

# Strategic leadership of ethical behavior in business

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## Executive Overview

*The strategic leadership of ethical behavior in business can no longer be ignored. Executives must accept the fact that the moral impact of their leadership presence and behaviors will rarely, if ever, be neutral. In the leadership capacity, executives have great power to shift the ethics mindfulness of organizational members in positive as well as negative directions. Rather than being left to chance, this power to serve as ethics leaders must be used to establish a social context within which positive self-regulation of ethical behavior becomes a clear and compelling organizational norm and in which people act ethically as a matter of routine. This article frames the responsibility for strategic leadership of ethical behavior on three premises: (1) It must be done—a stakeholder analysis of the total costs of ethical failures confirms the urgency for ethics change; (2) It can be done—exemplars show that a compelling majority of an organization's membership can be influenced to make ethical choices; (3) It is sustainable—integrity programs help build and confirm corporate cultures in which principled actions and ethics norms predominate.*

The once fashionable notion that business ethics could be safely relegated toward the bottom of the corporate "things to do" list exists no longer. Like the roaring 1920's, the roaring 1990's ended with a crash, and amid the carnage we awoke to a blizzard of sensational headlines: WorldCom Facing Charges of Fraud; How Enron Bosses Created a Culture of Pushing Limits; Andersen's Wrong Turns Grew Obvious; A 'Stellar Reputation' Shattered, to recall just a few. Ethical failures became facts of the new century, not just textbook possibilities. The reports were as discouraging as they were elucidating; they left us feeling cynical, pessimistic, and even helpless regarding the state of business leadership in our society. Now we can look back and say that it needn't be so; a more positive and promising perspective can be taken from this experience. Nancy Higgins, newly appointed Executive Vice President and Chief Ethics Officer for MCI, says:

Out of difficult times often spring innovation and resiliency. MCI will emerge from its recent troubled past as a beacon of ethical leadership, where employees at all levels understand and commit to the highest standards of

behavior. Our goal, which is fully realizable, is to create a culture where ethics permeates the company and forms a portion of every business decision we make, at every level.<sup>1</sup>

The ethics message that begins at the top of a firm and cascades down and throughout its membership can be positive, neutral, or negative. Only the former is acceptable. Consistent ethical behavior in organizations cannot be left to chance;<sup>2</sup> it cannot be abandoned to external regulation. As Barbara Ley Toffler suggests, "The sad fact is that all the oversight in the world is not going to change what happens behind company doors."<sup>3</sup> Like profits, shareholder value, return on investment, or any other desired performance outcome, ethical behavior in business is something to be created. Executives must accept their leadership responsibilities to define ethical behavior clearly into a firm's value system and to pursue it relentlessly as a top-priority goal.

There is too much at stake for this ethics leadership agenda to be denied. Recent experience with a troubled economy has taught citizens that business is an essential part of the social fabric. They

are also recognizing, perhaps belatedly, that when business fails ethically, we all fail. Rebuilding the ethical character of our institutions and regaining public confidence in them are realizable aspirations. Real progress, however, can be made only when the initiatives for ethics change come from within the firm and from its leaders.

Writing in this journal in 1999, Michael Hitt and Duane Ireland defined *strategic leadership* as "a person's ability to anticipate, envision, maintain flexibility, think strategically, and work with others to initiate changes that will create a viable future for the organization."<sup>4</sup> We believe that for business executives the strategic leadership responsibility for "initiating changes" has to include the goals of creating and sustaining ethical climates within which employees act ethically as a matter of routine. We also recognize that in fulfilling this responsibility, executives face the same leadership challenges as in any large-scale organizational change program. Borrowing from John Kotter's work on transformational change, we suggest that successful ethics change initiatives will require that leaders: (1) create a sense of urgency to break any sense of complacency; (2) take action to center momentum for change within the membership; and, (3) anchor changes in the organization's culture to make them sustainable.<sup>5</sup>

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Our purpose here is to discuss how executives can utilize Kotter's framework to confidently pursue change that leads organizations strategically toward sustainable ethical behavior. The article focuses on three key premises for the strategic leadership of ethical behavior in business: (1) *It must be done*—a sense of urgency for ethics change can be confirmed and aroused by analysis of the total costs of ethical failures; (2) *It can be done*—exemplars show that leadership acts can influence a substantial majority of an organization's membership to make ethical choices; (3) *It is sustainable*—through integrity programs executives can help build and confirm corporate cultures in which principled actions and ethics norms predominate.

