

CHAPTER 5



Ethical Decision Making and Ethical Leadership

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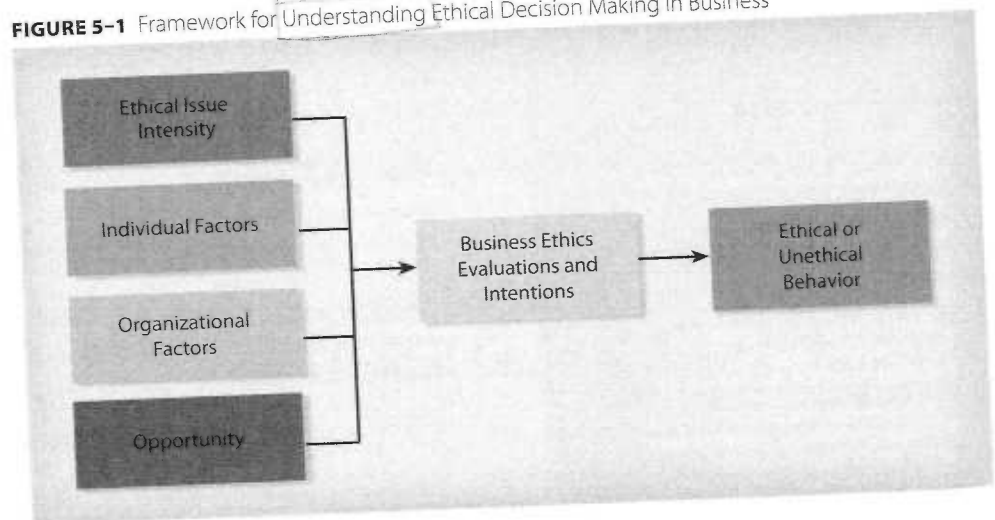
To improve ethical decision making in business, one must first understand how individuals make ethical decisions in an organizational environment. Too often it is assumed that individuals in organizations make ethical decisions in the same way that they make ethical decisions at home, in their family, or in their personal lives. Within the context of an organizational work group, however, few individuals have the freedom to decide ethical issues independent of organizational pressures.

This chapter summarizes our current knowledge of ethical decision making in business and provides insights into ethical decision making in organizations. Although it is impossible to describe exactly how any one individual or work group might make ethical decisions, we can offer generalizations about average or typical behavior patterns within organizations. These generalizations are based on many studies and at least six ethical decision models that have been widely accepted by academics and practitioners.¹ Based on these models, we present a framework for understanding ethical decision making in the context of business organizations. In addition to business, this framework integrates concepts from philosophy, psychology, sociology, and organizational behavior. This framework should be helpful in understanding organizational ethics and developing ethical programs.

A FRAMEWORK FOR ETHICAL DECISION MAKING IN BUSINESS

As Figure 5-1 shows, our model of the ethical decision making process in business includes ethical issue intensity, individual factors, and organizational factors such as corporate culture and opportunity. All of these interrelated factors influence the evaluations of and intentions behind the decisions that produce ethical or unethical behavior. This model does not describe how to make ethical decisions, but it does help one to understand the factors and processes related to ethical decision making.

FIGURE 5-1 Framework for Understanding Ethical Decision Making in Business



Ethical Issue Intensity

The first step in ethical decision making is to recognize that an ethical issue requires an individual or work group to choose among several actions that various stakeholders inside or outside the firm will ultimately evaluate as right or wrong. The intensity of an ethical issue relates to its perceived importance to the decision maker.² **Ethical issue intensity**, then, can be defined as the relevance or importance of an ethical issue in the eyes of the individual, work group, and/or organization. It is personal and temporal in character to accommodate values, beliefs, needs, perceptions, the special characteristics of the situation, and the personal pressures prevailing at a particular place and time.³ Senior employees and those with administrative authority contribute significantly to intensity because they typically dictate an organization's stance on ethical issues. In fact, under current law, managers can be held liable for the unethical and illegal actions of subordinates. In the United States, the Federal Sentencing Guidelines for Organizations have a liability formula that judges those who are in positions of authority in regard to their action or inaction regarding the unethical and illegal activities of those around them. For example, many of the Enron employees and managers who were aware of the firm's use of off-balance-sheet partnerships—which turned out to be the major cause of the energy firm's collapse—were advised that these partnerships were legal, so they did not perceive them as an ethical issue. Although such partnerships were in fact legal at that time, the way that some Enron officials designed them and the methods they used to provide collateral (that is, Enron stock) created a scheme that brought about the collapse of the company.⁴ Thus, ethical issue intensity involves individuals' cognitive state of concern about an issue, whether or not they have knowledge that an issue is unethical, which indicates their involvement in making choices.

Ethical issue intensity reflects the ethical sensitivity of the individual or work group that faces the ethical decision making process. Research suggests that individuals are subject to six "spheres of influence" when confronted with ethical choices—the workplace, family, religion, legal system, community, and profession—and that the level of importance of each of these influences will vary depending on how important the decision maker perceives the issue to be.⁵ Additionally, the individual's sense of the situation's **moral intensity** increases the individual's perceptiveness regarding ethical problems, which in turn reduces his or her intention to act unethically.⁶ **Moral intensity** relates to a person's perception of social pressure and the harm the decision will have on others.⁷ All other factors in Figure 5-1, including individual factors, organizational factors, and intentions, determine why different individuals perceive ethical issues differently. Unless individuals in an organization share common concerns about ethical issues, the stage is set for ethical conflict. The perception of ethical issue intensity can be influenced by management's use of rewards and punishments, corporate policies, and corporate values to sensitize employees. In other words, managers can affect the degree to which employees perceive the importance of an ethical issue through positive and/or negative incentives.⁸

For some employees, ethical issues may not reach the critical awareness level if managers fail to identify and educate employees about specific problem areas. Subprime lenders, such as Countrywide Finance, failed to educate brokers about the damages of misrepresenting financial data to help individuals secure loans. Organizations that consist of employees with diverse values and backgrounds must train them in the way the firm wants specific ethical issues handled. Identifying the ethical issues and risks that employees might encounter is a significant step toward developing their ability to make ethical decisions. Many ethical issues are identified by industry groups or through general

information available to a firm. Companies must assess areas of ethical and legal risk that are in reality ethical issues. Issues that are communicated as being high in ethical importance could trigger increases in employees' ethical issue intensity. The perceived importance of an ethical issue has been found to have a strong influence on both employees' ethical judgment and their behavioral intention. In other words, the more likely individuals are to perceive an ethical issue as important, the less likely they are to engage in questionable or unethical behavior.⁹ Therefore, ethical issue intensity should be considered a key factor in the ethical decision making process.

