

Governance Symposium Session

Leading Ethically

- Welcome
- Qualities of Ethical Leadership
- Independent reflection on qualities
- Small group discussion on fostering these qualities in organizations
- Large group sharing

JUST LEADERSHIP: CREATING A VALUES-DRIVEN COMMUNITY

Drea Zigarmi

Why should leaders care about justice—the subjective opinions of people concerning what is fair or what “ought” to be done? Because people’s perceptions of organizational justice have a direct impact on turnover, service, organizational citizenship, sabotage, and levels of trust in leadership. Not only that, but perceptions of injustice and unfairness are the major reasons why people leave their organizations.

While studying, training, and consulting on the art of leadership, I have had the opportunity to watch all kinds of leaders. I have observed egotistical leaders, angry leaders, controlling leaders, vindictive leaders, threatening leaders, as well as friendly leaders, supportive leaders, and loving leaders. They all try hard, and while not always well-intentioned, I believe, smart leaders sense what is at stake as they try to influence people. What is at stake, of course, is the *hearts* of people, the *commitment* of people, and *vision* of people, all of which are desperately needed for effective collective action.

I have also seen the sadness, the disillusionment, the loss of hope, and the inertia created when followers lose faith in their leader. This outcome usually occurs because they come to believe their leaders are selfish, morally bankrupt, and unjust. Employees learn to put away their deep desire for justice. They become resigned to the fact that although we are born into a democracy and we may live in a democratic society, most people do not *work* in a democratic organization.

This means there is no “common will” or “public mind” that can be appealed to—only decisions made by the leader and those the leader listens to. As a result, there is often no way to influence the process or the content of the decisions made, nor to participate in the decisions that affect those who have to implement them.

The burden of leadership carries with it by nature a sense of inherent inequality. Power, authority, and autonomy are all distributed unequally—and all in favor of leaders. To follow therefore requires a commitment of

trust on the part of the follower. Followers must trust that leaders will be fair, just, and true to their word.

This article is not about why justice is important. Its topic is something much more important: how leaders can create a just organization. I focus on the five most important leader behaviors that you can use to foster a just organization:

- Create and communicate a clear, humane organizational vision.
- Develop a personal sense of fairness and help others do the same.
- Cherish change agents and whistle-blowers.
- Build in checks and balances for access to information and decision making.
- Ensure procedural fairness.

The following sections present these behaviors in detail. Then, as a working example, they discuss what Tyco did, after its much-publicized scandal, to turn its culture around using each behavior. Tyco's efforts were chosen as an example because of the author's intimate knowl-

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edge of the sincere, comprehensive nature of the changes that were made.

Create and Communicate a Clear, Humane Organizational Vision

A vision consists of three elements: a purpose, a set of values, and an image of the desired end state. The purpose describes what the company does, and a set of prioritized values gives guidelines for how the company's purpose will be carried out. For example, fairness and justice are values that help accomplish a worthwhile social purpose. The image of the desired end state is a clearly defined picture of what would actually take place if the vision is achieved.

The strength of your vision lies in the clarity of your values. It isn't surprising that most people want jobs in organizations that do meaningful work. Therefore, the purpose, which describes a meaningful endeavor—and values to accomplish that endeavor—are the heart of your vision. To have impact, your organizational vision must have a meaning-based perspective. Vision statements that do not resonate with the values of employees will garner very little motivation and energy. Work that people do in organizational settings must resonate with their personal values if they are to stay motivated and energized to accomplish that work. In other words, meaning must precede action.

Research shows that organizations that employ clear visions and goals have significantly greater profits than those organizations that do not. But, in most employees' minds, it isn't the profits that make the vision worth doing—it is the meaning the product or service has for the customer. The worth of the service or product to

your customer should therefore be made clear to all in the purpose statement of the organizational vision.

The values embodied in your vision are ultimately used to create and sustain meaningful work environments without sacrificing a company's perfectly legitimate concern for the bottom line. You want to be fair *and* profitable. Sometimes, however, the two are not possible at a given time, and you must therefore put them in priority order. To earn and keep the trust of your employees, this means putting fairness before profitability.

To lead at a higher level, the needs and values that the leader represents cannot just be *any* values. They must be the noblest needs and values of humankind—not secular, not idiosyncratic, not self-invested nor hegemonic, nor full of hubris—but needs and values that serve each individual by firmly and yet gently establishing and reminding everyone of the obvious responsibility each individual has to the welfare of the whole. In short, they must be humane.

Effective leaders stress relationships and build connections between people. They stress the potential for employees to be more tomorrow than they are today, and they create an ideal of harmony—an ideal of grace and giving—that will ultimately produce peace, balance, and productivity in an organizational setting.

Values at Tyco

After the company's public scandal, incoming Tyco executives reestablished clear organizational values to be behaviorally observed by all employees: integrity, excellence, teamwork, and accountability. They then proceeded to weave these values into Tyco's performance evaluation process. They conducted six months of training and had

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an annual recertification of their vision and expectations. The new executives created a clear vision of a just and ethical organization and then cascaded that vision throughout Tyco. (For more information on this case, see Eric Pillmore's in-depth article, "How We're Fixing Up Tyco," in *Harvard Business Review*, December 2003.)

Develop a Personal Sense of Fairness in Self and Others

Few would-be leaders realize that the success of a leader depends on that leader's beliefs about the meaning of life. If a leader believes that the meaning of life is to gain personal wealth, have power, have authority, or be the one who garners most of the attention, then that will send off corresponding signals to followers about what is fair and just.

If, on the other hand, a leader believes that the meaning of life is to focus energy on the well-being of those being served—customers and employees—the meaning of the work is clearly and consciously focused on the welfare of others. A just and fair organization can only happen when the leader's actions are consciously understood in relation to the welfare of the whole.

A personal sense of fairness results when a full examination of one's rights is pursued in parallel with a full examination one's responsibility for the welfare of the whole on a particular issue, over time. This means that leaders must look out for what's best for others. Leaders must honestly face their own selfishness and must give more than they take. They must stand up for the rights of others when others cannot defend their own rights.

You can see that the hardest battle that may have to be won is with the self. The creation of a values-driven community requires a habitual pattern of open discussion. It requires a consistent pattern of truth telling, in which individuals trust that the conflict that occurs in the course of speaking their truth will result in greater understanding, stronger emotional connections, and more in-unison behavior.

It should also be evident that values-driven leaders and values-driven organizations are formed through meaningful, choice-filled dialogue and action. It implies that

leaders and followers take the time to look at alternatives and consequences in order to make fair decisions that nurture the welfare of all.

