Q-0007

CODES OF ETHICS IN BUSINESS

Western Michigan University
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Philosophers have a reputation for being too concerned with questions of definition. The reputation is deserved. Still, the subject of business ethics is such a jumble that I will, I hope, be forgiven for beginning this talk with a few definitions.

## I.

Morality, as I shall use this term, may be divided into two parts, rules and ideals.

Moral rules are those standards of conduct each of us wants everyone else to follow even if their following the standards means we must do the same. Moral rules are requirements everyone is supposed to obey. There are few such rules. Those most relevant to business are "Don't lie", "Don't cheat", "Don't steal", and "Keep your promises". If you don't do as one of these rules requires, and do not have a good justification, your conduct is morally wrong; and, if you don't have even a good excuse for what you did, you deserve blame and perhaps punishment.

So much for moral rules. Now moral ideals. Unlike moral rules, moral ideals are not requirements. They are rather ways of acting everyone wants everyone else to support or, at least, is willing to have them support. The golden rule is a good example of a moral ideal. While we are quite willing to have everyone else praise, reward, and otherwise encourage people to treat each other as they themselves would like to be treated, we are not willing to <u>require</u> that. We don't want that much regimentation.

We can fall well short of the ideal without deserving blame. Indeed, we can fall well short of the ideal and still deserve praise if we come closer than people normally do. Often we speak of people as being "ethical" or "highly ethical" when we wish to praise them for coming closer to some moral ideal than people like them normally do. While this use of "ethics" doesn't fit the definition I will give that term, it's too convenient to avoid entirely. Still, whenever possible, I shall speak of 'morally good conduct" instead.

Ethics, as I shall use the term, means a set of morally permissible standards of conduct each member of a group wants all other members to follow even if their following them means she must do the same. Ethics may differ from group to group. Legal ethics governs lawyers, not anyone else; Hopi ethics, Hopis; and business ethics, people engaged in business. Though ethics includes the rules of morality, it differs from ordinary morality in requiring something more. Ethics is "morality plus..."

A <u>code</u> of ethics is a formal statement of a group's ethics. A code of business ethics is a code of ethics adopted by a for-profit organization, whether a corporation, partnership, or small business, or by some association of such organizations (for example, their trade association). My topic tonight is, however, not just codes of business ethics, but codes of ethics <u>in</u> business. The difference is worth stressing.

Codes of business ethics are not the only codes of ethics in business. Most large businesses employ some professionals--CPA's, lawyers, engineers, or the like. Since each profession is defined in part by its special code of ethics, each professional will bring with her a professional code. An employer concerned about the conduct of employees needs to take those codes into account. For professionals, one's professional code takes precedence over anything an employer says.

## II.

That, I think, is enough definition. Now let's get to work. Though I shall focus tonight on codes of business ethics, I shall begin by saying a bit more about professional codes. I shall begin in this way because I think few managers sufficiently appreciate the difference between professionals and ordinary employees or the special role professional codes have in business. Perhaps Chris Anderson, a management consultant at Notre Dame University, best expressed this lack of appreciation: "There's no question," he said, "that the so-called professional, because of myths of professional charisma, often develops resistance to being managed. If you chip away the rhetoric, the crap, he's saying, 'If I'm productive, you keep out of my face. You do not have a right to manage me.'" (Johns Hopkins Magazine, June 1988, p. 26)

Managers are, of course, right to think that a professional will resist being managed--especially if being managed means being told to act in ways violating her profession's code. But managers are wrong to think that this resistence rests on any "myth of professional charisma." Generally, we want professionals to do certain jobs because they have a reputation for doing them right. Part of the reason professionals get this reputation is their technical know-how. But part too is that professionals tend to adhere to their profession's standards even when a "lay person" would not. Professionals are the people we rely on to maintain those standards.

Managers often seem to want to "eat their cake and have it too". They both want a professional in a job because he is supposed to know how to do it right and want to be able to tell him to do it some other way.

Wanting to be able to tell a professional how to do his job might be defensible if doing the job right were just a matter of business judgment. The manager could have information about the context of work the professional lacked. Often, however, doing the job right is not just a matter of business judgment. It is in part a matter of conforming to the professional's code--for engineers, for example, giving priority to public safety, health, and welfare over ordinary business concerns. In such circumstances, a professional need not appeal to "professional charisma" to explain why the manager should "keep out of [his] face". The professional's claim of right rests on more than "myth".

My impression is that business schools do absolutely nothing to help managers understand the professional's perspective, much less to recognize its legitimacy. Few businesses do more. The result is a serious problem in the relations between managers and professionals.