Individual Factors

When people need to resolve ethical issues in their daily lives, they often base their decisions on their own values and principles of right or wrong. They generally learn these values and principles through the socialization process with family members, social groups, and religion and in their formal education. The actions of specific individuals in scandal-plagued companies such as AIG, Countrywide Financial, Fannie Mae, and Freddie Mac often raise questions about those individuals' personal character and integrity. They appear to operate in their own self-interest or in total disregard of the law and interests of society. Fannie Mae has become one of the high-profile figures in the 2008–2009 financial meltdown. It is a stockholder-owned corporation created to purchase and securitize mortgages, and was a key figure in the subprime mortgage debacle.¹⁰ Many people granted mortgages by Fannie Mae were not strong candidates to receive mortgages, and their homes have since been foreclosed. Civil charges had already been filed against Fannie Mae's CEO, CFO, and the former controller, who allegedly manipulated earnings to increase their bonuses. CEO Daniel Mudd was also investigated for lying to investors about earnings. Bad decisions and managerial misconduct clearly contributed to the company's downfall.¹¹

The more likely individuals are to perceive an ethical issue as important, the less likely they are to engage in questionable or unethical behavior.

In the workplace, personal ethical issues typically involve honesty, conflicts of interest, discrimination, nepotism, and theft of organizational resources. For example, many individuals use the company computer system for several hours of work time a day for personal reasons. Most employees limit the use of their work time for personal use, and most companies probably overlook these as reasonable. Some employees, however, use times in excess of 30 minutes for personal Internet communications, which companies are likely to view as an excessive use of company time for personal reasons. The decision to use company time for personal affairs is an example of an ethical decision. It illustrates the fine line between what may be acceptable or unacceptable in a business environment. It also reflects how well an individual will assume responsibilities in the work environment. Often this decision will depend on company policy and the corporate environment.

The way the public perceives individual ethics generally varies according to the profession in question. Telemarketers, car salespersons, advertising practitioners, stockbrokers, and real estate brokers are often perceived as having the lowest ethics. Research regarding individual factors that affect ethical awareness, judgment, intent, and behavior include gender, education, work experience, nationality, age, and locus of control.

Extensive research has been done regarding the link between gender and ethical decision making. The research shows that in many aspects there are no differences between men and women, but when differences are found, women are generally more ethical than men.¹² By "more ethical," we mean that women seem to be more sensitive to

ethical scenarios and less tolerant of unethical actions. In a study on gender and intentions for fraudulent financial reporting, females reported higher intentions to report them than male participants.¹³ As more and more women work in managerial positions, these findings may become increasingly significant.

Education, the number of years spent in pursuit of academic knowledge, is also a significant factor in the ethical decision making process. The important thing to remember about education is that it does not reflect experience. Work experience is defined as the number of years within a specific job, occupation, and/or industry. Generally, the more education or work experience that one has, the better he or she is at ethical decision making. The type of education has little or no effect on ethics. For example, it doesn't matter if you are a business student or a liberal arts student—you are pretty much the same in terms of ethical decision making. Current research, however, shows that students are less ethical than businesspeople, which is likely because businesspeople have been exposed to more ethically challenging situations than students.¹⁴

Nationality is the legal relationship between a person and the country in which he or she is born. Within the twenty-first century, nationality is being redefined by regional economic integration such as the European Union (EU). When European students are asked their nationality, they are less likely to state where they were born than where they currently live. The same thing is happening in the United States, as someone born in Florida who lives in New York might consider him- or herself to be a New Yorker. Research about nationality and ethics appears to be significant in that it affects ethical decision making; however, the true effect is somewhat hard to interpret.¹⁵ Because of cultural differences, it is impossible to state that ethical decision making in an organizational context will differ significantly. The reality of today is that multinational companies look for businesspeople who can make decisions regardless of nationality. Perhaps in twenty years, nationality will no longer be an issue in that the multinational's culture will replace the national status as the most significant factor in ethical decision making.

Age is another individual factor that has been researched within business ethics. Several decades ago, we believed that age was positively correlated with ethical decision making. In other words, the older you are, the more ethical you are. However, recent research suggests that there is probably a more complex relationship between ethics and age.¹⁶ We do believe that older employees with more experience have greater knowledge to deal with complex industry-specific ethical issues.

Locus of control relates to individual differences in relation to a generalized belief about how one is affected by internal versus external events or reinforcements. In other words, the concept relates to where people view themselves in relation to power. Those who believe in **external control** (that is, externals) see themselves as going with the flow because that's all they can do. They believe that the events in their lives are due to uncontrollable forces. They consider that what they want to achieve depends on luck, chance, and powerful people in their company. In addition, they believe that the probability of being able to control their lives by their own actions and efforts is low. Conversely, those who believe in **internal control** (that is, internals) believe that they control the events in their lives by their own effort and skill, viewing themselves as masters of their destinies and trusting in their capacity to influence their environment.

Current research suggests that we still can't be sure how significant locus of control is in terms of ethical decision making. One study that found a relationship between locus of control and ethical decision making concluded that internals were positively related whereas externals were negative.¹⁷ In other words, those who believe that their fate is in the hands of others were more ethical than those who believed that they formed their own destiny.

Organizational Factors

Although people can and do make individual ethical choices in business situations, no one operates in a vacuum. Indeed, research has established that in the workplace the organization's values often have greater influence on decisions than a person's own values.¹⁸ Ethical choices in business are most often made jointly, in work groups and committees, or in conversations and discussions with coworkers. Employees approach ethical issues on the basis of what they have learned not only from their own backgrounds but also from others in the organization. The outcome of this learning process depends on the strength of each person's personal values, the opportunities he or she has to behave unethically, and the exposure he or she has to others who behave ethically or unethically. Although people outside the organization, such as family members and friends, also influence decision makers, an organization's culture and structure operate through the relationships of its members to influence their ethical decisions.

The more ethical employees perceive an organization's culture to be, the less likely they are to make unethical decisions.

A **corporate culture** can be defined as a set of values, norms, and artifacts, including ways of solving problems that members (employees) of an organization share. As time passes, stakeholders come to view the company or organization as a living organism, with a mind and will of its own. The Walt Disney Company, for example, requires all new employees to take a course in the traditions and history of Disneyland and Walt Disney, including the ethical dimensions of the company. The corporate culture at American Express Company stresses that employees help customers out of difficult situations whenever possible. This attitude is reinforced through numerous company legends of employees who have gone above and beyond the call of duty to help customers. This strong tradition of customer loyalty thus might encourage an American Express employee to take unorthodox steps to help a customer who encounters a problem while traveling overseas. Employees learn that they can take some risks in helping customers. Such strong traditions and values have become a driving force in many companies, including McDonald's, IBM, Procter & Gamble, Southwest Airlines, and Hershey Foods.

