionnaire was composed of 3 parts: company demographics, assessment of supervisory board, assessment of the impact on the procedures.

Our research model explores the following dimensions. The first characteristic to be analysed is the supervisory board composition through the analysis of the

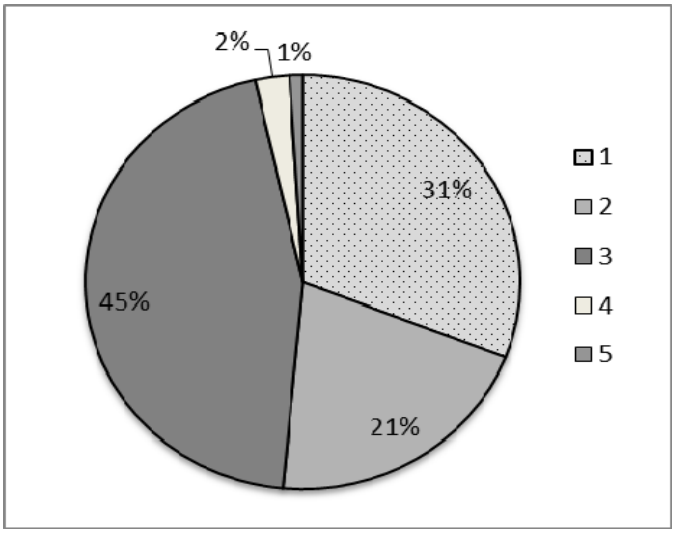
provenance of members, identifying supervisory unit with external members, in-house members or a mixed composition. Regarding the supervisory board composition, our attention goes to the relevant presence of outside directors, which is one of the most important characteristics of good governance as suggested by the codes of good governance in many countries, which call for more independent directors in boards. Then we measured the frequency of supervisory board meetings, that is an important dimension of board operations. Finally, the last section of the questionnaire was focused on the performance and the organizational impact. Since it is not realistic to think that this type of supervisory board can lead to a significant impact on company's financial performance, here it seems to be more appropriate and coherent with supervisory board mission pursuant to Decree 231 to consider the performance intended as efficacy of the compliance to lead to a positive impact on organisation and a better formalization of procedure. All in light of the fact that the supervisory body is appointed to oversee the adoption of the organisational model anticipated by Decree 231 and is a condition for exempting the company from responsibility in the case of felony.

Given this uncertainty, we used as benchmark the support and interpretation given to the "concept of the organisational model" by trade associations which have, in recent years, provided specific guidelines and useful hints on organisational model design and implementation to several industries, as well another important source of clarification is jurisprudence, and in particular it's worth analysing the decree established by the Tribunal of Milan on November 9 2014 which outlines ten key requirements for an optimal organisational model pursuant to Legislative Decree 231, and finally we considered the best practices suggested by consulting companies and senior experts.

4. Results

The first area we looked at was the number of members in the supervisory unit. According to the above mentioned best practices, it is preferable to have a collective composition, in order to provide the necessary effectiveness and a high level of competencies, as well as ensure the autonomy and independence of the body. As shown in figure 2, 31% of the sample have a supervisory unit with a monocratic composition, 21% have 2 members, while just 48% have 3 or more members.

Figure n. 2 – Composition of supervisory unit by number of members



In other words, the majority of supervisory units are composed of just 1 or 2 members which is not in keeping with best practices and guidelines for governance and control.

In considering the number of members, it is also important to identify the "quality" of the members in relation to their provenance, whether they come from inside or outside the company. The choice of an organ already operating within the enterprise would foster the company's need to curb additional costs. By opting for this choice, however, it is necessary to clarify the profiles of compatibility with the existing structures, as well as to guarantee its independence, objectivity and competency. An alternative to in-house members is the choice of external professionals with the necessary independence and competencies. With regards to the qualitative composition of the supervisory body, 11% of the VET providers used an in-house body that coincided with an existing function; 36% preferred a mix between internal and external members; and 53% adopted a composition made up of external members (figure 3).