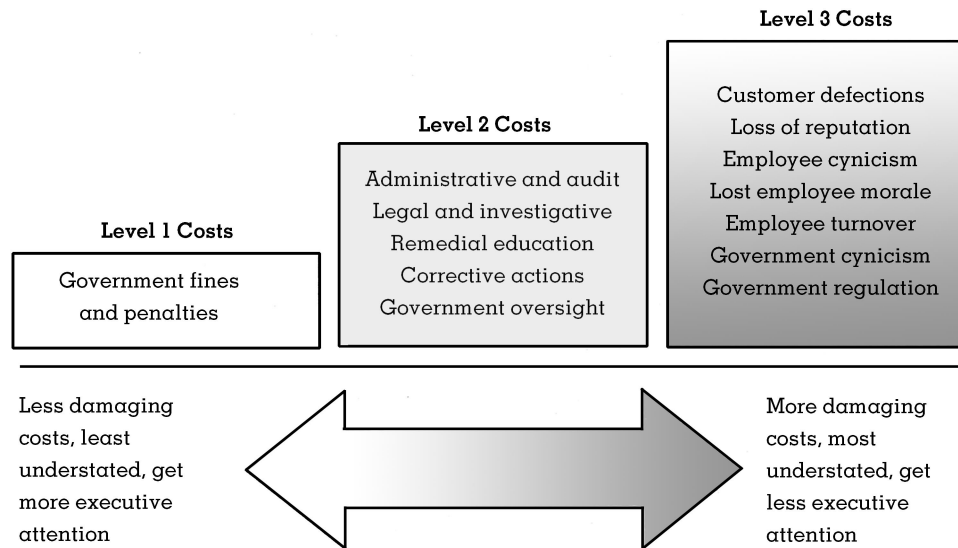
## **It Must Be Done**

In December of 2001, three months after the attack on the World Trade Center, Enron declared bankruptcy, the largest in U.S. history. In July 2002, the WorldCom bankruptcy bettered Enron by 60 per cent, coming in at \$104 billion. Caught in Enron's web of catastrophe, Arthur Andersen, LLP, with breathtaking speed, fell from being one of the largest certified public accounting firms in the world to extinction. This eventful period also witnessed 11 other of the largest bankruptcies in U.S. history.<sup>6</sup> Although these cases certainly involved basic business errors, the roots of the Enron, WorldCom, and many of the other bankruptcies were not confined to poor business models or misjudgments of markets. They involved substantial and well-documented failures of ethics.<sup>7</sup> Notwithstanding efforts by employees like Sherron Watkins and Margaret Ceconi of Enron to expose wrongdoing, executives engaged in and supported unethical practices to the point that they became acceptable in organizational norms.<sup>8</sup> Lynn Sharp Paine has noted the significance of this phenomenon, saying: "Unethical business practice involves the tacit, if not explicit, cooperation of others and reflects the values... and behavioral patterns that define an organization's operating culture."<sup>9</sup>

## **Stakeholders and the Costs of Ethics Failures**

Crucial to creating the sense of urgency regarding ethical business behavior is an accurate appreciation of the full costs of ethical failures. Yet many of these costs appear nowhere in an annual report, on the balance sheet, or in the income statement, even though they are real and, in extreme cases, are of such significance that they can literally destroy the company. In Figure 1 we describe the potential business costs of ethics failures at three levels. As shown in the figure, we contend that some of these costs, particularly those at higher levels, are chronically undervalued in executive decision-making, even to the point of often escaping management's attention entirely. This tendency is explained in the work of scholars David Messick and Max Bazerman as due to lack of knowledge and common reasoning errors.<sup>10</sup> Specifically, they argue that a common human trait is to ignore important stakeholders when making decisions and resolving problems. Even when stakeholders are considered, furthermore, it is common to undervalue their potential impact.

Different ethical pressures emanate from primary and secondary organizational stakeholders.<sup>11</sup> Primary stakeholders are employees, manag-



**FIGURE 1**  
Executive Decisions and the Business Costs of Ethical Failures

ers, owners, suppliers, and customers; secondary stakeholders are individuals and groups that create or influence the environments in which business operates, like civil society organizations (NGOs), governments, and communities. All stakeholders can impose costs on an organization that has experienced a major ethical failure. When one considers how stakeholders affect organizations, secondary stakeholders may be viewed with more urgency by executives than primary stakeholders. The government can shut down a business in a matter of hours; it takes much longer for disgruntled customers to have such a drastic effect.