An important component of corporate, or organizational, culture is the company's ethical culture. Whereas corporate culture involves values and norms that prescribe a wide range of behavior for organizational members, the **ethical culture** reflects whether the firm also has an ethical conscience. Ethical culture is a function of many factors, including corporate policies on ethics, top management's leadership on ethical issues, the influence of coworkers, and the opportunity for unethical behavior. Within the organization as a whole, subclimates can develop within individual departments or work groups, but they are influenced by the strength of the firm's overall ethical culture, as well as the function of the department and the stakeholders it serves.¹⁹

The more ethical employees perceive an organization's culture to be, the less likely they are to make unethical decisions. Corporate culture and ethical culture are closely associated with the idea that significant others within the organization help determine ethical decisions within that organization. Research also indicates that the ethical values embodied in an organization's culture are positively related to employees' commitment to the firm and their sense that they fit into the company. These findings suggest that companies should develop and promote ethical values to enhance employees' experiences in the workplace.²⁰

Those who have influence in a work group, including peers, managers, coworkers, and subordinates, are referred to as **significant others**. They help workers on a daily basis with unfamiliar tasks and provide advice and information in both formal and informal ways.

Coworkers, for instance, can offer help in the comments they make in discussions over lunch or when the boss is away. Likewise, a manager may provide directives about certain types of activities that employees perform on the job. Indeed, an employee's supervisor can play a central role in helping employees develop and fit in socially in the workplace.²¹ Numerous studies conducted over the years confirm that significant others within an organization may have more impact on a worker's decisions on a daily basis than any other factor.²²

Obedience to authority is another aspect of the influence that significant others can exercise. Obedience to authority helps to explain why many employees resolve business ethics issues by simply following the directives of a superior. In organizations that emphasize respect for superiors, for example, employees may feel that they are expected to carry out orders by a supervisor even if those orders are contrary to the employees' sense of right and wrong. Later, if the employee's decision is judged to have been wrong, he or she is likely to say, "I was only carrying out orders" or "My boss told me to do it this way." In addition, the type of industry and the size of the organization have also been researched and found to be relevant factors; the bigger the company, the more potential for unethical activities.²³

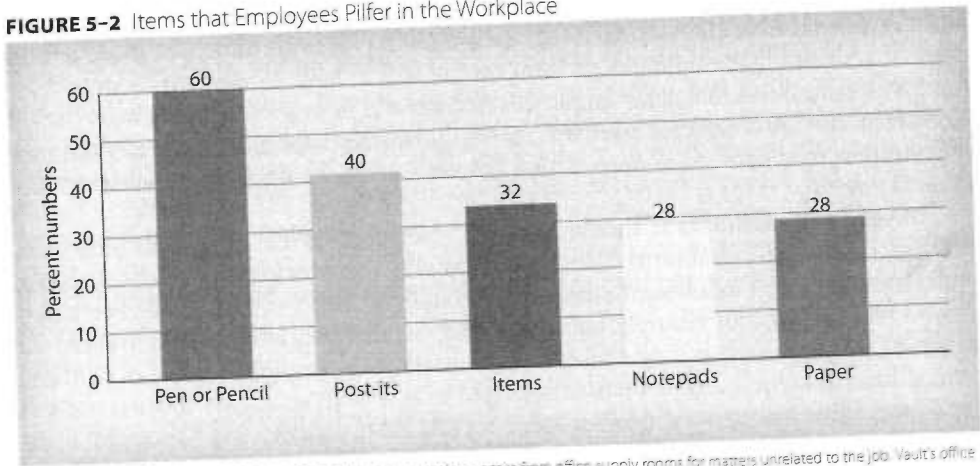
Opportunity

Opportunity describes the conditions in an organization that limit or permit ethical or unethical behavior. Opportunity results from conditions that either provide rewards, whether internal or external, or fail to erect barriers against unethical behavior. Examples of internal rewards include feelings of goodness and personal worth generated by performing altruistic acts. External rewards refer to what an individual expects to receive from others in the social environment. Rewards are external to the individual to the degree that they bring social approval, status, and esteem.

An example of a condition that fails to erect barriers against unethical behavior is a company policy that does not punish employees who accept large gifts from clients. The absence of punishment essentially provides an opportunity for unethical behavior because it allows individuals to engage in such behavior without fear of consequences. The prospect of a reward for unethical behavior can also create an opportunity for questionable decisions. For example, a salesperson who is given public recognition and a large bonus for making a valuable sale that he or she obtained through unethical tactics will probably be motivated to use such tactics in the future, even if such behavior goes against the salesperson's personal value system. If 10 percent of employees report observing others at the workplace abusing drugs or alcohol, then the opportunity to engage in these activities exists if there is a failure to report and respond to this conduct.²⁴

Opportunity relates to individuals' **immediate job context**—where they work, whom they work with, and the nature of the work. The immediate job context includes the motivational "carrots and sticks" that superiors use to influence employee behavior. Pay raises, bonuses, and public recognition act as carrots, or positive reinforcements, whereas demotions, firings, reprimands, and pay penalties act as sticks, the negative reinforcements. The United States Chamber of Commerce reports that 75 percent of employees steal from their workplaces, and most do so repeatedly.²⁵ As Figure 5-2 shows, many employees pilfer office-supply rooms for matters unrelated to the job. It is possible that the opportunity is provided, and in some cases, there are no concerns if employees take pens, Post-its, envelopes, notepads, and paper. Respondents to the survey by Vault.com indicated that 25 percent felt that no one cared if they took office supplies, 34 percent said that they never

FIGURE 5-2 Items that Employees Pilfer in the Workplace



Source: "Top Items Employees Pilfer," the most popular items employees take from office-supply rooms for matters unrelated to the job. Vault's office survey of 1,152 respondents. In Snapshot, USA Today, March 29, 2006, B1.

got caught, and 1 percent said that they were caught and got in trouble. If there is no policy against this practice, one concern is that employees will not learn where to draw the line and will get into the habit of taking even more expensive items for personal use.

