World Business Academy

Rekindling the Human Spirit in Business

PERSPECTIVES

Volume 16, Issue 1 **January 30, 2002**

Editor's note: We received this particularly relevant piece from Professor Smith long before the current Enron scandal. Dr. Smith examines the phenomenon of unethical behavior from the perspective of classical cost-benefit analysis and rational decision-making theory. Why are we not surprised by his conclusions? "There is no such thing as a conflict between long-term business success and ethical behavior. Good ethics pays over the long run, and the benefits of good ethics far outweigh the costs."

Had this fundamental understanding existed at Enron, the tragic toll of ruined lives, death and financial bankruptcy would have been avoided. Indeed, Enron's deception provides textbook examples of unethical behavior and its consequences. One wonders how Enron's Board of Directors could have voted to suspend its ethics code twice in order to create private partnerships? How could "insiders" profit while others' 401K plans were frozen? Why was there a need for massive shredding? Was Enron's accounting firm (Anderson) being paid $3 million monthly to look away from fraudulent books? And what did all of these schemes reap? A $67 billion company vaporized.

Critical ethics' decisions are "not made in a social vacuum," writes Dr. Smith. Individuals are affected greatly by their work context. Management is required, fundamentally, "to maximize the relative attractiveness of ethical choices." A synergy must exist between ethics-seeking individuals and ethics-oriented management. There is a need to understand "that self-interest and good ethics coincide." Enron is a tragedy that never should have happened. The rules they broke are too fundamental. One wonders, at this point in our evolution, how so many individuals can still be so blind.

Motivating Ethical Behavior through Cost-Benefit Analysis

Raymond D. Smith, Ph.D.

Cost-Benefit Theory and Ethics

Much has been written about the lamentable state of business ethics. A predominant theme is that "something is wrong" and it must be fixed. The notion is that there is a pressing urgency to our current moral and ethical state of affairs that requires action (Krohne, 1997). For example, studies have shown that 35 percent of 200 professionals admitted to lying to customers and fellow employees, 65 percent of 158 middle managers believed profits should take precedence over product safety, and in a role-playing scenario, 75 percent of MBA students were willing to commit fraud. Even more disheartening, 47 percent of senior executives were willing to countenance this behavior! (Krohne, op.cit.). While there are significant negative and pessimistic public opinions of the level of ethics in business, the highest priority is not that public opinion be changed, but rather that the deeper problem causing the negative public opinion be solved. Public opinion would be more positive were business to improve its level of ethics. Many operational suggestions have been advanced as to how the problem must be addressed. Calls for corporate codes of conduct, values-based leadership styles which emphasize accountability and caring, and corporate cultures valuing ethical behavior highly are but a few. And yet, the problem of ethics, or more accurately its lack, is not a problem directly solvable at anything but the individual level because ultimately ethics involves individual action at some point. Individuals regardless of organizational context cannot relieve themselves of the individual responsibility to behave ethically (Ladd, 1984).

It is dismaying that internalized personal ethics have been shown to be of such negligible importance in deterring executives from behaving unethically. Espoused values simply do not in reality deter unethical behavior because people tend to not walk their own talk. While some research shows that people ostensibly obey the law because they personally believe in its legitimacy, other research shows a clear tendency for people to obey orders, in violation of their own ethics, to get ahead and for them to feel pressure from supervisors to sacrifice their ethics to produce results (Cavanagh, 1980; Milgram, 1974). Paine (1994), while

-based ethics systems based on internalized values concedes that "some people do need the threat of sanctions." In sum, these findings show that changing people's behavior seems to be more easily accomplished by changing the context of the work and the culture of the organization as compared to changing an individual's inner character and internalized values.

Thus, the usefulness of interventions geared at the collective such as codes of conduct, corporate renewal efforts, changes in leadership and cultural transformations is dubious unless they somehow achieve a change in the specific behaviors of specific individuals. For example, the problem of corporate advertising being misleading is ultimately a problem of specific executives or staff persons choosing within their own realm of responsibility to accept a particular advertisement instead of rejecting it. Thus, ultimately it is the individual's behavior that must be shaped if a corporation is to become more socially responsible or ethical.