I recently spoke at a session on ethics at a national meeting of a major engineering society. Somehow during the question period, I thought to ask who would be willing to tell a superior, "I have an ethical problem with this." Not one member of the audience raised a hand. I asked why and was told that putting the matter as I had would be unwise. Their manager would not understand the problem. He would dismiss it as "crap" and wonder "whose team" the engineer was on. While these engineers did try to be ethical, they had to be sneaky about it. They had to make their ethical concerns sound like "bottom-line issues". The manager, in turn, had to accept or reject his staff's recommendation without understanding why the staff made it.

Managers have their own worries, of course, and most are justified. A company cannot survive if costs run too high. Professional standards have a tendency to impose high costs. When costs do run too high, the manager will take the blame, not the professionals.

But, before developing too much sympathy for management's perspective on what professionals do, we should recall that the manager pressuring a particular professional to cut costs even if cutting them means violating a professional standard, is probably not the author of the job description requiring a professional in the job. Sometimes the professional is required by law; sometimes by the company's board of directors, senior management, or insurer. The professional is often in his job in part to blunt or bridle the natural impulses of managers--to assure, say, that a concern to keep short-term costs down does not undermine long-term safety. As hard as it is for managers to understand, a manager pressuring a professional to ignore professional standards may well be threatening a system of checks and balances meant to prevent management ingenuity from becoming dangerous to the public or to the long-term interests of the company.

Managers need to understand that it is not good for them to have too much control. Any company concerned with ethics should have programs to help managers learn about, and appreciate, the professional ethics of those they manage. It should also examine its practices to see whether they encourage managers to respect professional judgment or devalue it. Companies should, I think, pay special attention to such common practices as large bonuses for achieving short-term objectives, poor long-term accountability, and lack of independent quality control.

That, I think, is enough about professional codes in business. Now, what about codes of business ethics? I want to make three points. First, "good ethics" is not necessarily good business. Second, there is no necessary connection between "good ethics" and a code of ethics. And third, a company should not adopt a code of ethics unless it is willing to give up direct control of a good deal of employee conduct. Let's take these points in order.

III.

My first point is: "good ethics", that is, morally good conduct, is not necessarily good business. There is, I admit, a good deal of evidence commonly offered to show the contrary. I don't think the evidence shows what those who offer it claim. The studies on which such claims rest generally concern the long-term profitability of companies with a reputation for good ethics. These are not laboratory experiments but statistical studies. I have questions about the sample, the reliance on reputation, and the term "good ethics" in this context. Let's take these questions in order.

First, the sample. The companies identified as ethical tend to be concentrated in highly regulated markets. The studies seldom compare similar companies in similar markets. That is understandable. Most markets have so few companies that such comparisons would be statistically useless. Still, as a result, such studies leave open the question whether the reported long-term profitability of ethical companies is a measure of "ethics", of regulation, or some combination of ethics and regulation.

Second, reliance on reputation. The studies generally rely on the reputation of companies. Few consider whether the companies in fact deserve the reputation--how, that is, they behave differently from other companies in their market. Many of the companies studied put a good deal of money into image advertising, perhaps because the absence of competition gives them this luxury. So, the studies may show no more than that advertising can buy a reputation for good ethics and buying such a reputation is good business.

Third, the term "good ethics" itself. The studies in question never mean a whole lot by "good ethics". Generally, they mean no more than staying within the law, doing a certain amount of public service, and perhaps having an "ethics document", even if only a statement of aspirations. No study has undertaken direct examination of the relative long-term profitability of companies that <u>systematically</u> engage in morally good conduct.

I take it these methodological flaws are both serious and obvious, indeed, so serious and obvious as to make me ask why so many sensible people, not only people in the ethics business but hard-nosed business people, would claim that such studies show that good ethics is good business. The answer may be some combination of the following:

One reason so many sensible people make such claims may be that they are implicitly contrasting short-term expediency with a company's long-term welfare. If that is what they are doing, then they are probably right. Too much concern with the short term can ruin a company's reputation and, in time, the company too. Yet, if that is all they mean to claim, why state the claim as an equation between good ethics and good business? The claim really has little to do with ethics. The claim would be better stated, and better supported by the evidence, if put this way: <u>long-term expediency is good business--in the long term</u>.

Another reason so many sensible people claim the evidence shows that good ethics is good business may be that they are confusing two functions of business ethics. One function is to protect the company from the self-interest of employees. So, for example, telling purchasing agents that they may not accept gifts from suppliers would serve this first function. The company is better off if its purchasing agents have no conflicts of interest. But a second function of busines ethics is to protect those outside the company from what would serve the company's interests--or, at least, its interests narrowly conceived. So, for example, directing the billing department to inform suppliers of all errors in billing, especially those favoring the company, would serve this second function. It would protect suppliers from their own errors--at company expense.