The opportunity that employees have for unethical behavior in an organization can be eliminated through formal codes, policies, and rules that are adequately enforced by management. For example, financial companies—such as banks, savings and loan associations, and securities companies—have developed elaborate sets of rules and procedures to avoid the opportunity for individual employees to manipulate or take advantage of their trusted position. In banks, one such rule requires most employees to take a vacation and stay out of the bank a certain number of days every year so that they cannot be physically present to cover up embezzlement or other diversion of funds. This rule prevents the opportunity for inappropriate conduct. Even after audits by prestigious accounting firm PricewaterhouseCoopers, the founder and chairman of one of India's largest technology companies, Satyam Computer Services Ltd., admitted he invented financial results, including a fictitious cash balance of more than \$1 billion. He was able to overstate profits and understate liabilities. This was allowed to happen, even though Satyam had independent directors, including a Harvard business school professor, on its board. The question is: How did the CEO manage to blatantly manipulate financial information without anyone catching on? There had to be loopholes in the oversight of the company's accounting, audits, and corporate governance that allowed this fraud. In addition, government regulation of financial reporting allowed the opportunity for misconduct. To avoid situations like this in the future, there must be checks and balances that create transparency.²⁶

Opportunity also comes from knowledge. Major misconduct observed among employees in the workplace include lying to employees, customers, vendors, or the public or withholding needed information from them.²⁷ A person who has an information base, expertise, or information about the competition has the opportunity to exploit this knowledge. An individual can be a source of information because he or she is familiar with the organization. Individuals who have been employed by one organization for many years become "gatekeepers" of its culture and often have the opportunity to make decisions related to unwritten traditions and rules. They help socialize newer employees to abide

by the rules and norms of the company's internal and external ways of doing business, as well as understanding when the opportunity exists to cross the line. They may function as mentors or supervise managers in training. Like drill sergeants in the army, these trainers mold the new recruits into what the company wants. This can contribute to either ethical or unethical conduct.

The opportunity for unethical behavior cannot be eliminated without aggressive enforcement of codes and rules. A national jewelry store-chain president explained to us how he dealt with a jewelry buyer in one of his stores who had taken a bribe from a supplier. There was an explicit company policy against taking incentive payments in order to deal with a specific supplier. When the president of the firm learned that one of his buyers had taken a bribe, he immediately traveled to that buyer's office and terminated his employment. He then traveled to the supplier (manufacturer) selling jewelry to his stores and terminated his relationship with the firm. The message was clear: Taking a bribe is unacceptable for the store's buyers, and salespeople from supplying companies could cost their firm significant sales by offering bribes. This type of policy enforcement illustrates how the opportunity to commit unethical acts can be eliminated.

Business Ethics Evaluations and Intentions

Ethical dilemmas involve problem-solving situations in which decision rules are often vague or in conflict. The results of an ethical decision are often uncertain; no one can always tell us whether we have made the right decision. There are no magic formulas, nor is there computer software that ethical dilemmas can be plugged into for a solution. Even if they mean well, most businesspeople will make ethical mistakes. Thus, there is no substitute for critical thinking and the ability to take responsibility for our own decisions.

An individual's intentions and the final decision regarding what action he or she will take are the last steps in the ethical decision making process. When the individual's intentions and behavior are inconsistent with his or her ethical judgment, the person may feel guilty. For example, when an advertising account executive is asked by her client to create an advertisement that she perceives as misleading, she has two alternatives: to comply or to refuse. If she refuses, she stands to lose business from that client and possibly her job. Other factors—such as pressure from the client, the need to keep her job to pay her debts and living expenses, and the possibility of a raise if she develops the advertisement successfully—may influence her resolution of this ethical dilemma. Because of these other factors, she may decide to act unethically and develop the advertisement even though she believes it to be inaccurate. Because her actions are inconsistent with her ethical judgment, she will probably feel guilty about her decision.

Guilt or uneasiness is the first sign that an unethical decision has occurred. The next step is changing one's behavior to reduce such feelings. This change can reflect a person's values shifting to fit the decision or the person changing his or her decision type the next time a similar situation occurs. Finally, one can eliminate some of the situational factors by quitting. For those who begin the value shift, the following are the usual justifications that will reduce and finally eliminate guilt:

1. I need the paycheck and can't afford to quit right now.
2. Those around me are doing it so why shouldn't I? They believe it's okay.
3. If I don't do this, I might not be able to get a good reference from my boss or company when I leave.

4. This is not such a big deal, given the potential benefits.
5. Business is business with a different set of rules.
6. If not me, someone else would do it and get rewarded.

The road to success depends on how the businessperson defines *success*. The success concept drives intentions and behavior in business either implicitly or explicitly. Money, security, family, power, wealth, and personal or group gratification are all types of success measures that people use. The list described is not comprehensive, and in the next chapter, you will understand more about how success can be defined. Another concept that affects behavior is the probability of rewards and punishments. That too will be explained further in Chapter 6.

USING THE ETHICAL DECISION MAKING FRAMEWORK TO IMPROVE ETHICAL DECISIONS

The ethical decision making framework presented in this chapter cannot tell you if a business decision is ethical or unethical. It bears repeating that it is impossible to tell you what is right or wrong; instead, we are attempting to prepare you to make informed ethical decisions. Although this chapter does not moralize by telling you what to do in a specific situation, it does provide an overview of typical decision making processes and factors that influence ethical decisions. The framework is not a guide for how to make decisions but is intended to provide you with insights and knowledge about typical ethical decision making processes in business organizations.

Because it is impossible to agree on normative judgments about what is ethical, business ethics scholars developing descriptive models have instead focused on regularities in decision making and the various phenomena that interact in a dynamic environment to produce predictable behavioral patterns. Furthermore, it is unlikely that an organization's ethical problems will be solved strictly by having a thorough knowledge about how ethical decisions are made. By its very nature, business ethics involves value judgments and collective agreement about acceptable patterns of behavior.

We propose that gaining an understanding of typical ethical decision making in business organizations will reveal several ways that such decision making could be improved. With more knowledge about how the decision process works, you will be better prepared to analyze critical ethical dilemmas and to provide ethical leadership regardless of your role in the organization. One important conclusion that should be taken from our framework is that ethical decision making within an organization does not rely strictly on the personal values and morals of individuals. Knowledge of moral philosophies or principles must be balanced with business knowledge and understanding of the complexities of the dilemma requiring a decision. For example, a manager who embraces honesty, fairness, and equity has to understand the diverse risks associated with a complex financial instrument such as options or derivatives. Business competence must exist, along with personal accountability, in ethical decisions. Organizations take on a

culture of their own, with managers and coworkers exerting a significant influence on ethical decisions.

THE ROLE OF LEADERSHIP IN A CORPORATE CULTURE

Top managers provide a blueprint for what a firm's corporate culture should be.²⁸ If these leaders fail to express desired behaviors and goals, a corporate culture will evolve on its own but will still reflect the values and norms of the company. **Leadership**, the ability or authority to guide and direct others toward achievement of a goal, has a significant impact on ethical decision making because leaders have the power to motivate others and enforce the organization's norms and policies as well as their own viewpoints. Leaders are key to influencing an organization's corporate culture and ethical posture. However, one poll found that less than half (47 percent) of employees in large (2,500 employees or more) organizations think that the senior leadership in their firm is highly ethical.²⁹

Although we often think of CEOs and other top managers as the most important leaders in an organization, the corporate governance reforms discussed in Chapter 4 make it clear that a firm's board of directors is also an important leadership component. Indeed, directors have a legal obligation to manage companies "for the best interests of the corporation." To determine what is in the best interest of the firm, directors can consider the effects that a decision may have on not only shareholders and employees but also other important stakeholders.³⁰ Therefore, when we discuss leadership, we include the corporate directors as well as top executives.