Only individuals have the ability to make an intentional choice to change the ethical quality of their decisions, and therefore must of necessity be the object of intervention. Individuals regardless of organizational context relieve themselves of the individual responsibility to behave ethically (Ladd, 1984). The sad experiences of two Beech-Nut executives imprisoned for consumer fraud involving infant juice are a testimony to the fact that corporate pressures are not an acceptable legal defense. Under the U.S. Sentencing Commission's guidelines, a corporation will not be prosecuted for illegal actions if it can show it took significant, responsible steps to deter employees from unethical conduct. Instead, *only the individual will be prosecuted*. According to Victor R. Loucks, Jr. Chief Executive Officer of the Baxter Travenol Laboratories, Inc. "..(I)t really isn't companies but people who are ethical or unethical. Corporate charters...take no action right or wrong. They just sit there, leaving it to individual people to act properly or not." (1987)

Ethics critical choices are not made in a social vacuum. Since individuals are greatly affected by work context, these very same contextual factors may be shaped by managers and used to bring about better ethical choices. Specifically, in order to raise the morality of action within the organization, managers must act to manage the relative costs and benefits of ethical and unethical actions so as to make the ethical actions maximally attractive and unethical ones similarly unattractive. It is the management of these contextual factors in order to maximize the relative attractiveness of ethical choices that is the subject of the remainder of the paper.

Minimizing the Benefits of Unethical Action

There is a management truism that "managers get what they reward, not what they want." If managers reward unethical behavior by valuing ends more than means, they will get it. This problem is called "*the folly of rewarding A while hoping for B*" (Kerr, 1995) and can occur when managers pressure employees for high performance, set poor moral examples, and yet, hope employees will act ethically in spite of the pressure. Such an expectation flies in the face of repeated findings that performance pressure contributes to the incidence of unethical behavior. The employee who falsifies data concerning product specifications on a contract negotiation may find that this misrepresentation was a deciding factor in winning the contract and enjoying the monetary and psychic benefits that go along with it. The employee may realize that such conduct is injurious to the client; however, the client's costs are not incurred directly or indirectly by the employee and thus considered irrelevant. The manager, by focusing solely on performance, may hope for better ethics but will not get it because there is no reward for ethical behavior, only for winning the contract.[1]

Corporate values, statements and cultures which place a high degree of value on personal honor and integrity can be helpful in making the rewards of unethical behavior unattractive. If this cannot be accomplished, at least the benefit itself can be taken away. In the securities industry, for example, capital gains from insider trading are disallowed. Similarly, in athletic competitions, competitors found to have cheated must give back their medals. Thus, where gain is found to be the result of unethical action, the gain must be forfeited. Ultimately, in order for individuals to value the benefits of unethical behavior less, there must be a synergistic co-functioning of an ethics-seeking individual coupled with ethics-oriented managers and co-workers.

[1] A classic account of how group norms and pressures can lead individuals to violate their own consciences is found in Bowen McCoy's "The Parable of the Sadhu" (1997). In it, a group of career oriented, amateur climbers come across an incapacitated Hindu holy man and are faced with the dilemma of rendering him aid and forsaking their goal of reaching the summit, or continuing on and trusting the man's fate to the mercy of others.

Maximizing the Costs of Unethical Action

Much of the effort at improving corporate ethics has found its emphasis in this area. Penalties such as reprimands, fines, firings and imprisonment all fall into this category. The effectiveness of such measures is consequent upon two main factors: the perceived severity of the punishment and the chances of getting caught (Trevino and Youngblood, 1990). These two factors taken together yield the "expected cost" of committing the offense. If one perceives no chance of being caught, the penalty is irrelevant. Conversely, if the chances of being caught are high but the penalty is meaningless, the individual is similarly undeterred. The solution is for punishment to be sufficiently severe while at the same time maximally certain. An example where this did not occur is the Ford Pinto case of some 20 years ago. Executives used a figure of $215,000 as the cost per person in lawsuits they would face if they did not undertake the expensive option of altering the Pinto's gas tank retaining straps. The executives chose to absorb the lawsuit costs rather than fix the straps. Similarly, in the Space Shuttle explosion, testimony by Morton-Thiokol managers revealed an indifference to their concerns about the ability of O-ring seals to perform in cold weather. Such indifference led to the launch not being postponed and the subsequent death of all crewmembers. It is clear their estimate of the costs of acting unethically did not play enough of a role in their decision-making *when compared to the perceived benefits.* Had there been the expectation of strong censure for allowing the cars to not be repaired or the O-rings to be used in cold weather, the ethical lapses would not have occurred.

