Leaders’ Perspectives on Business Ethics: An Interim Report

John F. Magee and P. Ranganath Nayak

We are engaged in a series of conversations with chief executives of large international companies about the ways they define, promulgate, and implement standards of ethical behavior in their firms. This progress statement is intended in part to prompt responses from *Prism* readers. We hope that your thoughtful comments on our tentative conclusions may enlarge the scope of these conversations and contribute to our own understanding of this complex and elusive subject.

The topic of ethical conduct in business has received a great deal of public attention recently. Dozens of articles have appeared in the business and general press. Organizations such as the Conference Board have held meetings on the topic, and the Business Roundtable has sponsored inquiries into codes of ethical practice. Schools of business have begun to approach the issue, albeit warily and with difficulty. (One reason for the business schools’ difficulties seems to be a tendency to treat business ethics in an abstract and somewhat prescriptive fashion, separate from the mainstream of their curriculum; this will change in time.)

We became interested in this topic because of the growing recognition of the importance of culture – what William Ferguson, chairman and chief executive officer of NYNEX, has called the „soft areas“ – in the operation of a business. In the face of international competition and the need to improve productivity, chief executives are pushing their companies to change, and they recognize that part of the change needed is in the culture. On that point, William Ferguson notes, „Having worked on both ‘soft’ and ‘hard’ issues, I can tell you that there’s nothing ‘soft’ or ‘easy’ about changing the way you do business – any more than getting results in earnings, costs, or service quality. Moreover, unless you can change the ‘soft’ things about your business, you’re not going to be terribly successful in getting at the ‘hard’ things you face.“[1]

The ethical standards of the business – the behaviors understood and accepted as „proper“ – are part of its culture. Under pressure to improve, when people in the firm adapt to a new culture, will they be inclined or pressed to compromise their ethical standards?

In our investigation of these issues, we are *not* trying to prescribe which standards of behavior are „right.“ We are interested in knowing whether business leaders consider ethical issues to be subject to companywide standards, or whether they permit varying „situational“ resolutions. We also want to know whether, as their companies change, they are under pressure to change their ethical standards, and if so, how they respond. Do they even view questions of the ethical impact of change as important? If so, how do they go about asserting leadership, getting in front of the direction of change? And what is the relationship between the CEO’s personal moral code and the ethics of the firm?

The people we have talked with are leading or have led their large multinational businesses through major change. They must exert their leadership over a wide geographic range and throughout large, complex organizations. Our conversations with them have been long, candid, and – except where they have expressly permitted us to quote them – off the record.

Defining Ethical Issues

The people we have talked with tend to understand ethical behavior as the enlightened resolution of the claims of their firms’ diverse constituencies. In other words, in the terms we use in our High Performance Business model, ethical issues generally involve trade-offs among the interests of two or more stakeholder constituencies. (In this context, the stakeholders of a company must be understood to include not only its employees, customers, suppliers, and shareholders, but the public at large.)

Ethical issues often arise when someone in a position of power has the opportunity to use it inappropriately or unfairly. Harassment of an employee by a supervisor is an example. Another is misuse of information, which is a source of power. A company that knowingly ships a defective product is abusing the customer’s trust. A salesperson who convinces a customer to buy on false grounds is abusing his or her superior information about the product. Trading shares on inside information disadvantages the people who don’t have that information. Having information per se is not the issue; the issue is how it is used.

When all interested parties cannot participate in making a decision – which is often the case – the decision-maker must take the legitimate interests of all constituents into account, whether they are there to argue their interest or not. For example, the board of directors, in setting top management compensation, must consider the company’s other employees, customers, and owners, while a company president considering a major layoff in a distant plant must consider the impact on everyone involved.

Here are examples of the ethical issues that have been raised in our discussions:

• *Social concerns:* environmental protection, hazardous waste treatment, prevention of plant disasters, employment levels

• *Customer concerns:* product safety, product quality, avoidance of deceptive sales practices

• *Employee concerns:* fair pay, proper evaluation, worker safety, freedom from harassment, job security

• *Shareholder concerns:* fair return on investment, theft or fraud, exposure of the firm to severe losses or penalties, waste

• *Supplier concerns:* extortion, unfair treatment

We have found that the relative amount of attention paid to each of these concerns by a chief executive depends very much on the business. The head of a large financial services company is especially concerned about field sales practices, while the leader of an international chemical business has arrangements in place so that he can be reached anywhere, anytime, in case of a plant accident. Of the people we've talked with so far, no one focused particularly on employee relations – although employees judge how ethical a company is primarily by the fairness of their treatment.