Fairness at Tyco

Tyco executives issued a guide to ethical conduct for all employees, which explained their responsibilities regarding corporate ethics. They instituted a corporate-wide training program and built ethical behavior into the performance evaluation process, making ethical behavior a criterion for promotion. The training provided guidance to employees in the identification of unethical behavior. By emphasizing and standardizing ethical behaviors, Tyco developed a personal sense of fairness for all its employees.

Cherish Change Agents and Whistle-Blowers

I feel hesitant about using the term *whistle-blower*. It is only when I think of its origin that I feel better. It comes from the actions of an English Bobby, or policeman, who blew his whistle to alert the community that wrongdoing was afoot. This heroic action has become somewhat tarnished in today's age. Values-driven organizations are maintained through the ever-present opportunities each individual has to act upon the agreed-upon collective values of the organization.

Whistle-blowing is the act of reporting illegal, immoral, or illegitimate practices to those who can provide a remedy. Interestingly enough, a national business ethics study showed that while 56 percent of employees surveyed thought that expectations of ethical behavior have been well communicated within their organization, only 33 percent of the employees surveyed felt comfortable reporting ethical misconduct. Leaders must find ways to enhance and encourage organization members to create an ethically sound environment.

People are most apt to act when they feel the public or their coworkers will be harmed, there are other observers, or the organization is highly regulated. Contrary to popular belief, most whistle-blowers engage in rational behavior, weighing the costs and benefits that will result if they speak up. Research says that the incli-

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nation to speak up is related to the probability that things will change and the situation will be corrected—that is, that justice will be done.

Leaders need to cherish their whistle-blowers. They need to encourage people to speak up and voice their concerns, because the research shows people are less apt to speak out when they do not feel morally compelled, do not see it as part of their job, when they reported their job performance as low, or were employed by highly bureaucratic organizations. And it is almost guaranteed that if employees believe they work for a leader who is not fair, or that they work in an organization that is not just, then they will not speak up and voice their concerns.

Protecting Whistle-Blowers at Tyco

Tyco executives created a position of ombudsman reporting to the audit committee of the Board of Directors to provide a direct, confidential, and impartial resource for any employee who wanted to raise issues about the company's compliance with industry regulations or its corporate vision and values. They also established a toll-free confidential telephone number and an online system that allowed people to report ethical concerns, and a new policy, which asked everyone to embrace this change and not punish those who spoke up. By demonstrating that they cherished their whistle-blowers, Tyco gave explicit permission for employees to speak up.

Build in Checks and Balances for Access to Information and Decision Making

The correlation between open access to information and positive endorsement of and trust for leaders is high.

And the correlation between participation in decision making and employee commitment to the organization is very high. There is an obvious corollary: an organization is as sick as it is secret. Research has shown that secrecy about pay, performance measures, or promotion criteria, for example, leaves ample room for perceptions of bias and inequality and results in decreased leadership credibility and employee morale. Without adequate checks and balances for access to information and decision making, organizations can easily slide from an environment of trust to one of cynicism.

The availability of a wide variety of organizational information, informally or formally accessed, results in people viewing leaders as open and forthright in dealing with employees. However it is not just access to information that is important; people also need to be allowed to participate in decision making. Participation in decision making increases acceptance and helps shape perceptions of fairness.

Most executives I have talked to, both privately and publicly, welcome the structure that Sarbanes-Oxley gives to the reporting of accurate information to organizational stakeholders. Here are some of the typical checks and balances that have been put in place: a VP of corporate governance who reports directly to the board, an internal audit committee that reports directly to the board, and an officer assigned to audit executive compensation to assure proper oversight of management and incentive programs.

Information Access and Decision Making at Tyco

Tyco's board and senior leadership developed and implemented a sophisticated means to evaluate senior management character. They created a variety of open communication outlets to call attention to bad leadership behavior when it occurred, and established a formal policy on delegation of authority that expressly prohibits individuals, no matter what their rank, from taking action in their own self-interest. They also made a complete delineation between finance and operations management. These multiple systems of checks and balances further established Tyco as an ethical and just organization—one that looked out

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for the best interests of all involved, not just those at the top.

Ensure Procedural Fairness

The concept of procedural fairness refers to employees' perceptions of the fairness of the process by which decisions are made. Procedural fairness rather than job satisfaction or the distribution of financial resources is a direct predictor of a given employee's commitment to the organization. In other words, intent to stay is determined by the perceived fairness of policies and procedures used to derive the allocation of resources—not by what the individual receives.

Procedural fairness is connected to employee perceptions of process issues, such as the level of employee voice, appropriateness of evaluation criteria, and accuracy of the information used to render a decision. The issues that influence employee perceptions of procedural fairness include *consistency* (do the criteria apply to all?), *accuracy* (is the latest information used to make the decision?), *fidelity* (is the process in line with the espoused vision?), *representativeness* (are all the stakeholders' interests considered?), *voice* (are the people affected given a say in the decision and the chosen solution?), and *correctability* (will someone check to see if the decisions have their intended effects?).

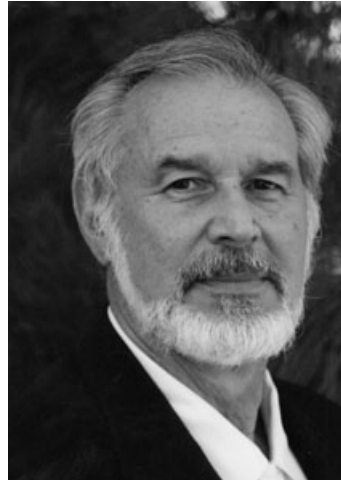
Employees who are treated fairly are more apt to act as good citizens in their organizations, displaying altruism, conscientiousness, courtesy, and other positive behaviors. They are also less likely to engage in anti-organizational behaviors, such as resisting authority, work avoidance, sabotage, or aggression.

Fairness at Tyco

Tyco executives established a performance review system that evaluated people on the basis of the attainment

of professional development–related goals, which included observable ethical behaviors, as well as on financial performance goals. They established a nominating and governance committee—which recommended prospective director nominees for the board to select—and a compensation committee to review and approve compensation and benefits. They also established a compliance risk committee to examine business risks and the decisions associated with new business, and a succession planning process at the corporate level to teach behaviors required of those who would get ahead.

In summary, the way to win employees, hearts and commitment is by creating organizations that are perceived just. Leaders accomplish this goal by communicating a humane vision, developing a personal sense of fairness in self and others, cherishing their change agents and whistle-blowers, building in checks and balances for access to information and decision making, and ensuring procedural fairness. It can be done, because companies have done it and are doing it. Some leaders are using these behaviors proactively, before they get into trouble, or reactively—as Tyco so aptly demonstrates. Are you willing to take up the challenge?



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By supporting ethically sound behavior, managers can strengthen the relationships and reputations their companies depend on.