As Bishop (1991) points out, the reward systems of businesses simply do not sufficiently punish ethical breaches if conformity to ethics costs too much in terms of organizational goals. An example of this is found in the revelations that school authorities were overlooking cheating on standardized tests because punishing it could lead to lower test scores and an associated negative reaction from higher level school officials. Managers and employees must therefore be diligent in policing the actions of themselves, their superiors and subordinates to ensure persons acting unethically experience negative consequences. A type of honor system whereby employees anonymously report dishonest practices by co-workers called the “silent whistleblower” is being used with good results. Regular, ongoing ethics audits of employee conduct must also be undertaken, where ethical breaches are considered as part of periodic performance reviews. Unfortunately, such effort is seen as burdensome to managers and often seems to contribute little to the bottom line for which managers are chiefly evaluated.

Maximizing the Benefits of Ethical Action

As more and more managers embrace a broader view of firm accountability, called *stakeholder management*, it is becoming clear that the ethics of caring about more than just shareholders is good business. The epitome of an ethical organization is one that, in addition to breaking no laws, also serves the needs of a broader constituency than just shareholders. Employees, customers, suppliers and the community at large are all seen as having valid claims on the organization’s time and energy and so decisions are made with a view to these groups welfare. The overall effect of all this is increased customer service, more satisfied motivated employees, better supplier relationships and service and fewer public relations problems. It is obvious that, taken together, such a situation would be conducive to good long-term profitability. The following is a snapshot of the ethics supportive culture in place at Motorola, one of the world’s leading electronics companies. The company was founded in 1928 and currently enjoys sales of just over $30 billion. The basis of the corporate culture is its code of business conduct, which embodies the insights of hundreds of focus groups throughout the company’s operations. The code itself is part of a larger overall initiative called the Motorola Ethics Renewal Process (Thompson and Strickland, 2001). In the words of CEO Christopher Calvin, grandson of the founder, it embodies an “active, open participative process where Motorolans worldwide can discuss how to determine right and wrong in various situations.” The guiding document used by all employees is the *“Total Customer Satisfaction Card.”* It embodies key beliefs -- constant respect for people, uncompromising integrity; key goals – best in class for people and product; and key initiatives – Six Sigma Quality, Total Cycle Time reduction and empowerment for all. As Motorola diversified and became more global, it established categories for ethics standards in terms of how flexible managers were willing to be in terms of enforcement. For example, bribing officials is in the verboten category still, while gift acceptance, a part of Japanese culture, was permitted on a limited basis in that country. Thus it is clear to employees that the success of Motorola is in no small part due to its well-known reputation for integrity and excellence. Such qualities now serve the purpose of being essential strategic cornerstones.

Baseball player and manager Leo Durocher once quipped: "Nice guys finish last." What he meant was that scant attention or reward is given to "nice guys" and that to win, one must be willing to be other than "nice." It is implied that winning is more important than being nice. Not so surprisingly, it has recently come to light that the 1951 New York Giants, managed by Durocher, used an elaborate telescope and electric signaling system to inform batters of opponents' pitch selection, (although Bobby Thompson, who won the pennant for the Giants by hitting a home run in a special playoff game against the Brooklyn Dodgers, maintains he was not tipped off to that pitch). The benefits of ethics in terms of self-esteem, company pride, integrity and *long-term financial success* should be valued more than the benefits of ill-gotten monetary gain. Yet, in corporate cultures where winning is everything, this is a difficult attitude to hold.