The Meaning of Ethical Standards

Some of our interview respondents are uncomfortable with the idea of ethical standards in the abstract, as something standing apart, against which choices might be judged. As Alfred Zeien, chairman of Gillette, put it, „I'm not sure we've ever had a broad campaign on ethics per se. We have had a broad campaign on values – how we will conduct ourselves – going beyond just ethics." Another respondent said, „I suppose ethical issues arrive in this office packaged up with all the other issues we deal with." On the other hand, we have heard opinions expressed to the effect that large organizations will head toward the „law of the jungle" unless an explicit and forceful effort is made to keep them civilized – and ethical.

We also find people have some difficulty, at least at first, sorting out ethical standards from legal requirements. In most cases, actions that are illegal and therefore expose a company to penalties are considered unethical. Our respondents seem to make the connection between ethics and legality in these terms: „It is a part of our code of conduct to obey the law of the land. So breaking a law, even a stupid one, is a violation of our code." However, some of the people we spoke with also recognized that ethical principles may transcend local laws. For example, companies that subscribed to the Sullivan Principles to combat apartheid in South Africa were committed to breaking South African laws – or at least testing them to the extreme – on ethical grounds.

Issues of legality aside, the business leaders we have interviewed see ethical standards in terms of commitment rather than compliance. That is, they see adherence to ethical standards in positive terms, as embracing a set of beliefs and conduct that help define the business, rather than as a way to stay out of trouble. Viewed from this perspective, regulations and laws not only set a minimum standard, but also give voice to public opinion and concern. As such, they often show management the „handwriting on the wall" and set the direction for moving beyond compliance. For example, environmental protection regulations have helped make business leaders aware of this issue and also have caused them to move their companies beyond compliance toward active initiatives to redesign products, packaging, or processes to eliminate waste or hazardous by-products.

Such efforts may arise as much from enlightened self-interest as from an abstract notion of ethical behavior. In many arenas, the failure to manage ethical issues effectively triggers a public reaction that leads to regulation – which can be far more intrusive and confining than self-imposed ethical standards.

Another form of enlightened self-interest was expressed by a chief executive who, commenting on his aggressive goals for a racially diverse work force, argued that, in the long run, the company's success in the marketplace will depend on presenting to the world a face that reflects the diversity of the marketplace itself.

Yet standards do exist that transcend direct, material self-interest. Alfred Zeien, chairman of Gillette, described a case where Gillette was offered a potentially very profitable chance to promote one of its products jointly with a cigarette promotion. He turned it down. He decided Gillette should not get involved with encouraging cigarette consumption. While there was no written statement banning promotion of cigarettes, in Mr. Zeien's view the answer is straightforward: „It's not up to our standards."

And all our respondents agreed that the arguments „everyone else is doing it" and „if we don't, someone else will" don't justify violating ethical standards.

The Multinational Question

Is it true that standards of business ethics differ from culture to culture, and that successful multinational companies have to be flexible and do business the local way? We pressed our respondents on this issue and got a unanimous response: No. In fact, they went further: not only is it *not* necessary or even desirable to compromise on fundamental values, it is important to assert a consistent set of company values worldwide.

This position has to be treated with a dose of pragmatism. Some of the people we spoke with acknowledged that if it is necessary to pay a „tip" – or, if you will, a bribe – to get a bureaucrat to do his or her job (for example, to authorize a legitimate import license), they pay the tip. This issue arises more often in some countries than in others, though none are immune.

The companies taking this position set limits on their behavior in terms of two ethical governing principles. First, the company makes the payment only if it is legitimately entitled to the action it seeks, so that no stakeholders' interests are being compromised. Second, it does not purposefully disguise the payment in the company's books. Often it treats the payment – legitimately – as a petty cash item. In other words, some business leaders acknowledge that although bribery may be illegal, they do not necessarily see it as unethical in all cases.