In the long run, if stakeholders are not reasonably satisfied with a company's leader, he or she will not retain a leadership position. A leader must have not only his or her followers' respect but also provide a standard of ethical conduct to them. Former chairman of Korean electronics giant Samsung Group, Lee Kun-hee, resigned in disgrace after 20 years on the Samsung board after being accused of evading \$128 million in taxes. His son and heir to the company, Lee Jae-yong, also resigned from the board. This was only the final in a long string of corruption charges against Lee. He was also convicted of bribery 10 years ago. Since his resignation, the company has sought to improve its image.³¹ Table 5-1 summarizes the steps executives should take to demonstrate that they understand the importance of ethics in doing business.

TABLE 5-1 The Managerial Role in Developing Ethics Program Leadership

1. Organizational commitment from board of directors and top management
2. Organizational resources for ethics initiatives
3. Determine ethical risks and develop contingency plans
4. Develop an effective ethics program to address risks and maintain compliance with ethical standards
5. Provide oversight for implementation and audits of ethical programs
6. Communicate with stakeholders to establish shared commitment and values for ethical conduct.

LEADERSHIP STYLES INFLUENCE ETHICAL DECISIONS

Leadership styles influence many aspects of organizational behavior, including employees' acceptance of and adherence to organizational norms and values. Styles that focus on building strong organizational values among employees contribute to shared standards of conduct. They also influence the organization's transmittal and monitoring of values, norms, and codes of ethics.³² In short, the leadership style of an organization influences how its employees act. For example, the management philosophy of Mike Armstrong, former CEO of AT&T, is characterized by the observations of its lab's chief, David Nagel: "Most bosses hate conflict. Mike is delighted when he sees us getting at each other." Armstrong has been characterized as scary, demanding, a taskmaster, and a maniac—in an affectionate way. The fast-paced, intensely competitive telecommunications industry requires a "nontraditional" leadership style to achieve success.³³ Studying a firm's leadership styles and attitudes can also help pinpoint where future ethical issues may arise. Even for actions that may be against the law, employees often look to their organizational leaders to determine how to resolve the issue.

The ethical leadership concept is not only for CEOs, boards of directors, and managers but can also be fellow employees.

Although we often think of CEOs and other top managers as the most important leaders in an organization, a firm's board of directors is also a required leadership and an oversight component. The ethical leadership concept is not only for CEOs, boards of directors, and managers but can also be fellow employees. Ethical leadership by the CEO requires an understanding of the firm's vision and values, as well as the challenges of responsibility and the risk in achieving organizational objectives. Lapses in ethical leadership can occur even in people who possess strong ethical character, especially if they view the organization's ethical culture as being outside the realm of decision making that exists in the home, family, and community. This phenomenon has been observed in countless cases of so-called good community citizens engaging in unethical business activities. For example, Robin Szeliga, former CFO of Qwest, who pleaded guilty for insider trading, was an excellent community leader, even serving on a college of business advisory board.

Ethical leaders need both knowledge and experience to make decisions. Strong ethical leaders must have the right kind of moral integrity. Such integrity must be transparent or, in other words, do in private as if it were always public. This type of integrity relates to values and is discussed in later chapters. They must be proactive and ready to leave the organization if its corporate governance system makes it impossible to make the right choice. Such right choices are complex by definition. The ethical leader must choose a balance of all involved today as well as in the future. Such a person must be concerned with shareholders as well as the lowest-paid employee. Experience shows that no leader can always be right or judged ethical by stakeholders in every case. The acknowledgment of this may be perceived as a weakness, but in reality it supports integrity and increases the debate exchange of views on ethics and openness.

Six leadership styles that are based on emotional intelligence—the ability to manage ourselves and our relationships effectively—have been identified by Daniel Goleman.³⁴

1. The coercive leader demands instantaneous obedience and focuses on achievement, initiative, and self-control. Although this style can be very effective during times of

crisis or during a turnaround, it otherwise creates a negative climate for organizational performance.

2. The authoritative leader—considered to be one of the most effective styles—inspires employees to follow a vision, facilitates change, and creates a strongly positive performance climate.
3. The affiliative leader values people, their emotions, and their needs and relies on friendship and trust to promote flexibility, innovation, and risk taking.
4. The democratic leader relies on participation and teamwork to reach collaborative decisions. This style focuses on communication and creates a positive climate for achieving results.
5. The pacesetter leader can create a negative climate because of the high standards that he or she sets. This style works best for attaining quick results from highly motivated individuals who value achievement and take the initiative.
6. The coaching leader builds a positive climate by developing skills to foster long-term success, delegating responsibility, and skillfully issuing challenging assignments.

The most successful leaders do not rely on one style but alter their techniques based on the characteristics of the situation. Different styles can be effective in developing an ethical culture depending on the leader's assessment of risks and desire to achieve a positive climate for organizational performance.

Another way to consider leadership styles is to classify them as transactional or transformational. **Transactional leaders** attempt to create employee satisfaction through negotiating, or "bartering," for desired behaviors or levels of performance. **Transformational leaders** strive to raise employees' level of commitment and to foster trust and motivation.³⁵ Both transformational and transactional leaders can positively influence the corporate culture.

Transformational leaders communicate a sense of mission, stimulate new ways of thinking, and enhance as well as generate new learning experiences. They consider employee needs and aspirations in conjunction with organizational needs. They also build commitment and respect for values that provide agreement on how to deal with ethical issues.

Thus, transformational leaders strive to promote activities and behavior through a shared vision and common learning experience. As a result, they have a stronger influence on coworker support for ethical decisions and building an ethical culture than do transactional leaders. Transformational ethical leadership is best suited for organizations that have higher levels of ethical commitment among employees and strong stakeholder support for an ethical culture. A number of industry trade associations—including the American Institute of Certified Public Accountants, Defense Industry Initiative on Business Ethics and Conduct, Ethics and Compliance Officer Association, and Mortgage Bankers Association of America—are helping companies provide transformational leadership.³⁶

In contrast, transactional leaders focus on ensuring that required conduct and procedures are implemented. Their negotiations to achieve desired outcomes result in a dynamic relationship with subordinates in which reactions, conflict, and crisis influence the relationship more than ethical concerns. Transactional leaders produce employees who achieve a negotiated level of performance, including compliance with ethical and legal standards. As long as employees and leaders both find this exchange mutually rewarding, the relationship is likely to be successful. However, transactional leadership is best suited for rapidly changing situations, including those that require responses to

ethical problems or issues. When Eric Pillmore took over as senior vice president of corporate governance at Tyco, after a major scandal involving CEO Dennis Kozlowski, the company needed transitional leadership. To turn the company around, many ethics and corporate governance decisions needed to be made quickly. The company also needed cross-functional leadership, improved accountability, and empowered leaders in order to improve corporate culture. Pillmore helped install a new ethics program that changed leadership policies and allowed him direct communications with the board in order to help implement the leadership transition.³⁷