Managing for Organizational Integrity

by Lynn Sharp Paine

Many managers think of ethics as a question of personal scruples, a confidential matter between individuals and their consciences. These executives are quick to describe any wrongdoing as an isolated incident, the work of a rogue employee. The thought that the company could bear any responsibility for an individual's misdeeds never enters their minds. Ethics, after all, has nothing to do with management.

In fact, ethics has everything to do with management. Rarely do the character flaws of a lone actor fully explain corporate misconduct. More typically, unethical business practice involves the tacit, if not explicit, cooperation of others and reflects the values, attitudes, beliefs, language, and behavioral patterns that define an organization's operating culture. Ethics, then, is as much an organizational as a personal issue. Managers who fail to provide proper leadership and to institute systems that facilitate ethical conduct share responsibility with those who conceive, execute, and knowingly benefit from corporate misdeeds.

Managers must acknowledge their role in shaping organizational ethics and seize this opportunity to create a climate that can strengthen the relationships and reputations on which their companies' success depends. Executives who ignore ethics run the risk of personal and corporate liability in to-

day's increasingly tough legal environment. In addition, they deprive their organizations of the benefits available under new federal guidelines for sentencing organizations convicted of wrongdoing. These sentencing guidelines recognize for the first time the organizational and managerial roots of unlawful conduct and base fines partly on the extent to which companies have taken steps to prevent that misconduct.

Prompted by the prospect of leniency, many companies are rushing to implement compliance-based ethics programs. Designed by corporate counsel, the goal of these programs is to prevent, detect, and punish legal violations. But organizational ethics means more than avoiding illegal practice; and providing employees with a rule book will do little to address the problems underlying unlawful conduct. To foster a climate that encourages exemplary behavior, corporations need a comprehensive approach that goes beyond the often punitive legal compliance stance.

An integrity-based approach to ethics management combines a concern for the law with an emphasis on managerial responsibility for ethical be-

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havior. Though integrity strategies may vary in design and scope, all strive to define companies' guiding values, aspirations, and patterns of thought and conduct. When integrated into the day-to-day operations of an organization, such strategies can help prevent damaging ethical lapses while tapping into powerful human impulses for moral thought and action. Then an ethical framework becomes no longer a burdensome constraint within which companies must operate, but the governing ethos of an organization.

How Organizations Shape Individuals' Behavior

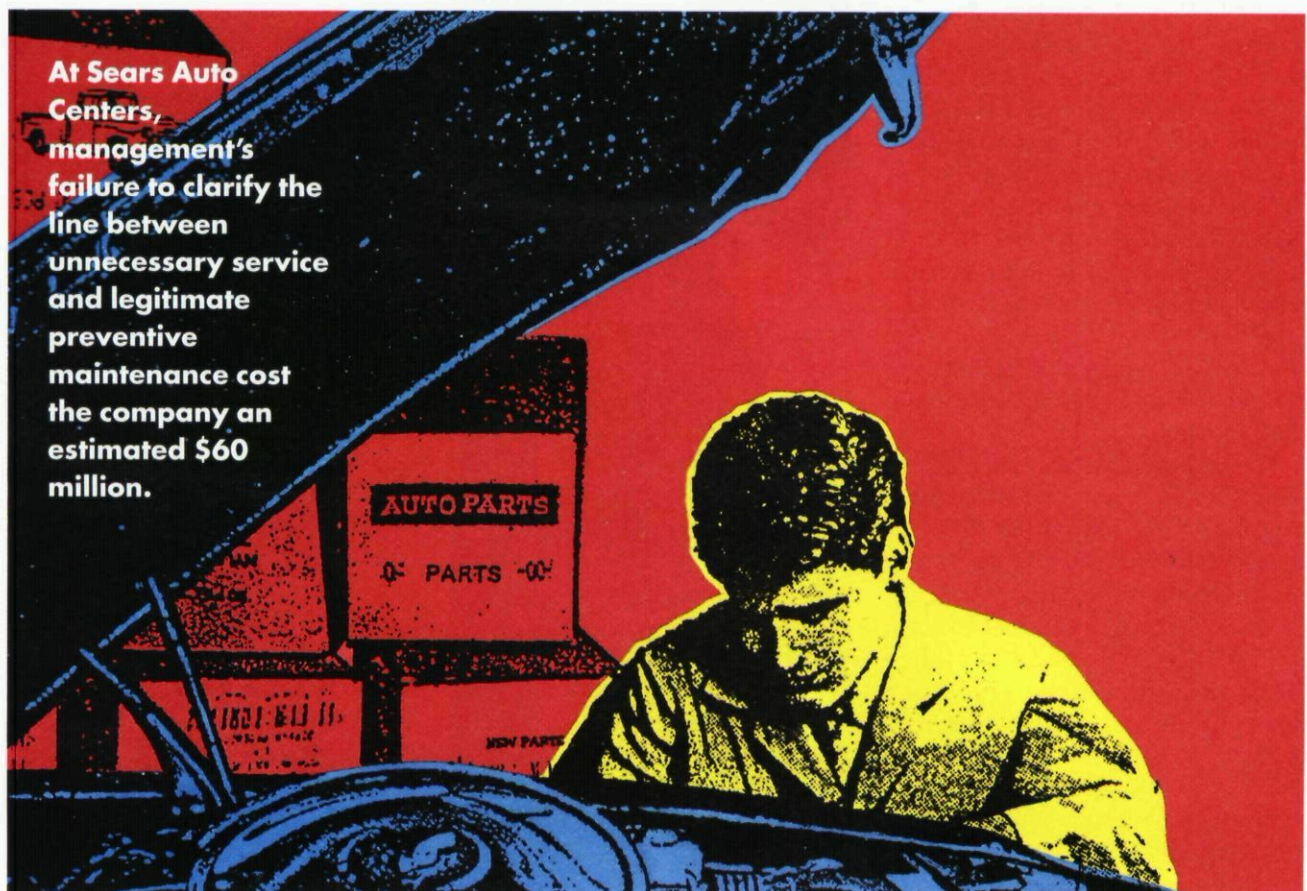
The once familiar picture of ethics as individualistic, unchanging, and impervious to organizational influences has not stood up to scrutiny in recent years. Sears Auto Centers' and Beech-Nut Nutrition Corporation's experiences illustrate the role organizations play in shaping individuals' behavior—and how even sound moral fiber can fray when stretched too thin.

In 1992, Sears, Roebuck & Company was inundated with complaints about its automotive service business. Consumers and attorneys general in more than 40 states had accused the company of mislead-

ing customers and selling them unnecessary parts and services, from brake jobs to front-end alignments. It would be a mistake, however, to see this situation exclusively in terms of any one individual's moral failings. Nor did management set out to defraud Sears customers. Instead, a number of organizational factors contributed to the problematic sales practices.