Figure n. 3 – Composition of supervisory unit by provenence of members

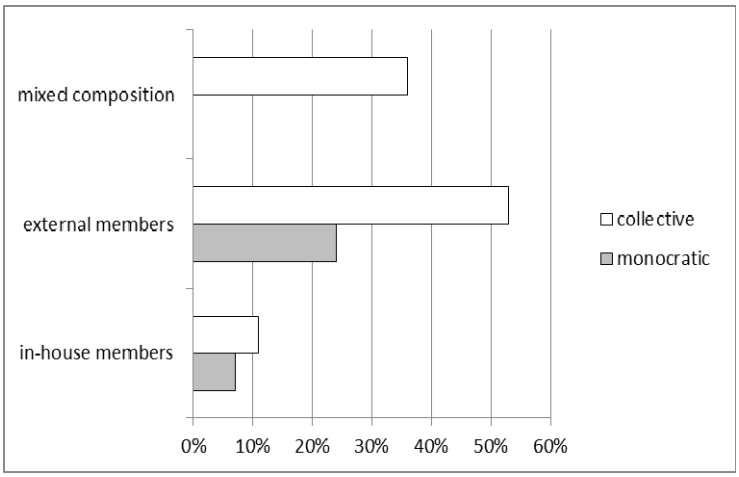
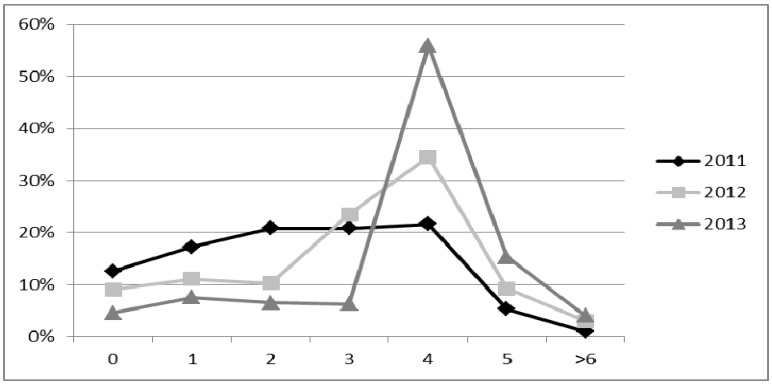


Figure 3 shows that a large percentage of the supervisory units composed of internal members have a monocratic configuration. This last point casts significant doubt on the independence and autonomy of judgment of the unit. In cases where the only member of the body is an employee of the company, it is clear that their decisional powers and operative proxies may lack the indispensable requisite of independence, even more so if they are a manager or on the board of directors.

To determine the continuity of actions promoted by the supervisory body, we analysed (as proxy) the frequency with which the members meet together and draw up the meeting minutes. The results are quite surprising: the majority of the units meets together 3 or 4 times a year, while only a few units provided 6 or more meeting minutes. Between 30 % and 40% of the sample produced less than 3 meeting minutes a year (figure 4).