HABITS OF STRONG ETHICAL LEADERS

Archie Carroll, a University of Georgia business professor, crafted “7 Habits of Highly Moral Leaders” based on the idea of Stephen Covey’s *The 7 Habits of Highly Effective People*.³⁸ We have adapted Carroll’s “7 Habits of Highly Moral Leaders”³⁹ to create our own “Seven Habits of Strong Ethical Leaders” (Table 5-2). In particular, we believe that ethical leadership is based on holistic thinking that embraces the complex and challenging issues that companies face on a daily basis. Ethical leaders need both knowledge and experience to make the right decision. Strong ethical leaders have both the courage and the most complete information to make decisions that will be the best in the long run. Strong ethical leaders must stick to their principles and, if necessary, be ready to leave the organization if its corporate governance system is so flawed that it is impossible to make the right choice.

Many corporate founders—such as Sam Walton, Bill Gates, Milton Hershey, Michael Dell, and Steve Jobs, as well as Ben Cohen and Jerry Greenfield—left their ethical stamp on their companies. Their conduct set the tone, making them role models for desired conduct in the early growth of their respective corporations. In the case of Milton Hershey, his legacy endures, and Hershey Foods continues to be a role model for ethical corporate culture. In the case of Sam Walton, Wal-Mart embarked on a course of rapid growth after his death and became involved in numerous conflicts with various stakeholder groups, especially employees, regulators, competitors, and communities. Despite the ethical foundation left by Sam Walton, Wal-Mart, as well as most large corporations, deals with hundreds of reported ethical lapses every month.⁴⁰

TABLE 5-2 Seven Habits of Strong Ethical Leaders

1. Ethical leaders have strong personal character.
2. Ethical leaders have a passion to do right.
3. Ethical leaders are proactive.
4. Ethical leaders consider stakeholders’ interests.
5. Ethical leaders are role models for the organization’s values.
6. Ethical leaders are transparent and actively involved in organizational decision making.
7. Ethical leaders are competent managers who take a holistic view of the firm’s ethical culture.

Ethical Leaders Have Strong Personal Character

There is general agreement that ethical leadership is highly unlikely without a strong personal character. The question is how to teach or develop a moral person in a corporate environment. Thomas I. White, a leading authority on character development, believes the focus should be on “ethical reasoning” rather than on being a “moral person.” According to White, the ability to resolve the complex ethical dilemmas encountered in a corporate culture requires intellectual skills.⁴¹ For example, when Lawrence S. Benjamin took over as president of U.S. Food Service after a major ethical disaster, he initiated an ethics and compliance program to promote transparency and to teach employees how to make difficult ethical choices. A fundamental problem in traditional character development is that specific values and virtues are used to teach a belief or philosophy. This approach may be inappropriate for a business environment where cultural diversity and privacy must be respected. On the other hand, teaching individuals who want to do the right thing regarding corporate values and ethical codes, and equipping them with the intellectual skills to address the complexities of ethical issues, is the correct approach.

Ethical Leaders Have a Passion to Do Right

The passion to do right is “the glue that holds ethical concepts together.” Some leaders develop this trait early in life, whereas others develop it over time through experience, reason, or spiritual growth. They often cite familiar arguments for doing right—to keep society from disintegrating, to alleviate human suffering, to advance human prosperity, to resolve conflicts of interest fairly and logically, to praise the good and punish the guilty, or just because something “is the right thing to do.”⁴² Having a passion to do right indicates a personal characteristic of not only recognizing the importance of ethical behavior but also the willingness to face challenges and make tough choices. Courageous leadership requires making and defending the right decision. Consider the crisis faced by Harry Kraemer, the CEO of Baxter International, after 53 dialysis patients died during treatment. “We have this situation. The financial people will assess the potential financial impact. The legal people will do the same. But at the end of the day, if we think it’s a problem that a Baxter product was involved in the deaths of 53 people, then those other issues become pretty easy. If we don’t do the right thing, then we won’t be around to address those other issues.”⁴³

Ethical Leaders Are Proactive

Ethical leaders do not hang around waiting for ethical problems to arise. They anticipate, plan, and act proactively to avoid potential ethical crises.⁴⁴ One way to be proactive is to take a leadership role in developing effective programs that provide employees with guidance and support for making more ethical choices even in the face of considerable pressure to do otherwise. Ethical leaders who are proactive understand social needs and apply or even develop “the best practices” of ethical leadership that exist in their industry. One of *Fortune* magazine’s Best Companies to Work For in 2009, office furniture maker Herman Miller is also known for its highly ethical culture. *Fortune* also has ranked it the Most Admired Company in its industry for the past 20 years. Its strong ethical culture has placed Herman Miller at the top of the Human Rights Campaign’s Corporate Equality Index for years. Additionally, the company ranks as one of the safest, coolest, and most ethical companies in its industry.⁴⁵ Strong leadership is key in maintaining such impressive credentials over the long term.

Ethical Leaders Consider Stakeholders' Interests

Ethical leaders consider the interests of and implications for all stakeholders, not just those that have an economic impact on the firm. This requires acknowledging and monitoring the concerns of all legitimate stakeholders, actively communicating and cooperating with them, employing processes that are respectful of them, recognizing interdependencies among them, avoiding activities that would harm their human rights, and recognizing the potential conflicts between leaders' "own role as corporate stakeholders and their legal and moral responsibilities for the interests of other stakeholders."⁴⁶

Ethical leaders have the responsibility to balance stakeholder interests to ensure that the organization maximizes its role as a responsible corporate citizen. In addition to being one of the world's most admired companies, according to *Fortune* magazine, Xerox has taken significant strides toward reducing its environmental impact, increasing social responsibility, and improving diversity. Xerox is the largest document management and technology company in the world with sales of over \$17.6 billion annually, and as such a large company it produces a lot of waste every day. Xerox is aware of its carbon footprint and has produced such innovations as erasable paper to be used in testing machines so that the company does not throw away so much paper each day. The company also aims to be carbon neutral and tries to source its paper from sustainable sources.⁴⁷ The company also recently celebrated some significant diversity milestones. In 2009 Ursula Burns became the first African American female to be the CEO of a major American company, and Xerox was the first major company in history to have a female-to-female CEO succession.⁴⁸ The company also extends its commitment to diversity to suppliers as well, because its own research has found that minority and women-owned businesses often have higher standards.⁴⁹

Ethical Leaders Are Role Models for the Organization's Values

If leaders do not actively serve as role models for the organization's core values, then those values become nothing more than lip service. According to behavioral scientist Brent Smith, as role models, leaders are the primary influence on individual ethical behavior. Leaders whose decisions and actions are contrary to the firm's values send a signal that the firm's values are trivial or irrelevant.⁵⁰ Firms such as Countrywide Financial articulated core values that were only used as window dressing. On the other hand, when leaders model the firm's core values at every turn, the results can be powerful.