In the face of declining revenues, shrinking market share, and an increasingly competitive market for undercar services, Sears management attempted to spur the performance of its auto centers by introducing new goals and incentives for employees. The company increased minimum work quotas and introduced productivity incentives for mechanics. The automotive service advisers were given product-specific sales quotas—sell so many springs, shock absorbers, alignments, or brake jobs per shift—and paid a commission based on sales. According to advisers, failure to meet quotas could lead to a transfer or a reduction in work hours. Some employees spoke of the “pressure, pressure, pressure” to bring in sales.

Under this new set of organizational pressures and incentives, with few options for meeting their sales goals legitimately, some employees' judgment understandably suffered. Management's failure to



At Sears Auto Centers, management's failure to clarify the line between unnecessary service and legitimate preventive maintenance cost the company an estimated \$60 million.

clarify the line between unnecessary service and legitimate preventive maintenance, coupled with consumer ignorance, left employees to chart their own courses through a vast gray area, subject to a wide range of interpretations. Without active management support for ethical practice and mechanisms to detect and check questionable sales methods and poor work, it is not surprising that some employees may have reacted to contextual forces by resorting to exaggeration, carelessness, or even misrepresentation.

Shortly after the allegations against Sears became public, CEO Edward Brennan acknowledged management's responsibility for putting in place compensation and goal-setting systems that "created an environment in which mistakes did occur." Although the company denied any intent to deceive consumers, senior executives eliminated commissions for service advisers and discontinued sales quotas for specific parts. They also instituted a system of unannounced shopping audits and made plans to expand the internal monitoring of service. In settling the pending lawsuits, Sears offered coupons to customers who had bought certain auto services between 1990 and 1992. The total cost of the settlement, including potential customer refunds, was an estimated \$60 million.

Contextual forces can also influence the behavior of top management, as a former CEO of Beech-Nut Nutrition Corporation discovered. In the early 1980s, only two years after joining the company, the CEO found evidence suggesting that the apple juice concentrate, supplied by the company's vendors for use in Beech-Nut's "100% pure" apple juice, contained nothing more than sugar water and chemicals. The CEO could have destroyed the bogus in-

When a Beech-Nut employee voiced concerns about the purity of apple juice concentrate, he was accused of not being a team player.



ventory and withdrawn the juice from grocers' shelves, but he was under extraordinary pressure to turn the ailing company around. Eliminating the inventory would have killed any hope of turning even the meager \$700,000 profit promised to Beech-Nut's then parent, Nestlé.

A number of people in the corporation, it turned out, had doubted the purity of the juice for several years before the CEO arrived. But the 25% price advantage offered by the supplier of the bogus concentrate allowed the operations head to meet cost-control goals. Furthermore, the company lacked an effective quality control system, and a conclusive lab test for juice purity did not yet exist. When a member of the research department voiced concerns about the juice to operating management, he was accused of not being a team player and of acting like "Chicken Little." His judgment, his supervisor wrote in an annual performance review, was "colored by naïveté and impractical ideals." No one else seemed to have considered the company's obligations to its customers or to have thought about the potential harm of disclosure. No one considered the fact that the sale of adulterated or misbranded juice is a legal offense, putting the company and its top management at risk of criminal liability.

An FDA investigation taught Beech-Nut the hard way. In 1987, the company pleaded guilty to selling adulterated and misbranded juice. Two years and two criminal trials later, the CEO pleaded guilty to ten counts of mislabeling. The total cost to the company—including fines, legal expenses, and lost sales—was an estimated \$25 million.

Such errors of judgment rarely reflect an organizational culture and management philosophy that sets out to harm or deceive. More

often, they reveal a culture that is insensitive or indifferent to ethical considerations or one that lacks effective organizational systems. By the same token, exemplary conduct usually reflects an organizational culture and philosophy that is infused with a sense of responsibility.

For example, Johnson & Johnson's handling of the Tylenol crisis is sometimes attributed to the singular personality of then-CEO James Burke. However, the decision to do a nationwide recall of Tylenol capsules in order to avoid further loss of life from product tampering was in reality not one decision but thousands of decisions made by individuals at all levels of the organization. The "Tylenol decision," then, is best understood not as an isolated incident, the achievement of a lone individual, but as the reflection of an organization's culture. Without a shared set of values and guiding principles deeply ingrained throughout the organization, it is doubtful that Johnson & Johnson's response would have been as rapid, cohesive, and ethically sound.

Many people resist acknowledging the influence of organizational factors on individual behavior—especially on misconduct—for fear of diluting people's sense of personal moral responsibility. But this fear is based on a false dichotomy between holding individual transgressors accountable and holding "the system" accountable. Acknowledging the importance of organizational context need not imply exculpating individual wrongdoers. To understand all is not to forgive all.

The Limits of a Legal Compliance Program

The consequences of an ethical lapse can be serious and far-reaching. Organizations can quickly become entangled in an all-consuming web of legal proceedings. The risk of litigation and liability has increased in the past decade as lawmakers have legislated new civil and criminal offenses, stepped up penalties, and improved support for law enforcement. Equally—if not more—important is the damage an ethical lapse can do to an organization's reputation and relationships. Both Sears and Beech-Nut, for instance, struggled to regain consumer trust and market share long after legal proceedings had ended.

As more managers have become alerted to the importance of organizational ethics, many have asked their lawyers to develop corporate ethics pro-

grams to detect and prevent violations of the law. The 1991 Federal Sentencing Guidelines offer a compelling rationale. Sanctions such as fines and probation for organizations convicted of wrongdoing can vary dramatically depending both on the degree of management cooperation in reporting and investigating corporate misdeeds and on whether or not the company has implemented a legal compli-

Acknowledging the importance of organizational context in ethics does not imply forgiving individual wrongdoers.

ance program. (See the insert "Corporate Fines Under the Federal Sentencing Guidelines.")

Such programs tend to emphasize the prevention of unlawful conduct, primarily by increasing surveillance and control and by imposing penalties for wrongdoers. While plans vary, the basic framework is outlined in the sentencing guidelines. Managers must establish compliance standards and procedures; designate high-level personnel to oversee compliance; avoid delegating discretionary authority to those likely to act unlawfully; effectively communicate the company's standards and procedures through training or publications; take reasonable steps to achieve compliance through audits, monitoring processes, and a system for employees to report criminal misconduct without fear of retribution; consistently enforce standards through appropriate disciplinary measures; respond appropriately when offenses are detected; and, finally, take reasonable steps to prevent the occurrence of similar offenses in the future.

There is no question of the necessity of a sound, well-articulated strategy for legal compliance in an organization. After all, employees can be frustrated and frightened by the complexity of today's legal environment. And even managers who claim to use the law as a guide to ethical behavior often lack more than a rudimentary understanding of complex legal issues.