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The *Level 1* costs of ethical failure are the easiest to calculate because they concern stakeholders of which executives are keenly aware: themselves, their company, and the government. These are the costs of fines and penalties attendant upon a civil settlement or a conviction that arises out of an ethics failure. In the Enron case, for example, Andersen's ethical and legal wrongdoings were: failure in its audit duty to question certain Enron

transactions, conflict of interest in performing dual roles of auditor and management consultant, and acting through its employees to commit the crime of obstruction of justice in an attempt to cover up its unethical acts. At its sentencing for obstruction, the firm received a fine of \$500,000.<sup>12</sup> This amount of money, on its own, would have had no material effect on Andersen's financial health, which was valued at four billion dollars before the scandal.<sup>13</sup> Compared with Andersen's value and the tens of millions of dollars Andersen was making from its Enron accounts, these *Level 1* costs were entirely bearable. They were the *least* serious and *most survivable* burdens of ethical failure suffered by the firm.

The *Level 2* costs are primarily administrative in nature: the "clean-up" costs. These costs are sometimes difficult to ascribe to any particular ethics failure. Consisting of such things as attorney and audit fees, investigative costs, and the cost of remedial actions, they are frequently buried within the general costs of doing business. We are unaware of any standard accounting method that systematically ties these costs directly to specific ethics failures with which they are associated. As such, we believe them to be significantly underappreciated by management.

Andersen incurred heavy *Level 2* costs. To defend itself against lawsuits filed by clients, investors, and the government, Andersen had to retain the services of expensive lawyers, auditors, and other professionals, all of whom are inevitably called in when any firm gets into serious trouble. These costs far exceeded Andersen's *Level 1* costs

and doubtlessly ran into the multiple millions of dollars. Although severe, these Level 2 costs of ethics failure were also likely survivable by Andersen.

Level 3 costs are the most difficult to quantify and as such are most likely to be underappreciated by executives. They include such things as customer defection, reputation loss, morale loss, employee and government cynicism, and, ultimately, increased government regulation. The stakeholder base for these costs are customers, employees, investors, and the voting public, all of whom hold expectations for business performance. The first instinct of a firm's management may well be to discount or deride the Level 3 costs associated with the interests of these stakeholders when facing significant business problems. But, they do so at their extreme peril.

As the Andersen case clearly demonstrates, Level 3 costs can be devastating. They effectively ended the 100+ year history of the firm. The Enron aftermath left the firm's reputation in shreds, with its problems broadcast widely in every medium from front-page news reports to late night television jokes to editorial cartoons. Morale among employees, the vast majority of whom had done nothing wrong and had no responsibility for the debacle, plunged. Many, fearing for their jobs, left the firm, causing a severe talent drain. As soon as the company was indicted, the loss of reputation and fear of more problems caused dozens of Andersen's longstanding customers to defect. Ultimately, the cascading effect of Level 3 costs crushed the life out of a firm that, as we have seen, could have easily withstood both the Type 1 and Type 2 costs. When Texas, on August 16, 2002, became the first state to revoke Andersen's accounting license, the company's fate was sealed.

### *Limits of Government Regulation*

Externalities pushed the negative impact of Andersen's ethics failures far beyond the firm alone. Others in the auditing industry incurred costs as they scrambled to rethink and restructure their businesses to avoid similar fates. The case provoked government intervention in the attempt to substitute external regulations for the lack of ethics leadership at the firm and industry levels. President Bush signed the Sarbanes-Oxley Act into law on July 30, 2002. This act makes it easier for CEOs and CFOs to go to jail for financial misconduct. It creates a new standard (Section 404) for auditors to sign off on reporting processes within the companies they audit. It also creates a new regulatory body: The Public Company Accounting

Oversight Board. Its substantial budget will be drawn from fees assessed against public companies. In a final irony, the salary of the Board chairperson for one year will be greater than the Level 1 costs Andersen faced for obstruction of justice.