Consider Whole Foods, the world's largest organic and natural grocer. Ever since its conception in Austin, Texas, in 1980, Whole Foods has demonstrated a commitment to social responsibility and strong core values. (See Table 5-3) In addition to providing consumers with fresh, healthy foods, Whole Foods cares for its employees by creating a transparent and friendly work environment. The company encourages a sense of teamwork through imposing a salary cap for top executives. The company also works to support growers and the environment through sourcing from sustainable growers and such efforts as recycling and reducing energy whenever possible. Whole Foods donates a minimum of 5 percent of profits to local communities in which it operates. Especially in a time of repeated food contamination scares, many people are drawn to grocers like Whole Foods because of its high quality standards, educational initiatives, and close relationships with many of its suppliers.⁵¹

TABLE 5-3 Whole Food's Core Values

- Selling the highest quality natural and organic products
- Satisfying and delighting our customers
- Supporting team member happiness and excellence
- Creating wealth through profits and growth
- Caring about our communities and our environment
- Creating ongoing win-win partnerships with our suppliers
- Promoting the health of our stakeholders through healthy eating education.

Source: "Our Core Values," Whole Foods Markets, www.wholefoodsmarket.com/company/corevalues.php (accessed June 5, 2009).

Ethical Leaders Are Transparent and Actively Involved in Organizational Decision Making

Being transparent fosters openness, freedom to express ideas, and the ability to question conduct, and it encourages stakeholders to learn about and comment on what a firm is doing. Transparent leaders will not be effective unless they are personally involved in the key decisions that have ethical ramifications. Transformational leaders are collaborative, which opens the door for transparency through interpersonal exchange. Earlier we said that transformational leaders instill commitment and respect for values that provide guidance on how to deal with ethical issues. Herb Baum, former CEO of the Dial Corporation, says, "In today's business environment, if you're a leader—or want to be—and you aren't contributing to a values-based business culture that encourages your entire organization to operate with integrity, your company is as vulnerable as a baby chick in a pit of rattlesnakes." Baum's three remarkably simple principles of transparency are (1) tell the whole truth, (2) build a values-based culture, and (3) hire "people people."⁵²

Ethical Leaders Are Competent Managers Who Take a Holistic View of the Firm's Ethical Culture

Ethical leaders can see a holistic view of their organization and therefore view ethics as a strategic component of decision making, much like marketing, information systems, production, and so on. Although his company is called Waste Management, CEO David P. Steiner is as committed to renewable energy as just about anyone working for a multibillion dollar business. Steiner was selected as one of the 100 Most Influential People in Business Ethics by the Ethisphere Institute in 2007, and his company, Waste Management, was chosen as one of the World's Most Ethical Companies in 2008.⁵³ Steiner likes to point out that Waste Management produces more renewable energy than the entire U.S. solar industry. In fact, nearly half of the company's revenues come from "green" services.⁵⁴ Steiner's personal commitment to social responsibility and sustainability has dramatically changed a company that was previously known primarily as a garbage collection service.

The challenge of being an effective leader is illustrated in Table 5-4. Most senior executives believe that it is much more challenging to be a leader in today's business environment compared to five years ago. Leadership continues to be one of the most important drivers of ethical conduct in organizations.

TABLE 5-4 Leadership Is More Challenging in Today's Business Environment

Do you think it is more or less challenging to be a company leader in today's business environment compared with five years ago?	
More challenging	89%
No change	9%
Less challenging	1%
Don't know	1%

Source: Robert Half Management Resources poll of 150 senior executives at companies with revenue of \$1 billion to \$40 billion, in USA Today, March 6, 2006, B1.

SUMMARY

The key components of the ethical decision making framework include ethical issue intensity, individual factors, organizational factors, and opportunity. These factors are interrelated and influence business ethics evaluations and intentions, which result in ethical or unethical behavior.

The first step in ethical decision making is to recognize that an ethical issue requires that an individual or work group choose among several actions that will ultimately be evaluated as ethical or unethical by various stakeholders. Ethical issue intensity is the perceived relevance or importance of an ethical issue to the individual or work group. It reflects the ethical sensitivity of the individual or work group that triggers the ethical decision process. Other factors in our ethical decision making framework influence this sensitivity, thus determining why different individuals often perceive ethical issues differently.

Individual factors such as gender, education, nationality, age, and locus of control can affect the ethical decision making process, with some factors being more important than others. Organizational factors such as an organization's values often have greater influence on an individual's decisions than that person's own values. In addition, decisions in business are most often made jointly, in work groups and committees, or in conversations and discussions with coworkers. Corporate cultures and structures operate through the individual relationships of the organization's members to influence those members' ethical decisions. A corporate culture can be defined as a set of values, beliefs, goals, norms, and ways of solving problems that members (employees) of an organization share. Corporate culture involves norms that prescribe a wide range of behavior for the organization's members. The ethical culture of an organization indicates whether it has an ethical conscience. Significant others—including peers, managers, coworkers, and subordinates—who influence the work group have more daily impact on an employee's decisions than any other factor in the decision making framework. Obedience to authority may explain why many business ethics issues are resolved simply by following the directives of a superior.

Ethical opportunity results from conditions that either provide rewards, whether internal or external, or limit barriers to ethical or unethical behavior. Included in opportunity is a person's immediate job context, which includes the motivational techniques superiors use to influence employee behavior. The opportunity employees have for unethical behavior in an organization can be eliminated through formal codes, policies, and rules that are adequately enforced by management.

The ethical decision making framework is not a guide for making decisions. It is intended to provide insights and knowledge about typical ethical decision making processes in business organizations. Ethical decision making within organizations does not rely strictly on the personal values and morals of employees. Organizations have a culture of their own, which when combined with corporate governance mechanisms may significantly influence business ethics.

Leadership styles and habits promote an organizational ethical climate. Leadership styles include coercive, authoritative, affiliative, democratic, and coaching elements. Transactional leaders negotiate or barter with employees. Transformational leaders strive for a shared vision and common learning experience. Strong ethical leaders have a strong personal character, have a passion to do the right thing, are proactive, focus on stakeholders' interests, are role models for the organization's values, make transparent decisions, and take a holistic view of the firm's ethical culture.