Managers would be mistaken, however, to regard legal compliance as an adequate means for addressing the full range of ethical issues that arise every day. "If it's legal, it's ethical," is a frequently heard slogan. But conduct that is lawful may be highly problematic from an ethical point of view. Consider the sale in some countries of hazardous products

Corporate Fines Under the Federal Sentencing Guidelines

What size fine is a corporation likely to pay if convicted of a crime? It depends on a number of factors, some of which are beyond a CEO's control, such as the existence of a prior record of similar misconduct. But it also depends on more controllable factors. The most important of these are reporting and accepting responsibility for the crime, cooperating with authorities, and having an effective program in place to prevent and detect unlawful behavior.

The following example, based on a case studied by the United States Sentencing Commission, shows how the 1991 Federal Sentencing Guidelines have affected overall fine levels and how managers' actions influence organizational fines.

Acme Corporation was charged and convicted of mail fraud. The company systematically charged customers who damaged rented automobiles more than the actual cost of repairs. Acme also billed some customers for the cost of repairs to vehicles for which they were not responsible. Prior to the criminal adjudication, Acme paid \$13.7 million in restitution to the customers who had been overcharged.

Deciding before the enactment of the sentencing guidelines, the judge in the criminal case imposed a fine of \$6.85 million, roughly half the pecuniary loss suffered by Acme's

customers. Under the sentencing guidelines, however, the results could have been dramatically different. Acme could have been fined anywhere from 5% to 200% the loss suffered by customers, depending on whether or not it had an effective program to prevent and detect violations of law and on whether or not it reported the crime, cooperated with authorities, and accepted responsibility for the unlawful conduct. If a high ranking official at Acme were found to have been involved, the maximum fine could have been as large as \$54,800,000 or four times the loss to Acme customers. The following chart shows a possible range of fines for each situation:

What Fine Can Acme Expect?

	Maximum	Minimum
Program, reporting, cooperation, responsibility	\$2,740,000	\$685,000
Program only	10,960,000	5,480,000
No program, no reporting no cooperation, no responsibility	27,400,000	13,700,000
No program, no reporting no cooperation, no responsibility, involvement of high-level personnel	54,800,000	27,400,000

Based on Case No.: 88-266, United States Sentencing Commission, Supplementary Report on Sentencing Guidelines for Organizations.

without appropriate warnings or the purchase of goods from suppliers who operate inhumane sweatshops in developing countries. Companies engaged in international business often discover that conduct that infringes on recognized standards of human rights and decency is legally permissible in some jurisdictions.

Legal clearance does not certify the absence of ethical problems in the United States either, as a 1991 case at Salomon Brothers illustrates. Four top-level executives failed to take appropriate action when learning of unlawful activities on the government trading desk. Company lawyers found no law obligating the executives to disclose the improprieties. Nevertheless, the executives' delay in disclosing and failure to reveal their prior knowledge

prompted a serious crisis of confidence among employees, creditors, shareholders, and customers. The executives were forced to resign, having lost the moral authority to lead. Their ethical lapse compounded the trading desk's legal offenses, and the company ended up suffering losses—including legal costs, increased funding costs, and lost business—estimated at nearly \$1 billion.

A compliance approach to ethics also overemphasizes the threat of detection and punishment in order to channel behavior in lawful directions. The underlying model for this approach is deterrence theory, which envisions people as rational maximizers of self-interest, responsive to the personal costs and benefits of their choices, yet indifferent to the moral legitimacy of those choices. But a recent

study reported in *Why People Obey the Law* by Tom R. Tyler shows that obedience to the law is strongly influenced by a belief in its legitimacy and its moral correctness. People generally feel that they have a strong obligation to obey the law. Education about the legal standards and a supportive environment may be all that's required to insure compliance.

Discipline is, of course, a necessary part of any ethical system. Justified penalties for the infringement of legitimate norms are fair and appropriate. Some people do need the threat of sanctions. However, an overemphasis on potential sanctions can be superfluous and even counterproductive. Employees may rebel against programs that stress penalties, particularly if they are designed and imposed without employee involvement or if the standards are vague or unrealistic. Management may talk of mutual trust when unveiling a compliance plan, but employees often receive the message as a warning from on high. Indeed, the more skeptical among them may view compliance programs as nothing more than liability insurance for senior management. This is not an unreasonable conclusion, considering that compliance programs rarely address the root causes of misconduct.

Even in the best cases, legal compliance is unlikely to unleash much moral imagination or commitment. The law does not generally seek to inspire human excellence or distinction. It is no guide for exemplary behavior—or even good practice. Those managers who define ethics as legal compliance are implicitly endorsing a code of moral mediocrity for their organizations. As Richard Breeden, former chairman of the Securities and Exchange Commission, noted, "It is not an adequate ethical standard to aspire to get through the day without being indicted."

Integrity as a Governing Ethic

A strategy based on integrity holds organizations to a more robust standard. While compliance is rooted in avoiding legal sanctions, organizational integrity is based on the concept of self-governance in accordance with a set of guiding principles. From the perspective of integrity, the task of ethics management is to define and give life to an organization's guiding values, to create an environment that supports ethically sound behavior, and to instill a sense of shared accountability among employees. The need to obey the law is viewed as a positive as-

pect of organizational life, rather than an unwelcome constraint imposed by external authorities.

An integrity strategy is characterized by a conception of ethics as a driving force of an enterprise. Ethical values shape the search for opportunities, the design of organizational systems, and the decision-making process used by individuals and groups. They provide a common frame of reference and serve as a unifying force across different functions, lines of business, and employee groups. Orga-

Management may talk of mutual trust when unveiling a compliance plan, but employees often see a warning from on high.

nizational ethics helps define what a company is and what it stands for.

Many integrity initiatives have structural features common to compliance-based initiatives: a code of conduct, training in relevant areas of law, mechanisms for reporting and investigating potential misconduct, and audits and controls to insure that laws and company standards are being met. In addition, if suitably designed, an integrity-based initiative can establish a foundation for seeking the legal benefits that are available under the sentencing guidelines should criminal wrongdoing occur. (See the insert "The Hallmarks of an Effective Integrity Strategy.")

But an integrity strategy is broader, deeper, and more demanding than a legal compliance initiative. Broader in that it seeks to enable responsible conduct. Deeper in that it cuts to the ethos and operating systems of the organization and its members, their guiding values and patterns of thought and action. And more demanding in that it requires an active effort to define the responsibilities and aspirations that constitute an organization's ethical compass. Above all, organizational ethics is seen as the work of management. Corporate counsel may play a role in the design and implementation of integrity strategies, but managers at all levels and across all functions are involved in the process. (See the chart, "Strategies for Ethics Management.")