Insofar as business ethics serves that first function, it will certainly be good business--for the company but perhaps not for the employees. But insofar as it serves the second, it may not be good business for either. I must admit, however, that these two functions may not be as independent as they sound. Getting employees to engage in morally good conduct in their dealings with their company is likely to be easier if the company clearly treats others, especially helpless outsiders, in the same way it asks its employees to treat it.

A third reason so many sensible people claim the evidence shows that good ethics is good business may be that, as morally decent people, they want to be morally good. They hesitate to be so in business only because they fear that being so there is to fail in their primary responsibility as manager or owner. While they do not really expect to make more money by carrying on business in morally good ways, they are unwilling to make much less. They want both to make a good living and to be proud of what they do.

Tad Tuleja has a little book on business ethics, Beyond the Bottom Line (1985). "Can the Good Guys Finish First?" is his title for the chapter sumarizing much of the evidence we have been discussing. That title seems to me to catch the underlying concern of most business people who claim that good ethics is good business. All they really mean is that good ethics is not bad business. A good guy <u>can</u> finish first, or last, or any place a bad guy can. Ethics is not a serious handicap in business.

As I read the evidence, that seems to me about all we are entitled to conclude. But, for a morally decent person, that should be enough.

IV.

We come then to my second point: <u>there is no necessary connection between "good ethics", that is, morally good conduct, and a code of ethics</u>. This perhaps startling claim is really no more than a consequence of the defintions with which I began. A code of business ethics must have four features that together distinguish it from other guides to conduct.

First, a code of business ethics cannot call for morally bad conduct. Insofar as a code calls for an employee to lie, cheat, steal, or break promises, it is, by definition, not ethical. This, I suppose, hardly needs saying.

A second distinguishing feature of a code of business ethics is that it calls for something more than business as usual. So, for example, a company's sales force may be prohibited from pointing out flaws in a competitor's product even when such negative selling is legal, common in the market, and thought to be the most effective way to make a sale.

A third distinguishing feature of a code of business ethics is that it sets a minimum standard of conduct. A code may look aspirational: "Our employees should..." Or like a declaration of faith: "We believe that..." Or even like a set of factual statements: "Our company is committed to..." But unless the intent is to set minimum standards of conduct, the document is not a code of ethics but a statement of ideals, credo, or the like. A document does not become a code of ethics simply by having the title.

A fourth distinguishing feature of a code of business ethics is that it can serve the long-term interests of a company only if employees generally have reason to want everyone else to comply even when the company is in no position to assure individual compliance. A code of ethics is not just another management directive. It is rather a substitute for ordinary directives. A code of ethics has its own enforcement costs. I shall say more about these in a minute.

Given these four distinguishing features of a code of business ethics, the difference between good ethics and a code of ethics is obvious. On the one hand, a company can demand of itself and its employees conduct approaching a moral ideal without adopting a code of ethics. It need only enact the appropriate directives and make sure they are carried out in the usual ways management makes sure directives get carried out. So, good ethics is possible without a code of ethics. On the other hand, a company can enact a code of ethics and still conduct business in ways that are not simply morally bad but morally wrong. A code of ethics can fail to get action as easily as can any management directive.

## V.

That brings me to my third, and last, point: <u>A company should not adopt a code of ethics unless it is willing to give up direct control of a good deal of employee conduct</u>. This may seem a strange thing to say. Isn't a code of ethics just another way to control employee conduct? No, it is something more.

Put yourself in the position of a middle-level manager for a minute. Your superior has just handed you the company's brand-new code of ethics. What do you do with it? How do you motivate your subordinates to give it their support, that is, how do you get them to obey themselves and to help you get others to obey? Insofar as the code asks more than the law can make stick, you cannot rely on fear of the law. Insofar as employee compliance cannot be adequately supervised, you cannot rely on the ordinary penalties and rewards under your control. Insofar as the code is more than mere aspiration, you cannot be satisfied with quoting it occasionally.

Some companies try to motivate their employees to follow the code by requiring them to subscribe to it as a condition of employment. For many employees, the ceremony of subscription is no more memorable than filling out any other required form. It is no sooner completed than forgotten. Of those who remember the promise, many may feel it to have been wrung from them under conditions of sufficient inequality to make the promise void. Getting an employee to promise to support the code cannot by itself solve the problem of motivation.