Public choice theory suggests that government regulation of this nature is prompted as elected officials respond to voter demand.<sup>14</sup> When there is a crisis, voters demand a solution and look to elected officials to provide one. If the officials fail to do so, they suffer in the next election. There are many historical examples of governmental reaction to ethical disasters through the blunt expedient of increased regulation. The creation of the SEC and other legislation followed the Crash of 1929. Creation of the EPA followed environmental disasters in the 1960s. The Foreign Corrupt Practices Act of 1977 followed Lockheed's bribes of government officials. True to form, in the wake of the Enron, WorldCom, and Andersen debacles, Congress passed the Sarbanes-Oxley Act.

Ultimately, the costs of increased governmental oversight and regulation are passed along to society in the form of higher prices and taxes. At the level of the firm, government regulation of business generally creates Level 1 costs. No matter how great they are, these costs are absorbed by most businesses, typically by passing them on to consumers in the form of higher prices for goods and services. The unfortunate result is that even well-intended external ethics interventions by government regulation fail to create significant urgency for comprehensive ethics change.<sup>15</sup> The attempt to substitute regulatory interventions for ethics leadership, can, paradoxically, mask the absence of leadership.

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### *Change Urgency and the Costs of Ethical Failure*

Not all firms suffering ethical failures will collapse in the spectacular fashion of Andersen. Most will absorb their punishment and move on, inherently weaker perhaps, but still functioning. Because these firms will generally survive, the full costs of ethics failure are likely to remain undetected and/or underestimated as decision-makers make the choices that determine future business behavior. It is crucial to understand, however, that given today's historically high level of public and gov-

ernment oversight of every aspect of corporate governance, every ethics failure at *any* firm now carries with it significant risk that the firm will experience a debilitating combination of Level 1, Level 2, and Level 3 costs. Granted, as we move up in levels (from Level 1 to Level 3), the costs become more insidious and easier to overlook because by their nature they defy ready quantification. While the Level 1 and Level 2 costs that accompany the specter of top executives being led away in handcuffs cannot be ignored, how, for example, does one quantify the Level 3 costs of lost productivity attributable to employee cynicism or lowered morale in those left behind? What is the loss in market value that results from such a blot on a firm's reputation?

Although executives may not possess the tools to quantify all these costs, gaining a better appreciation of their existence and importance establishes a compelling urgency for sincere ethics change. Respondents in a Cone-Roper poll, for example, show that the public today is increasingly willing to raise Level 3 costs to punish unethical firms in these ways:<sup>16</sup>

- 91% would consider switching to another company's products or services.
- 85% would speak out against that company among family and friends.
- 83% would refuse to invest in that company's stock
- 80% would refuse to work at that company.
- 76% would boycott that company's products or services.
- 68% would be less loyal to a job at that company.

Only with awareness of all relevant stakeholders and full realization of the special devastation that all levels of costs can wreak will business leaders feel the urgency to take ethics seriously. Only when they take ethics seriously, moreover, can we expect them to commit to strategic leadership that establishes and maintains ethical climates in their firms. Skeptics may say that all this is well and good in theory, but it won't work in practice. In the broader business experience, however, there are ready examples that help to counter this claim.

### It Can Be Done

After becoming CEO and chairperson of Alcoa in 1987, Paul O'Neill said: "I went to Alcoa with a burning fire. . . to demonstrate that it is possible for a truly great organization to be values based without any reservations."<sup>17</sup> One ethical value that O'Neill championed was workplace safety. When it came to human dignity, he believed that all

Alcoa employees had rights to a safe workplace. At the time of his arrival, the annual lost workday rate was 1.87, well below the industry average. The firm's managers were proud to inform their new CEO of this number. To their chagrin, O'Neill told them it was not good enough. Behind the numbers were people with names and faces who were killed or injured; behind the names and faces were families and friends who were also suffering. Under O'Neill's leadership, workplace safety was not an issue mandated by law or regulation. It was an ethical obligation. The goal was zero in lost workdays.

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O'Neill pursued this goal using some old-fashioned and very effective leadership techniques. He gathered together the members of his executive team and clearly communicated the goal. He told them that workplace safety was about values, not about saving money. He even went so far as to say that if anyone calculated how much money safety would save the company, that person would be fired. He visited Alcoa plants, speaking with managers and employees to communicate his message about workplace safety. He told them that whenever anyone faced a safety issue it should be fixed, no matter what the expense. And he tied promotions, evaluations, and firing to workplace safety. The result was impressive. When O'Neill left in 1999, Alcoa's lost workday rate was .014.