During the past decade, a number of companies have undertaken integrity initiatives. They vary according to the ethical values focused on and the implementation approaches used. Some companies focus on the core values of integrity that reflect ba-

The Hallmarks of an Effective Integrity Strategy

There is no one right integrity strategy. Factors such as management personality, company history, culture, lines of business, and industry regulations must be taken into account when shaping an appropriate set of values and designing an implementation program. Still, several features are common to efforts that have achieved some success:

□ *The guiding values and commitments make sense and are clearly communicated.* They reflect important organizational obligations and widely shared aspirations that appeal to the organization's members. Employees at all levels take them seriously, feel comfortable discussing them, and have a concrete understanding of their practical importance. This does not signal the absence of ambiguity and conflict but a willingness to seek solutions compatible with the framework of values.

□ *Company leaders are personally committed, credible, and willing to take action on the values they espouse.* They are not mere mouthpieces. They are willing to scrutinize their own decisions. Consistency on the part of leadership is key. Waffling on values will lead to employee cynicism and a rejection of the program. At the same time, managers must assume responsibility for making tough calls when ethical obligations conflict.

□ *The espoused values are integrated into the normal channels of management decision making and are reflected in the organization's critical activities:* the de-

velopment of plans, the setting of goals, the search for opportunities, the allocation of resources, the gathering and communication of information, the measurement of performance, and the promotion and advancement of personnel.

□ *The company's systems and structures support and reinforce its values.* Information systems, for example, are designed to provide timely and accurate information. Reporting relationships are structured to build in checks and balances to promote objective judgment. Performance appraisal is sensitive to means as well as ends.

□ *Managers throughout the company have the decision-making skills, knowledge, and competencies needed to make ethically sound decisions on a day-to-day basis.* Ethical thinking and awareness must be part of every managers' mental equipment. Ethics education is usually part of the process.

Success in creating a climate for responsible and ethically sound behavior requires continuing effort and a considerable investment of time and resources. A glossy code of conduct, a high-ranking ethics officer, a training program, an annual ethics audit – these trappings of an ethics program do not necessarily add up to a responsible, law-abiding organization whose espoused values match its actions. A formal ethics program can serve as a catalyst and a support system, but organizational integrity depends on the integration of the company's values into its driving systems.

sic social obligations, such as respect for the rights of others, honesty, fair dealing, and obedience to the law. Other companies emphasize aspirations – values that are ethically desirable but not necessarily morally obligatory – such as good service to customers, a commitment to diversity, and involvement in the community.

When it comes to implementation, some companies begin with behavior. Following Aristotle's view that one becomes courageous by acting as a courageous person, such companies develop codes of conduct specifying appropriate behavior, along with a system of incentives, audits, and controls. Other companies focus less on specific actions and more on developing attitudes, decision-making processes, and ways of thinking that reflect their values. The assumption is that personal commitment and appropriate decision processes will lead to right action.

Martin Marietta, NovaCare, and Wetherill Associates have implemented and lived with quite dif-

ferent integrity strategies. In each case, management has found that the initiative has made important and often unexpected contributions to competitiveness, work environment, and key relationships on which the company depends.

Martin Marietta: Emphasizing Core Values

Martin Marietta Corporation, the U.S. aerospace and defense contractor, opted for an integrity-based ethics program in 1985. At the time, the defense industry was under attack for fraud and mismanagement, and Martin Marietta was under investigation for improper travel billings. Managers knew they needed a better form of self-governance but were skeptical that an ethics program could influence behavior. "Back then people asked, 'Do you really need an ethics program to be ethical?'" recalls current President Thomas Young. "Ethics was something personal. Either you had it, or you didn't."

The corporate general counsel played a pivotal role in promoting the program, and legal compliance was a critical objective. But it was conceived of and implemented from the start as a company-wide management initiative aimed at creating and maintaining a "do-it-right" climate. In its original conception, the program emphasized core values, such as honesty and fair play. Over time, it expanded to encompass quality and environmental responsibility as well.

Today the initiative consists of a code of conduct, an ethics training program, and procedures for reporting and investigating ethical concerns within the company. It also includes a system for disclos-

ing violations of federal procurement law to the government. A corporate ethics office manages the program, and ethics representatives are stationed at major facilities. An ethics steering committee, made up of Martin Marietta's president, senior executives, and two rotating members selected from field operations, oversees the ethics office. The audit and ethics committee of the board of directors oversees the steering committee.

The ethics office is responsible for responding to questions and concerns from the company's employees. Its network of representatives serves as a sounding board, a source of guidance, and a channel for raising a range of issues, from allegations of

Strategies for Ethics Management	
<p>Characteristics of Compliance Strategy</p> <p>Ethos conformity with externally imposed standards</p> <p>Objective prevent criminal misconduct</p> <p>Leadership lawyer driven</p> <p>Methods education, reduced discretion, auditing and controls, penalties</p> <p>Behavioral Assumptions autonomous beings guided by material self-interest</p>	<p>Characteristics of Integrity Strategy</p> <p>Ethos self-governance according to chosen standards</p> <p>Objective enable responsible conduct</p> <p>Leadership management driven with aid of lawyers, HR, others</p> <p>Methods education, leadership, accountability, organizational systems and decision processes, auditing and controls, penalties</p> <p>Behavioral Assumptions social beings guided by material self-interest, values, ideals, peers</p>
<p>Implementation of Compliance Strategy</p> <p>Standards criminal and regulatory law</p> <p>Staffing lawyers</p> <p>Activities develop compliance standards train and communicate handle reports of misconduct conduct investigations oversee compliance audits enforce standards</p> <p>Education compliance standards and system</p>	<p>Implementation of Integrity Strategy</p> <p>Standards company values and aspirations social obligations, including law</p> <p>Staffing executives and managers with lawyers, others</p> <p>Activities lead development of company values and standards train and communicate integrate into company systems provide guidance and consultation assess values performance identify and resolve problems oversee compliance activities</p> <p>Education decision making and values compliance standards and system</p>

Martin Marietta's ethics training program teaches senior executives how to balance responsibilities.



wrongdoing to complaints about poor management, unfair supervision, and company policies and practices. Martin Marietta's ethics network, which accepts anonymous complaints, logged over 9,000 calls in 1991, when the company had about 60,000 employees. In 1992, it investigated 684 cases. The ethics office also works closely with the human resources, legal, audit, communications, and security functions to respond to employee concerns.

Shortly after establishing the program, the company began its first round of ethics training for the entire workforce, starting with the CEO and senior executives. Now in its third round, training for senior executives focuses on decision making, the challenges of balancing multiple responsibilities, and compliance with laws and regulations critical to the company. The incentive compensation plan for executives makes responsibility for promoting ethical conduct an explicit requirement for reward eligibility and requires that business and personal goals be achieved in accordance with the company's policy on ethics. Ethical conduct and support for the ethics program are also criteria in regular performance reviews.