On fundamental matters, where stakeholders' rights may be violated, our respondents assert that a company *must* have a commitment to common shared values. Alfred Zeien pointed out, „Our general managers, senior staff, and controllers may have an average tour of duty of about three and a half years, and may in the course of their careers work in an average of seven countries. If you haven't got the same values or standards, how do you move these people around? If you don't have the same standards, I don't know how you can hope to hold any kind of allegiance."

In the Cabot Corporation, because of the nature of the manufacturing processes used in production of carbon black, questions of employee safety are of high concern. Conventional wisdom might lead one to expect that, where local practices reflect differences in health and safety standards, Cabot might adopt more- or less-strict standards of safety. Cabot president Samuel Bodman asserts, „We have the same standards of safety in every plant we operate everywhere in the world. The *first* priority of this corporation – the first priority – is the safety of our plants." He went on to note that of the five Cabot plants with the best safety records, three are in Argentina, Malaysia, and the south of France.

The John Hancock Mutual Life Insurance Company has been expanding its activities in Southeast Asia, an area generally regarded as having widespread business and government practices that are questionable by Western standards. We asked Stephen Brown, chairman of John Hancock, whether the company had found it necessary to compromise its standards to accommodate local business practices. He responded, „We faced up to this issue early on when we started to deal with Southeast Asia. We told our international people that we had to have the same ethical standards, same procedures, same policies in these countries that we have in the United States. And we do."

Company management was told initially by residents of other countries, „You can't do this. It won't work." But John Hancock has found that it can operate in Asia by essentially the same rules that apply in the United States. Mr. Brown explained, „We just felt that things like payoffs were wrong – and if we had to do business that way, we'd rather not do business. Our employees would not feel good about having different levels of ethics. There may be countries where you have to do that kind of thing. We haven't found that country yet, and if we do, we won't do business there."

That is not to say that our respondents have found it easy to sustain commitment to high ethical standards worldwide. One respondent, in discussing a violation, noted the problem of being taken seriously. In this case, one of the firm's overseas distributors violated a corporate marketing policy against certain product resales. The practice was common and thought to be acceptable in the country in question. The distributor simply assumed that the company's stated policy against resale was put forth for „cosmetic" or political reasons and was not to be followed in practice. The chief executive concerned with this case said, „Now, I don't believe that was a case where we had done a poor job of communicating. I think the problem was a belief on the distributor's part that our communication was just covering our backside and we really didn't mean it."

Despite their overall commitment to worldwide standards, respondents did note exceptions. One remarked on a plant in southern Europe where air emissions significantly exceed the company's standard. He noted with some mixed feelings that the town was otherwise heavily polluted, and bringing this plant to company standards would make no noticeable difference to the town. The company will be prepared to control its emissions when the community as a whole is prepared to act on its broader problem.

Another CEO noted that worker safety standards in his firm's plant in Asia are not up to those in the United States, a discrepancy he characterized as a „matter of time," and the Asian plant is „a little behind on the curve." In both cases, the companies' commitment to implementing a universal standard – eventually – seemed sincere. But achieving full compliance with that standard was a question of how fast to deploy limited resources.

The leaders we talked with pointed out that the difficulties of building commitment to high ethical standards are not unique to multinational operations but are potentially exacerbated by distance and unfamiliarity. One respondent told a case of a young person with very high potential who was sent to manage an operation in Scotland. The plant had an agreement with local authorities to maintain a specified level of employment in return for a tax rebate. The young manager signed a false report that overstated employment because he was told by the local staff, „This is how we do things." The false report surfaced and the manager was fired. Why did he sign and submit the false affidavit? „He was young. He didn't understand what it was to be in charge. We didn't train him very well."

So What to Do?

Is the issue of ethical standards important enough to worry about, and if so, is it an area in which management can act usefully?

Paul J. Rizzo, former vice chairman of IBM, was quoted in *Business Week* (2/15/88), „If you asked the members of the Business Roundtable to list the five major issues they confront today, I don't think many of them would list ethics." *Yet* among our respondents, only one seemed relatively relaxed about this issue. As he put it, „I think it's something that we're comfortable with. But we're tested occasionally. I guess we would like to believe that it's ingrained in our DNA, that ethics are an enormously important thing but we don't need to spend much time teaching it. We hope it's just subliminal." He went on to say, however, „We've asked ourselves somewhat recently whether or not we're paying enough attention to the issue."