### Ethics Mindfulness

Writing about high-reliability organizations such as nuclear power stations and air traffic control centers, Karl E. Weick, Kathleen M. Sutcliff, and David Obstfeld discuss the concept of "mindfulness."<sup>18</sup> They consider it a form of "enriched awareness" among organizational members regarding the potential for catastrophe and resulting in an ever-present conscious engagement of personal responsibility to prevent its occurrence. In the context of O'Neill's campaign for improved workplace safety at Alcoa, executives would do well to consider that ethical leadership can and should be directed toward raising *ethics mindfulness* among organizational memberships.

This discussion reminds us of John Dewey's no-

tion that ethics is a matter of "reflective conduct" in which ethical thinking becomes a foundation for ethical action.<sup>19</sup> It also suggests that ethics mindfulness is part of what psychologists refer to as individual self-identity, a moral self-identity that is an enduring and an ever-present positive influence on behavior.<sup>20</sup> Ethics mindfulness becomes a form of self-regulation that causes one to behave with an ethical consciousness from one decision or behavioral event to another.<sup>21</sup> The leadership implications here are quite profound. Albert Bandura's classic work with social learning theory shows that self-regulation is highly responsive to learning from one's social context.<sup>22</sup> When people are exposed to role models who display self-regulatory behaviors, they also learn and subsequently display such behaviors. Following this reasoning, ethics leadership must be leadership that helps activate ethics mindfulness in others. This process, however, begins only when leaders develop and display personal ethics mindfulness, thus becoming models for positive learning by others.

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As with self-regulatory behavior in general, ethics mindfulness in the organizational membership is responsive to and even largely dependent on leadership activation and support. People benefit from assistance in meeting self-regulatory challenges such as resisting temptation, delaying gratification, maintaining attention, and, in general, maintaining sufficient willpower and determination to do what is required.<sup>23</sup> Providing this assistance to activate and maintain positive self-regulation toward ethical behavior is a leadership responsibility. The goal is not to separately influence each decision; the goal is to activate self-regulation that influences each decision.

We believe that O'Neill's success with workplace safety at Alcoa came about in substantial part because his leadership changed the ethical culture of the firm in a way that made everyone more mindful about workplace safety. The new culture encouraged employees and managers to take ethical action without extensive delay, supporting positive self-regulation. When faced with safety issues, the mindful employee response at Alcoa became "fix it," without someone telling them explicitly to do so. Instilling such ethics mindfulness in the organization's culture should

be a strategic leadership goal. We are confident that it is an achievable goal.

***Leadership and the Social Context for Ethical Behavior***

The executive task we are describing is to lead with a commitment to ethics mindfulness—to model positive self-regulation that values how business goals are accomplished as much as the goals themselves. Such leadership helps build an internal culture rich in the activation of similar positive self-regulation and ethics mindfulness by others. Consider this example.

Costco, a major player in the retail market, was expanding overseas. While investigating a move into the United Kingdom, its bankers recommended a way of structuring a borrowing transaction so that both principal and interest on the loan were tax deductible, as opposed to interest only, as is generally the case. The transaction would provide both significant tax savings and a lower effective rate of interest. When Costco executives looked more deeply at this issue, it became clear that the tax saving was an unintended consequence of the tax code.

*Mindful ethics response.* The company's top management decided that although the transaction would follow the letter of the law, it would not fall within the "spirit" of the law.<sup>24</sup> The leadership chose to forego the tax benefits. As Richard Galanti, Costco's CFO, says: "It did not pass the smell test."<sup>25</sup>

We believe this case illustrates how mindfulness can trigger further inquiry that leads to a fully informed decision,<sup>26</sup> one consistent with a company's strategic emphasis on ethics. It also suggests how significant leadership acts reinforce ethics mindfulness by strengthening and communicating ethics values throughout an organization. At Costco this and other similar incidents have become part of the cultural lore, and these stories are often retold.

Ethics mindfulness can also result in an ethical judgment and action that is virtually simultaneous with confronting an issue. Consider this example.

A mid-level manager at Fran-Tech, a Seattle software company, received a CD-ROM set containing the source code for a competitor's software product. The competitor was the market leader in the software niche in which

both companies competed; it was crushing Fran-Tech in the marketplace. An anonymous note accompanying the package stated that the package was sent by a disgruntled employee of the competitor and urged the recipient to use the data "as you see fit." The manager receiving the data was considered to be a "star" performer by her boss and her peers.