Today top-level managers say the ethics program has helped the company avoid serious problems and become more responsive to its more than 90,000 employees. The ethics network, which tracks the number and types of cases and complaints, has served as an early warning system for poor management, quality and safety defects, racial and gender discrimination, environmental concerns, inaccurate and false records, and personnel grievances regarding salaries, promotions, and layoffs. By providing an alternative channel for raising such concerns, Martin Marietta is able to take corrective action more quickly and with a lot less pain. In many cases, potentially embarrassing problems have been identified and dealt with before becoming a management crisis, a lawsuit, or a criminal investigation. Among employees who brought complaints in 1993, 75% were satisfied with the results.

Company executives are also convinced that the program has helped reduce the incidence of misconduct. When allegations of misconduct do surface, the company says it deals with them more openly. On several occasions, for instance, Martin Marietta has voluntarily disclosed and made restitution to the government for misconduct involving potential violations of federal procurement laws. In addition, when an employee alleged that the company had retaliated against him for voicing safety concerns about his plant on CBS news, top management commissioned an investigation by an outside law firm. Although failing to support the allega-

tions, the investigation found that employees at the plant feared retaliation when raising health, safety, or environmental complaints. The company redoubled its efforts to identify and discipline those employees taking retaliatory action and stressed the desirability of an open work environment in its ethics training and company communications.

Although the ethics program helps Martin Marietta avoid certain types of litigation, it has occasionally led to other kinds of legal action. In a few cases, employees dismissed for violating the code of ethics sued Martin Marietta, arguing that the company had violated its own code by imposing unfair and excessive discipline.

Still, the company believes that its attention to ethics has been worth it. The ethics program has led to better relationships with the government, as well as to new business opportunities. Along with prices and technology, Martin Marietta's record of integrity, quality, and reliability of estimates plays a role in the awarding of defense contracts, which account for some 75% of the company's revenues. Executives believe that the reputation they've earned through their ethics program has helped them build trust with government auditors, as well. By opening up communications, the company has reduced the time spent on redundant audits.

The program has also helped change employees' perceptions and priorities. Some managers compare their new ways of thinking about ethics to the way they understand quality. They consider more carefully how situations will be perceived by others, the possible long-term consequences of short-term thinking, and the need for continuous improvement. CEO Norman Augustine notes, "Ten years ago, people would have said that there were no ethical issues in business. Today employees think their number-one objective is to be thought of as decent people doing quality work."

NovaCare: Building Shared Aspirations

NovaCare Inc., one of the largest providers of rehabilitation services to nursing homes and hospitals in the United States, has oriented its ethics effort toward building a common core of shared aspirations. But in 1988, when the company was called InSpeech, the only sentiment shared was mutual mistrust.

Senior executives built the company from a series of aggressive acquisitions over a brief period of

time to take advantage of the expanding market for therapeutic services. However, in 1988, the viability of the company was in question. Turnover among its frontline employees—the clinicians and therapists who care for patients in nursing homes and hospitals—escalated to 57% per year. The company's inability to retain therapists caused customers to defect and the stock price to languish in an extended slump.

After months of soul-searching, InSpeech executives realized that the turnover rate was a symptom of a more basic problem: the lack of a common set of values and aspirations. There was, as one execu-

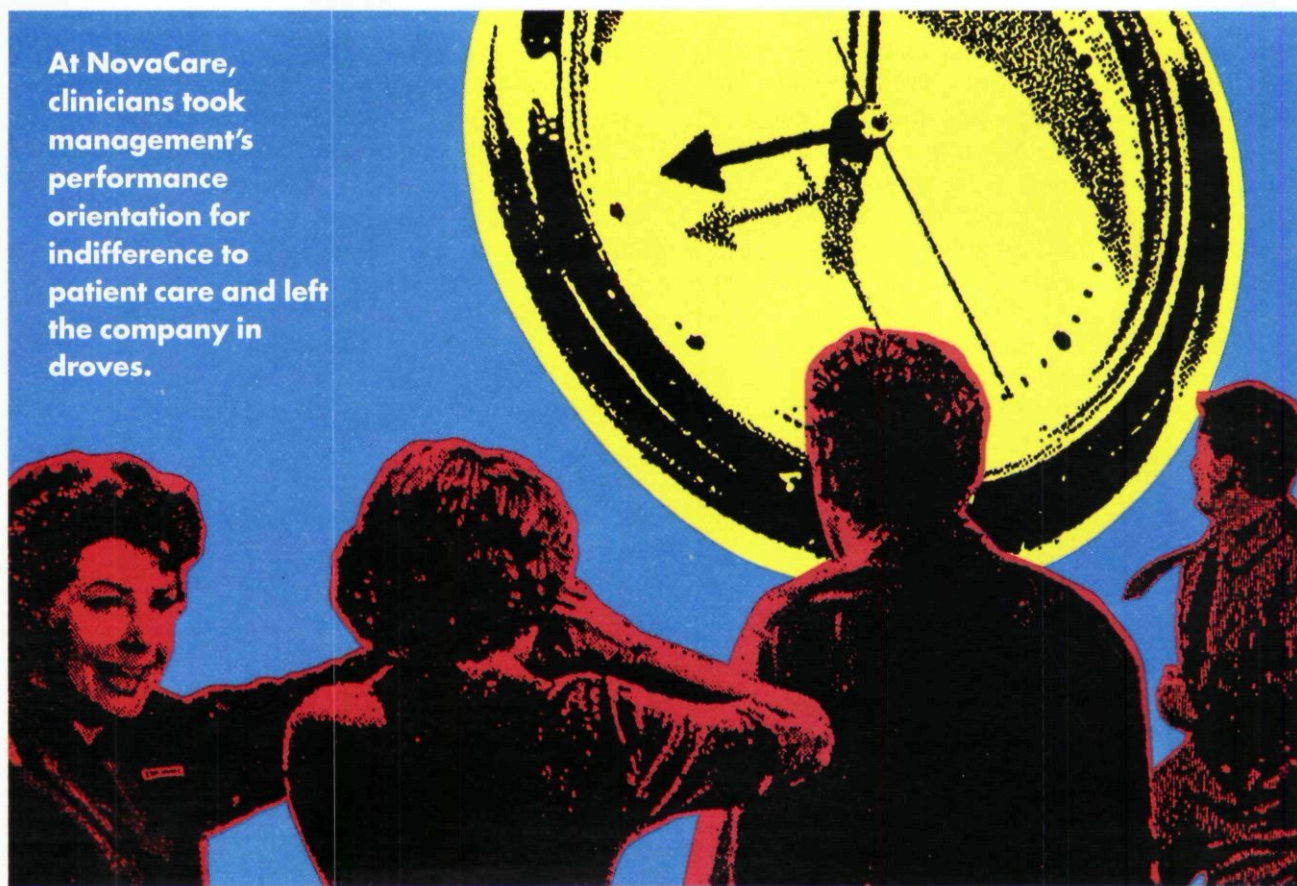
At NovaCare, executives defined organizational values and introduced structural changes to support those values.

tive put it, a "huge disconnect" between the values of the therapists and clinicians and those of the managers who ran the company. The therapists and clinicians evaluated the company's success in terms of its delivery of high-quality health care. InSpeech management, led by executives with financial services and venture capital backgrounds, measured the company's worth exclusively in terms of financial success. Management's single-minded emphasis on increasing hours of reimbursable care turned clinicians off. They took management's performance orientation for indifference to patient care and left the company in droves.