IMPORTANT TERMS FOR REVIEW

ethical issue intensity	locus of control	significant other	leadership
moral intensity	external control	obedience to authority	transactional leader
gender	internal control	opportunity	transformational leader
education	corporate culture	immediate job context	
nationality	ethical culture		

RESOLVING ETHICAL BUSINESS CHALLENGES*

Peter had been a human resource (HR) manager for 18 years and vice president for 2 more years for Zyedego Corporation, a small company in New Orleans. In the last decade, there have been many changes to what potential/actual employees can be asked and what

constitutes fair and equitable treatment. Frankly, the situation Peter was in was partly his own fault.

The first issue began with Hurricane Katrina. In its wake, Zyedego employees had been working around the clock to get the company up and running



again. The company had been calling all employees (if they could locate them) to get them to return to work. Gwyn, one of Peter's HR managers, was planning on rehiring Dana Gonzales but found out that Dana was pregnant. Because of the "rough" condition of the

workplace, Gwyn was concerned for Dana's safety. Gwyn felt that if Dana were rehired, employees' hourly wages should be decreased by 25 percent because the company had experienced setbacks during the hurricane and had to work with a reduced

budget. In addition, Gwyn had some concerns over Dana's citizenship because her passport appeared to be questionable. The flooding destroyed the original documents, and although Gwyn requested new documents, Dana had been slow in providing them. Gwyn had asked some difficult questions, and Dana stated that if not rehired she would go to a competitor and expected the company to pay severance of two weeks' wages for the time she was out of work during the hurricane. Another issue is the hiring of truck drivers. Zyedego hires many truck drivers and routinely requests driving records as part of the preemployment process. Several of the potential new hires have past DWI records. All have stated that they would never do it again, have maintained a clean record for at least five years, and understand the consequences of another infraction. Gwyn has hired some drivers with infractions to secure the necessary number of drivers needed for the company. However, Gwyn has some concerns over whether she is exposing the company to unnecessary risk because of the increased potential for accidents or repeat DWI violation. From Peter, Gwyn needs guidance related to continuing these hiring practices.

However, Zyedego has even deeper problems, which is what concerns Peter. The problem really started when Peter was still an HR manager, and involves one "family." Guy Martin started working for Zyedego 20 years ago. He was married with two children, and had a mortgage. A little over a year ago, Guy separated from his wife, and they divorced only to remarry six months later. When Guy was hired, Peter had made sure that Guy's son, who has asthma, would be covered by health insurance. Peter also helped out the family several times when money was tight and provided Guy with overtime work. But tragedy struck the Martins when Guy was killed in the hurricane. Police and rescue workers hunted for his body, but it was never found. Because Martha, Guy's wife, was a stay-at-home mother, their only income had been from Zyedego. The company's death benefits provide only 50 percent of the deceased's pension for a surviving spouse. Also, because the body had not been found, there was the legal question of death. Usually, it takes seven years before one can claim any type of insurance or death-benefit

payments, as well as medical insurance, for the family. Even with Social Security benefits, Martha would probably lose the house and could be forced to seek employment.

Zyedego had sustained substantial losses since the hurricane. Insurance companies were extremely slow concerning payments to all the small businesses, arguing about wind versus water damage. Impeding the process of obtaining benefits was the lack of many documents destroyed in the storm.

The storm really began for Peter late last week when he met with the insurance company about medical reimbursements, death benefits, and the pension plans. Darrell Lambert was the chief adjuster for Zyedego's insurance and pension provider.

"Here's another case that we will not cover," said Darrell as he flipped the file to Peter. "We can't help the Martins for a variety of reasons. There is no body, which means no payment until after a judge declares him legally dead. That will take at least a year. While that is being settled, Mrs. Martin and her family will not be eligible for medical coverage unless Zyedego is going to pay their amount. Finally, and I know this may sound heartless, but Mrs. Martin will only get a maximum of half of Mr. Martin's pension."

"But he was killed on the job!" exclaimed Peter.

"Did you require him to work that day? Did he punch in or out? Is there any record that he was called in from Zyedego to help? The answer is no to all of the above. He helped because he felt obligated to Zyedego. But I am not Zyedego, and I do not have any obligation to the Martins," Darrell said with a smile.

"Peter," exclaimed Darrell, "I know that Zyedego is under intense financial pressure, but we are too. You have approximately 100 families that we will have to pay something to. You and I can spend the next 12 months going over every case, bit-by-bit, item-by-item, but if that's what you want, Zyedego will go into bankruptcy. We don't want that to happen. But we also are not going to pay for everything that you claim you are due. Our lawyers will stall the system until you go broke, and your 100 families will get nothing. Well, maybe something in five to seven years. What I am

proposing is a way for you to stay in business and for my company to reduce its financial payouts. Remember, we have hundreds of small businesses like you to deal with.”

Darrell then calmly said, “My proposal is that you look over these files and reduce your total reimbursements to us by 40 percent. To help you out, I’ll start with this case [Martin’s]. You decide whether we pay out 40 percent or nothing. Tomorrow at 9:00 A.M., I want you to have 25 cases, including this one, pared down by 40 percent. If not, well, I’m sure my superiors have informed your superiors about this arrangement by now. You should be getting a call within the hour. So, I’ll see you here at 9:00,” and Darrell walked out the door.

Several hours later, Peter received a phone call from upper management about the deal he was to implement to save the company.

QUESTIONS • EXERCISES

1. What are the legal and ethical risks associated with the decision about hiring truck drivers at Zyedego?
2. What should Peter recommend to Gwyn about Dana’s case?
3. Do you think Peter is too emotionally attached to the Martin case to make an objective decision?

*This case is strictly hypothetical; any resemblance to real persons, companies, or situations is coincidental.

CHECK YOUR EQ

Check your EQ, or Ethics Quotient, by completing the following. Assess your performance to evaluate your overall understanding of the chapter material.

- | | | |
|--|------------|-----------|
| 1. The first step in ethical decision making is to understand the individual factors that influence the process. | Yes | No |
| 2. Opportunity describes the conditions within an organization that limit or permit ethical or unethical behavior. | Yes | No |
| 3. Transactional leaders negotiate compliance and ethics. | Yes | No |
| 4. The most significant influence on ethical behavior in an organization is the opportunity to engage in (un)ethical behavior. | Yes | No |
| 5. Obedience to authority relates to the influence of corporate culture. | Yes | No |

Answers **1. No.** The first step is to become more aware that an ethical issue exists and to consider its relevance to the individual or work group. **2. Yes.** Opportunity results from conditions that provide rewards or fail to erect barriers against unethical behavior. **3. Yes.** Transactional leaders barter or negotiate with employees. **4. No.** Significant others have more impact on ethical decisions within an organization. **5. No.** Obedience to authority relates to the influence of significant others and supervisors.