*Mindful ethics response.* Once the manager realized the contents of the CD-ROM, she picked up the telephone and called her counterpart at the competitor. "I think I have something that belongs to you," she said. She returned the CD-ROM to the competitor.<sup>27</sup>

The manager's decision in this case was made intuitively once she realized that the software was stolen.<sup>28</sup> There was no need for consultation with others and no thought of copying the information before returning it. The manager was at once expressing her ethics mindfulness, most likely confirming its valuation in the context of the prevailing organizational culture, and through self-regulation providing a positive example of ethics mindfulness for others in the organization.

Research strongly suggests that most people look to their culture to determine what is ethically right and wrong.<sup>29</sup> This means that, just as O'Neill did at Alcoa, executive attention to the ethical climate of a business can have a positive impact on the decisions and behaviors of people within it. Rather than focusing directly on individuals, leaders can find significant momentum for ethics change in the social context.

### **It Is Sustainable**

Looking back to the Costco and Fran-Tech cases, chances are that we would be describing different outcomes if unethical behavior was tacitly acceptable within the governing corporate cultures. In the absence of self-regulatory forces to the contrary, it would have been easy for the Costco executives to seize upon the tax loophole and easy for the manager at Fran-Tech to copy the source code. Executives shouldn't be surprised to find such behaviors in organizational cultures that do not place high value on ethics. And they shouldn't be surprised to find them even in settings where corporate documents and executive speeches espouse ethical themes, but active leadership modeling of ethical mindfulness and positive self-regulation is weak or nonexistent.

While nearly all companies have platitudes and slogans extolling the virtues of high ethics stan-

dards—Enron had an inspirational ethical code—the standards will only have substantial influence on others when leadership behavior matches the corporate message. People in organizations are keen observers of leadership behavior. They quickly note any disparities between what leaders say and what leaders do. Some will look away but try to sustain their values by acting in ways that confirm individual ethics standards. Some will leave, seeking alternative employment where the governing ethics and values are more compatible with their own. Others will adjust their behavior by lowering personal ethical standards to fit the perceived culture.

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### ***Enron had an inspirational ethical code.***

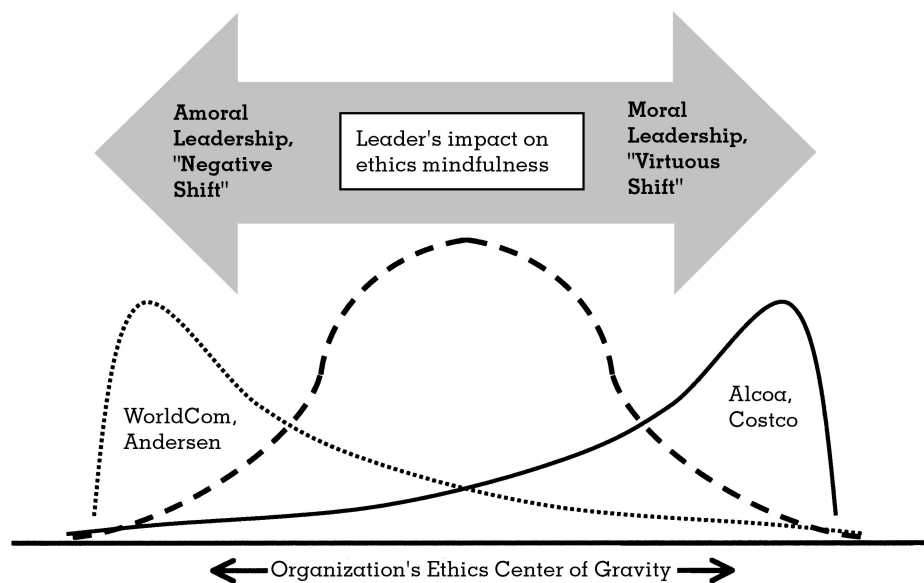
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#### ***Moving the Ethics Center of Gravity***

In his article "In Search of the Moral Manager," Archie B. Carroll describes the majority of middle managers as well-intentioned persons who simply fail to take ethical considerations into account when taking action and making decisions.<sup>30</sup> They are prone to act "amorally"—not thinking about the ethics of business behavior, but not necessarily acting "immorally" by choosing to be unethical. We believe this logic can be applied to the general population of organizations. As Carroll suggests, the vast majority may be well intentioned but amoral; their ethical tendencies may well depend more on what the group believes than on what they personally believe. Influenced largely by social context, they tend to respond to the ethical culture of the organization, ethics models set by supervisors, and ethical expectations of peers.