Once you see this, you might well wonder why _you_, a middle-level manager, should do anything about enforcing the code except what your superior tells you to do. After all, what is true of ordinary employees is true of you too. Since supervising managers closely is expensive and may well reduce efficiency, companies must depend on their managers' voluntary support of the code of ethics. Why then should you do more to support it than your superiors direct (and can verify)? If you can answer this question, you are well on your way to solving the problem of motivating subordinates. If you cannot, your company's code of ethics is probably going to end up another one of those documents used only in public relations.

Why should you, a middle-level manager, do more to support your company's ethics code than necessary to keep your boss happy? The answer must be in the code--if there is an answer. Consider a typical provision:

> Employees will not undertake any activity while on company premises, or while engaged in company business, that is or gives the appearance of being improper, illegal, or immoral, or could in any way harm or embarrass the company or its customers.

Why might you want your subordinates' voluntary support of this provision? The answer is obvious. If they voluntarily do as this provision requires, you will have fewer embarrassing situations to explain to superiors. You will not need to watch your subordinates as carefully as you now do. And you might well be able to do without certain of those invasions of privacy (for example, listening in on employee calls) that you now find unpleasant but necessary. A code of ethics can be a way to achieve a certain kind of conduct with less cost to you in time, employee goodwill, and the like than ordinary supervision has.

A code of ethics is, then, a way to increase net productivity--*if* employees cooperate enough. But why should ordinary employees cooperate? The answer is the same for ordinary employees as for you. They must benefit. But how? We might think of the code of ethics as a bargain between a company and its employees: *If you maintain these standards without close supervision, the company will not burden you with the procedures necessary to obtain your grudging obedience*. Employees get greater autonomy in return for greater self-discipline.

This bargain is easily misunderstood. It is a bargain between the company and a <u>group</u> of employees, not a bargain between the company and individual employees. A company cannot rationally make an "ethics bargain" without some way to tell whether the "other party" is living up to it. A company cannot tell whether an individual employee is living up to it except by closely supervising her. Since a company benefits from a code only insofar as the code makes close supervision unnecessary, an employee-by-employee bargain is pointless. A company can, on the other hand, without close supervision, tell whether its employees <u>in general</u> are living up to the code. It can even tell whether some department, plant, or other organized group of employees is. The company need only do spotchecks, measure overall productivity, or the like. So, a company can rationally enter into the "ethics bargain" with its employees as a group, but not as individuals.

With this in mind, you, the ordinary manager, can set about implementing your company's code of ethics. Consider a situation that might arise under the typical ethics provision I cited earlier.

You come upon an employee in your office taking bets. Betting is illegal under state law. So, the employee is engaged in an illegal act on company premises, a clear violation of the code of ethics. What should you do? You could report the employee to the police (if company policy allows that). You could fire him (or at least send the appropriate forms to personnel and hope they do as you ask.) You could threaten him or "chew him out". But none of these responses is in keeping with a code of ethics. Such responses may also be ineffective, leading your subordinates to keep a better lookout for you rather than actually stopping the betting.

What should you do? If your concern is to make the code of ethics something more than just another management directive, you should say something like this:

> What you do off company property on your own time is your business. What you do here reflects on the company. The police have been known to put undercover agents in a business to uncover even petty crimes such as this gambling. When the police have enough information, they make a lot of arrests, and the story hits the front page of the newspaper. If that happens here, nobody will go to jail, but you can be pretty sure the people upstairs are going to want you supervised more closely. I don't want to end up running this place like a kindergarten. You don't want that either. So, please, for all of our sakes, do your betting off company premises.

This little speech uses the basic idea behind a code of ethics. The reason each of us should go along with the code is that we will all be better off if everyone does. What must motivate each person to do as the code requires is that everyone will be better off if everyone does (and others are already doing their part). Though a code cannot work without management support, it will not work as a code of ethics unless managers treat it as something more than just another directive. Managers cannot command obedience to a code of ethics. The code must be a cooperative undertaking.

So, a company that adopts a code of ethics is changing the way it runs. It is decentralizing control over significant activities and weakening its chain of command. In this respect at least, a company code of ethics has the same effect on the entire company that professional codes have on employees who belong to some profession. A company willing to adopt a code of ethics should, then, have less trouble accommodating its employees' professional codes than would a company in which control is much more centralized.

VI.

To sum up: Good ethics is not necessarily good business, but it is not necessarily bad business either. A company can have good ethics without a code of ethics. But, if it decides it wants what a code of ethics can give it, it must pay a price in management control. There will have to be an "ethics bargain".