Figure n. 4 – Number of meeting minutes of the supervisory unit a year

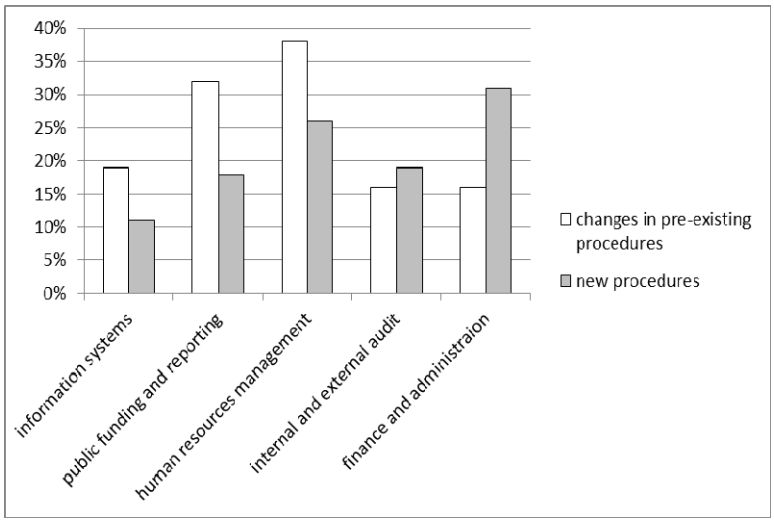


Fortunately, our results show a positive trend from 2011 to 2013, as one would expect from a learning process. Above all in 2013 we can see a clear shift in the average number of meeting minutes from 2-3 to 4 a year. But it should be noted that the Lombardy government issued a Decree at the end of 2012 that suggested VET providers and their supervisory units should not meet less than 4 times a year. This certainly had a positive impact on the frequency of meetings in 2013, and is a classic example of normative/coercive isomorphism. In this scenario, the VET provider does not plan the operation of their supervisory body by responding to its need for control, strategy and organisation, but "simply" by incorporating norms from their institutional environments thus gaining legitimacy, resources and stability. In this way they "institutionalise" compliance with Decree 231. Using the "lens of organisational theories", this example confirms our interpretation of new institutionalism theory.

The last part of the questionnaire aimed to analyse the organisational impact of Legislative Decree 231 on the VET providers' procedures and processes. The first group of procedures to be analysed were (figure 5):

- information systems, which are crucial as they concern the procedures providers use to request public funding and to make subsequent reports. For this kind of procedure, Decree 231 seems to have a low-medium impact, just 11% of the sample introduced new procedures, while 19% changed pre-existing procedures. The rest of the sample made no modifications to their procedures;
- public funding administration and reporting procedures, which are extremely important given that the majority of the VET providers receive substantial amounts of public funding. Here the impact seems to be higher, 18% of the sample introduced new procedures, while 32% changed pre-existing procedures, however, half of the sample made no changes to their procedures;
- human resources systems, from recruitment to evaluation and compensation. Here the impact seems to be more noticeable, 26% of the sample implemented new procedures and 38% modified pre-existing procedures;
- internal and external audit, for these procedures the effect seems to be low, since only 19% of the sample implemented new procedures and 15% modified pre-existing procedures, 66% declared no changes;
- finance and administration, for these procedures 31% introduced new procedures and 16% changed pre-existing ones.

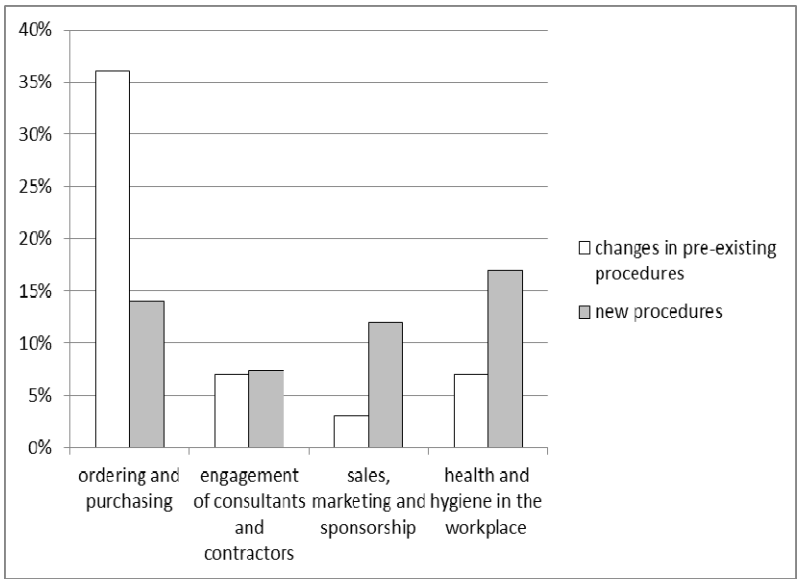
Figure n. 5 – Impacts on procedures (a)



The second group of procedures includes (figure 6):

- ordering and purchasing, these procedures were changed by 36% of the observed companies, while 14% of the sample introduced new ones;
- engagement of consultants, contractors and external service providers, this procedure was changed only slightly, 7% of the observed companies modified pre-existing procedures and 7% implemented new ones;
- the same small impact was observed for sales, sponsorship and marketing procedures, where only 3% modified its procedures and 12% created new ones;
- procedures for accident prevention for health and hygiene in the workplace were changed in 7% of the companies, while 17% created new ones.