Importantly, we believe that Carroll's majority represents a significant leadership opportunity. Like a mound of Jell-O®, one can consider the center of gravity of ethical tendencies in organizations to be inherently unstable. With only the slightest shove, corporate leaders can cause it to list either to the left or to the right. Leaders who both profess and consistently display morally positive values will, for the most part, be able to move the center of gravity in a "virtuous shift" toward ethics mindfulness and keep it there. As described in Figure 2, this occurred with Paul O'Neill's leadership of workplace safety at Alcoa. But leaders who set and/or allow a tone of ethical laxity or corruption will also influence this center of gravity, albeit unfortunately, causing a negative shift.

Leaders can and do move the ethics centers of gravity in organizations. But they must accept that in their behavior and example rests the capacity to



**FIGURE 2**  
Leadership Impact on the Ethics Center of Gravity

do this with great good or great harm. This is intended as an encouraging message but one that requires great personal and organizational commitment and discipline to fully enact. Corporate leaders who focus on ethics mindfulness should gain change momentum; they should find that the virtuous shift in ethical tendencies is not just a concept but an achievable goal. But those who mistakenly believe that their ethics leadership is complete just because the firm avoids substantial penalties for failures to comply with legal requirements, routinely punishes those who run afoul of the rules, and conducts ethics training programs for those who engage in questionable practices will be disappointed. While these efforts may look and feel good, they do not represent a true commitment to ethics leadership. It takes a lot more to truly move the critical mass of the organizational membership toward ethics mindfulness.

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#### ***Integrity Programs vs. Compliance Programs***

Two broad choices are available to executives committed to ethics leadership: integrity programs and compliance programs. Only the former offer sustainability. Lynn Sharp Paine contrasts integ-

riety and compliance programs as follows.<sup>31</sup> Integrity programs focus on excellence. The goal is self-governance according to self-chosen standards. Compliance programs focus on laws, regulations, and rules of the organization. The goal is conformity to externally imposed standards. Integrity programs are designed to encourage shared commitment by employees to responsible self-managed conduct. Compliance programs are designed to prevent criminal, externally policed misconduct. The leadership of integrity programs is management driven. The leadership of compliance programs is lawyer driven.

Looking back to the Alcoa and Costco examples, we find people's actions being driven by values, not by law. These firms exhibited integrity programs before we even had a name for them. Consider, by contrast, what a compliance program would have looked like at Alcoa. Training would have started with OSHA rules and regulations, standards forced on the company by outside regulators. Penalties would have been imposed on those who broke the rules. The lost workday rate could have been very high, as long as OSHA rules were being followed. A letter once sent by OSHA to companies who had very high rates of lost workdays said: "We recognize that an elevated lost work day injury and illness rate does not necessarily indicate a lack of interest in safety and health on the part of your business."<sup>32</sup> This is not the kind of letter that reduces the lost workday rate to Alcoa's .014.

The implications of shifting ethics leadership



away from a compliance orientation and toward a commitment to integrity can be expressed in the analogy of the water tank. The floor of the tank represents the legal minimum, establishing a compliance baseline below which the individual or firm cannot act. The level of water above the floor represents the level of ethics the firm has decided to adopt. This level is optional. As long as it remains above the legal minimum, this level can be as high or as low as the individual or firm wishes. How high the water gets above the minimum shows the extent to which people are willing to make discretionary ethical choices—ones driven not by compulsion of laws and rules but by the individual and organizational values they have decided to adopt.

The manager in the Fran-Tech case did not consider where the bottom of the water tank might be; she acted mindfully at a high ethics level. At Costco, due diligence required the managers, and presumably their attorneys and accountants, to determine where the bottom was with respect to the proposed transaction. Having found the answer, the senior managers were uncomfortable lowering the company's collective water level as far as would have been necessary to realize the full benefits of the deal. They acted at a higher ethics level. For Alcoa, OSHA rules set the compliance floor. At the time of O'Neill's arrival, the firm was doing better than the industry average; there was a fair amount of water already in Alcoa's tank. But that was not good enough for O'Neill, who pushed the firm to a higher ethics level.