Thus, a critical task in achieving a higher level of morality in individual decision making in organizations is to inculcate the fact that self-interest and good ethics coincide because it is in one's own interest to act morally. For example, Edward G. Harness, then CEO of Procter and Gamble, in announcing the decision to remove from the shelves a tampon thought linked to toxic shock syndrome made the point that: "Profitability..goes hand in hand with fair treatment of…consumers and the community." Regarding the benefits of morality, ethicist Robert Solomon (1993) noted, "*For the properly constituted self, the distinction between self-interest and social-mindedness is all but unintelligible, and what we call selfishness is guaranteed to be self-destructive in the long run.*"

What does it take for someone to perceive the ultimate net benefits of ethical conduct? The answer seems to lie in the concept of character, the possession of moral virtues. It takes the inculcation of *good character*, whereby values are internalized and doing good is attractive for its innate quality rather than its instrumental value. Thus it seems that good habits create virtue. (Cavanagh, 1998). Like learning to ride a bicycle, good character and an associated affinity for moral conduct are not something a person achieves by reason alone; they are something acquired through practice. The use of cost-benefit mechanisms to motivate good conduct can thus be a useful tool in beginning or increasing the prevalence of behavior patterns associated with good character and good ethical decisions. In inculcating a greater appreciation for ethical conduct, managers should create and sustain a culture where acting ethically is more important than winning. Ethical behavior will come to be seen as personally attractive and desirable as they are rewarded for such actions and as they experience through actual practice the psychic benefits of ethical conduct.

Minimizing The Costs Of Ethical Action

The final section deals with the need for managers to reduce the costs of ethical behavior. The costs of acting ethically include, but are not limited to, the costs employees incur when they stand-up for their values and ignore political correctness or the political dynamics of their workplace. Retribution may include harassment, censure, ostracism and even being fired. Whistleblowers have received attention because of being fired after having exposed wrongdoing. In contrast, AT&T has a whistleblower protection policy which states that persons reporting unethical behavior on the part of AT&T employees to outside sources will not be punished.

Employees are very aware of the costs incurred in taking issue with the immorality of a supervisor's actions. It is critical to understand, however, that it is often at this very point that the ethics battle is won or lost. Ethics cannot advance *collectively* as long as *individuals* are not willing to incur the wrath of less scrupulous colleagues and persist in doing what they believe to be the right thing (Smith and Singer, 1997).

In the interest of drawing out more ethical behavior from employees, managers must understand the pressures employees face in trying to do the right thing. Sadly, these pressures often arise from supervisors *not* doing the right thing and from overall cultural pressures that condone or encourage poor ethics. The solution involves initiating cultural shift so that the climate becomes more ethics friendly. The indispensable first step in such a transformation is managers leading by example.

Conclusion

The essential truth to be grasped from the paper is there is really no such thing as a conflict between long-term business success and ethical behavior. It has been an accepted axiom of business that emphasizing good ethics is fine, but it really is not the way to truly maximize profits, and that on the whole it is expensive to truly insist upon topnotch ethical behavior by all employees. The truth is, conversely, that good ethics pays over the long run and that the benefits of good ethics actually far outweigh the costs. Until businesses realize there is long term profit incentive for practicing sound ethics, the hopes for a markedly increased level of ethical practice in business remains dim. The great success of organizations like Motorola, Levi-Strauss and Wal-Mart all founded solidly on ethical bases supports this, namely, the truth that *"Good ethics is good business."*

In order to assist managers transition to a more explicitly ethics-based organization, this paper has discussed the problem of unethical behavior from a rational decision-making, cost-benefit perspective in order to bring into clear relief the central dynamic that produces such behavior in the first place. It seems clear, based on experience, that unless this dynamic is addressed, other, more impersonal approaches are of little value. However, since ethical choices occur within an organizational context, the organization has at its disposal potent tools to shape ethical conduct.

Raymond D. Smith, Ph.D.
Assistant Professor
Management Department
School of Business
Howard University
2600 6th St. NW
Washington, DC 20059
Phone: 202 806-1520
raysmith@howard.edu