CEO John Foster recognized the need for a common frame of reference and a common language to unify the diverse groups. So he brought in consultants to conduct interviews and focus groups with the company's health care professionals, managers, and customers. Based on the results, an employee task force drafted a proposed vision statement for the company, and another 250 employees suggested revisions. Then Foster and several senior managers developed a succinct statement of the company's guiding purpose and fundamental beliefs that could be used as a framework for making decisions and setting goals, policies, and practices.

Unlike a code of conduct, which articulates specific behavioral standards, the statement of vision, purposes, and beliefs lays out in very simple terms the company's central purpose and core values. The purpose—meeting the rehabilitation needs of pa-

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tients through clinical leadership—is supported by four key beliefs: respect for the individual, service to the customer, pursuit of excellence, and commitment to personal integrity. Each value is discussed with examples of how it is manifested in the day-to-day activities and policies of the company, such as how to measure the quality of care.

To support the newly defined values, the company changed its name to NovaCare and introduced a number of structural and operational changes. Field managers and clinicians were given greater decision-making authority; clinicians were provided with additional resources to assist in the delivery of effective therapy; and a new management structure integrated the various therapies offered by the company. The hiring of new corporate personnel with health care backgrounds reinforced the company's new clinical focus.

The introduction of the vision, purpose, and beliefs met with varied reactions from employees, ranging from cool skepticism to open enthusiasm. One employee remembered thinking the talk about values "much ado about nothing." Another recalled, "It was really wonderful. It gave us a goal that everyone aspired to, no matter what their place in the company." At first, some were baffled about how the vision, purpose, and beliefs were to be

used. But, over time, managers became more adept at explaining and using them as a guide. When a customer tried to hire away a valued employee, for example, managers considered raiding the customer's company for employees. After reviewing the beliefs, the managers abandoned the idea.

NovaCare managers acknowledge and company surveys indicate that there is plenty of room for improvement. While the values are used as a firm reference point for decision making and evaluation in some areas of the company, they are still viewed with reservation in others. Some managers do not "walk the talk," employees complain. And recently acquired companies have yet to be fully integrated into the program. Nevertheless, many NovaCare employees say the values initiative played a critical role in the company's 1990 turnaround.

The values reorientation also helped the company deal with its most serious problem: turnover among health care providers. In 1990, the turnover rate stood at 32%, still above target but a significant improvement over the 1988 rate of 57%. By 1993, turnover had dropped to 27%. Moreover, recruiting new clinicians became easier. Barely able to hire 25 new clinicians each month in 1988, the company added 776 in 1990 and 2,546 in 1993. Indeed, one employee who left during the 1988 tur-

moil said that her decision to return in 1990 hinged on the company's adoption of the vision, purpose, and beliefs.

Wetherill Associates: Defining Right Action

Wetherill Associates, Inc.—a small, privately held supplier of electrical parts to the automotive market—has neither a conventional code of conduct nor a statement of values. Instead, WAI has a *Quality Assurance Manual*—a combination of philosophy text, conduct guide, technical manual, and company profile—that describes the company's commitment to honesty and its guiding principle of right action.

WAI doesn't have a corporate ethics officer who reports to top management, because at WAI, the company's corporate ethics officer *is* top management. Marie Bothe, WAI's chief executive officer, sees her main function as keeping the 350-employee company on the path of right action and looking for opportunities to help the community. She delegates the "technical" aspects of the business—marketing, finance, personnel, operations—to other members of the organization.

Right action, the basis for all of WAI's decisions, is a well-developed approach that challenges most conventional management thinking. The company explicitly rejects the usual conceptual boundaries that separate morality and self-interest. Instead, they define right behavior as logically, expediently, and morally right. Managers teach employees to look at the needs of the customers, suppliers, and the community—in addition to those of the company and its employees—when making decisions.

WAI also has a unique approach to competition. One employee explains, "We are not 'in competition' with anybody. We just do what we have to do to serve the customer." Indeed, when occasionally unable to fill orders, WAI salespeople refer customers to competitors. Artificial incentives, such as sales contests, are never used to spur individual performance. Nor are sales results used in determining compensation. Instead, the focus is on teamwork and customer service. Managers tell all new recruits that absolute honesty, mutual courtesy, and respect are standard operating procedure.

Newcomers generally react positively to company philosophy, but not all are prepared for such a radical departure from the practices they have known elsewhere. Recalling her initial interview,


one recruit described her response to being told that lying was not allowed, "What do you mean? No lying? I'm a buyer. I lie for a living!" Today she is persuaded that the policy makes sound business sense. WAI is known for informing suppliers of overshipments as well as undershipments and for scrupulous honesty in the sale of parts, even when deception cannot be readily detected.

Since its entry into the distribution business 13 years ago, WAI has seen its revenues climb steadily from just under \$1 million to nearly \$98 million in 1993, and this in an industry with little growth. Once seen as an upstart beset by naysayers and industry skeptics, WAI is now credited with entering and professionalizing an industry in which kickbacks, bribes, and "gratuities" were commonplace.

Creating an organization that encourages exemplary conduct may be the best way to prevent damaging misconduct.

Employees—equal numbers of men and women ranging in age from 17 to 92—praise the work environment as both productive and supportive.

WAI's approach could be difficult to introduce in a larger, more traditional organization. WAI is a small company founded by 34 people who shared a belief in right action; its ethical values were naturally built into the organization from the start. Those values are so deeply ingrained in the company's culture and operating systems that they have been largely self-sustaining. Still, the company has developed its own training program and takes special care to hire people willing to support right action. Ethics and job skills are considered equally important in determining an individual's competence and suitability for employment. For WAI, the challenge will be to sustain its vision as the company grows and taps into markets overseas.

At WAI, as at Martin Marietta and NovaCare, a management-led commitment to ethical values has contributed to competitiveness, positive workforce morale, as well as solid sustainable relationships with the company's key constituencies. In the end, creating a climate that encourages exemplary conduct may be the best way to discourage damaging misconduct. Only in such an environment do rogues really act alone. 

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