Most of our respondents expressed active interest, as well as concern and a degree of frustration, in building consensus and commitment to high company ethical standards. For example, when we asked them how they find out about problems, one responded tersely, „Too late." Our respondents made the point that the chief executive cannot prevent ethical problems or violations from occurring. Ethical problems cannot be adminis tered out of existence by rules, checks, or approvals. There are just too many possibilities to write rules for them all.

Therefore, in our view, companies must set – and enforce – general standards of ethical behavior. There are two ways to go about this.

First, the chief executive must be actively and visibly committed to acceptance of high ethical standards throughout the company. This takes work. A few guidelines:

• *Lead by example.* The notion „Do as I say, not as I do" does not apply. One chief executive has given up accepting invitations to golf tournaments and weekends at hunting lodges from customers, suppliers, and business associates.

• *Lead in articulating corporate values.* A number of respondents described their personal roles in drafting corporate mission and value statements and then testing and refining these through dozens of meetings with staff at all levels around the world. This process has to be repeated perhaps every two or three years.

• *Visit at all levels.* All our respondents spoke of the need to visit operations around the world and meet face-to-face with local management on their own ground. Alfred Zeien described his activity in these terms: „What you do is, spread the word. The CEO has a major role in that respect. People will ask me, why do you travel? Part of the delegation process is making sure that the local manager is using the same ground rules you would use. You can't substitute your judgment for his, but you must be sure the ground rules he's using are the same ones you would use. Sit with him and his direct reports, so when he says some thing, he's looking at the people who are going to have to implement that."

• *Act decisively and discreetly* to deal with people who violate corporate ethical standards. It is not necessary to publicize actions, but it is helpful to let the grapevine work.

Second, companies can set up a variety of administra tive systems to give employees an outlet to express concerns, report problems, or ask questions. For example, John Hancock has set up an ethics review board to which employees, customers, and competitors can report activities they think are questionable or unethical. Many companies have set up similar „hot lines" to let employees report concerns about unethical activities.

Companies that have such hot lines have discovered they are used mostly by employees asking for advice in handling ethically ambiguous issues. As a result, for example, NYNEX renamed its hot line „Guideline." A well-publicized and reliable source of advice to help employees deal with new and ambiguous issues may be the best administrative vehicle for reinforcing the ethical standards spelled out by the top leadership. Third, the board of directors must take an active interest in the ethics of the firm, making sure (among other things) that ethical standards are an important factor in the selection of the chief executive. This is easier said than done, as a person's true ethical fiber, like other aspects of his or her character and competence, tends to become visible only when tested. Perhaps for this reason, boards of directors tend to be most comfortable choosing CEOs with whom they have considerable familiarity.

Without doubt, intensifying international competition and the drive for improved productivity put pressure on employees to cut ethical corners. Our respondents argue, however, that compliance with corporate ethical standards tends to go hand-in-hand with disciplined performance. Stephen Brown of John Hancock expressed it: „There are a lot of ways to become more productive. We're trying to channel people into the right way to be more productive – with integrity and fair dealing."

Conclusions

It seems inevitable that ethical issues will arise with greater frequency as competitive pressure, customer demands, and public scrutiny all intensify. Because unethical behavior can have a major impact on a company's reputation, the chief executive will find it insufficient merely to react to these issues as they happen. He or she will need to take a strong stance on ethical issues and back it with action. Four processes need to be managed: establishing ethical standards, promulgating them, monitoring behavior, and dealing with behavior that is unethical. Ethical standards need to be as nearly uniform as possible companywide, for these standards, embedded in the larger set of values, define the soul of the firm. *Every firm must have a soul in order to achieve sustained excellence.*

We sincerely welcome your comments.

[1] *Remarks at a Conference Board conference on ethics, 1993, extracted in a Verne Henderson newsletter.*

John F. Magee is chairman of the board of directors of Arthur D. Little, Inc. He was previously president and chief executive officer of the firm and has consulted extensively in the areas of operations research and general management.

P. Ranganath Nayak is a senior vice president of Arthur D. Little, Inc., responsible for the firm's worldwide operations management consulting practice. He has extensive experience helping companies around the world improve their operations, particularly in the areas of research, development, and manufacturing.