Figure n. 6 – Impacts on procedures (b)



5. Conclusions

Alongside the many VET providers who demonstrate a good application of the norm, there are other providers, who seem to have implemented a "rhetorical organisational model" which has unclear organisational implications and does not provide for improvements within the organisation. The supervisory units of this latter group are often composed of one internal member who lacks the indispensable requisite of independence and autonomy of judgment. The situation is even worse when we consider the continuity of actions promoted by the supervisory body where the majority meet together less than 3 times a year. Moreover, over half of the sample made no changes whatsoever to their procedures.

Our conclusion is that the majority of observed companies apply a "rhetorical 231" in a largely formal and symbolic way, they appear to be attentive to the law and thus gain legitimacy and public resources but, at the same time, they seek to minimise the law's constraints on traditional managerial prerogatives. As if to say, we comply to law at a minimum level, just to avoid sanctions. In this way, the organisational model pursuant to Decree 231 becomes a symbolic structure, which serves as a visible sign of compliance with the law, but because the supervisory unit does not perform an effective control on preventing risks and felonies, the procedures have no real impact on executive behaviour.

It is here, in our opinion, that the new institutionalism theory finds a perfect fit: providers simply incorporate norms, in our case the organisational model under Decree 231, so that they can gain legitimacy, resources and stability, while at the same time trying to avoid any real change in their functioning and organisation. In

so doing, they enter into a sort of "institutional inertia", which runs the risk of neutralising the effort made by the legislator, without necessarily creating significant change in behavior.

The scientific literature states that practices that impact on organisational models such as Legislative Decree 231 or quality management systems will be more efficient and deliver more benefits when they are applied on the basis of internal motives and not as a result of pressure from external forces. However, regardless of the top-down or bottom-up approach, it is our opinion that for this kind of organisational innovation to be fully effective it is necessary to apply a framework that takes into consideration the tricky relationship between compliance and ethics.

It is our understanding that to gain the full effectiveness of compliance pursuant to Decree 231, it is necessary to shift compliance from a merely formal and rhetorical approach to an approach, which makes concrete changes in organisational behaviour and efficacy. To do this, compliance must tend toward ethics, and ideally overlap. At the same time, ethics cannot just be based on individual consciousness and willingness, but it must become a value for the entire group and organisation, a basic pillar for the company's culture which orients day to day operations such as managerial and executive behaviours. And, finally, all of this must be aligned with a company's goals, human resources management and strategy. If a company tends toward ethics, it cannot focus its compensation system purely on performance, that is to say to what extent a manager achieves a goal but it must also focus on how and through which behaviour the goal is achieved. Company strategy that is oriented exclusively toward profit and economic growth cannot support its individuals' ethics sufficiently.

Instead, if all these variables are directed toward ensuring that compliance and ethics virtually overlap, then not only will companies that comply with rules be profitable, but a virtuous circle will be formed where compliance will drive toward ethics, which in turn will support compliance.

The major limitations of this study are related to the sample. Observing only 3 years as sample period could affect our findings. We cannot generalize to other years and we cannot even avoid the bias because of a single industry that is VET sector. Thus, the collection of data for more years can be profitable used to compare and evaluate the robustness of our results and to check the trends and possible evolution in the adoption of the decree 231/2001. And also the sample size focused only on Vet sector is not representative of the Italian scenario thus we could not consider the opportunity of running meaningful industry or sector comparison or cross country analysis. I believe that future work using inter-temporal and inter-sectors modelling could build upon and extend the insights presented here. Finally, our study doesn't allow to differ between compliance and the effective impact on organizational behavior, since guidelines and procedures issued by trade associations and other stakeholders used as benchmark in our survey, can be generated as "normative isomorphism".

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