Considerable evidence exists to show that integrity programs not only work well in sustaining ethics mindfulness but that they work better than compliance programs. A study of some 10,000 employees at all levels in six U.S. companies in a variety of industries found strong evidence that integrity programs outperform compliance programs on several dimensions of ethics.<sup>33</sup> Employees of companies with integrity programs report:

- Lower incidence of unethical/illegal behavior.
- Greater awareness of ethical/legal issues at work.
- Greater search for ethical/compliance advice.
- More willingness to deliver bad news to management.
- More reporting of ethics/compliance violations.
- More embedding of ethics/compliance in everyday decision-making.
- Greater employee commitment to the firm.

Two further studies of ethical climates and employee behavior—one a national multi-company study and the other a single-company study—

showed that employees are more concerned with the integrity of the workplace than with rules and sanctions. In the national multi-company study, employees were twice as likely to follow rules voluntarily as they were under threat of punishment. In the single-company study, the power of integrity to promote voluntary rule-following was even greater.

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Even as ethics leadership focuses on integrity, it should not ignore the importance of compliance. Instead, compliance should be viewed as a necessary foundation of an ethical culture, much as the water tank needs a strong bottom to support high water levels. Punishing those who fall below the compliance line sends the message that management takes its integrity program seriously.<sup>35</sup>

### **Strategic Leadership and the Ethics Bottom Line**

A contextual message in our work, equally applicable to ethics in business as well as in life, is this: Long-term, sustainable success can be achieved only through solid ethical behavior. The "ethics bottom line" in this sense derives first and foremost from the leader's behavior. Business executives must serve as public and vocal ethics role models; this is the basic building block of any positive leadership impact on ethical behavior by others. Moreover, in respect to ethical behavior, executives should act ethically not out of fear of being caught when doing wrong. Rather, they should embrace ethical behavior in business because of the freedom, self-confirmation, and success that it brings.

We began this article by quoting a definition of strategic leadership which states in part that the executive's strategic leadership responsibility includes working "with others to initiate changes that will create a viable future for the organization." Our premise here is that a viable, sustainable long-term future is inevitably linked with ethical business behavior. Acceptance of this fact and commitment to act within its guidance are essential hallmarks of real strategic leadership. We would hold executives accountable for including this ethics bottom line in their personal perfor-

mance commitments as well as in those of their organizations.

No one should fear or retreat from the responsibility we have been describing. Executives with an ethics vision can move themselves and their organizations forward, step by important step. The basic building blocks for success in the strategic leadership of ethical behavior in business have been set forth in this discussion: (1) Create and sustain change urgency through complete analysis of *all* costs of ethical failures; (2) Act to reinforce ethics mindfulness in one's self and others and to support the virtuous shift in an organization's ethics center of gravity; and (3) Anchor changes in the organization's culture by engaging in integrity programs that move people beyond mere compliance and toward ethics mindfulness.

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### **Executives with an ethics vision can move themselves and their organizations forward, step by important step.**

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Business executives can and must realize that the bottom line of business success always includes an ethics component. They must be willing to do even the small things every day that help to advance its accomplishment. *Executives must vocalize a clear and consistent positive ethics message from the top.* Commitment to ethics mindfulness must be stated often and clearly; ethics messages must be supported by positive examples of senior executives making tough choices that are driven by company values. *Executives must create and embrace opportunities for everyone in the organization to communicate positive ethics values and practices.* Everyone must experience a "voice" in the ethics culture, being encouraged to express concerns and preferences; they must have easy and secure access to mechanisms for doing so, including advice lines and tip lines for reporting violations; all questions and concerns must be followed to closure; all systemic sources of recurring problems must be traced and rectified. *Executives must ensure consequences for ethical and unethical conduct.* Ethical performance should be recognized and rewarded, visibly and regularly; unethical behavior should be met with sanctions up to and including termination, with no exclusions for senior executives.

The strategic leadership of ethical behavior in business is not an abstract concept. It is an achievable goal. When inspirational values are backed by personal example and a solid groundwork of compliance, it is possible to achieve ethics goals

such as the one Nancy Higgins has expressed for MCI: "A culture where ethics permeates the company and forms a portion of every business decision we make, at every level."<sup>35</sup>

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### **Endnotes**

<sup>1</sup> Quote from discussion with Nancy Higgins of MCI Corporation by Terry Thomas.

<sup>2</sup> See Cherrington, D. J., & Cherrington, J. O. 1997. Principles of moral leadership. CHC Forecast, Inc. Retrieved from [www.chc-forecast.com/PrinciplesofMoralLeadership.html](http://www.chc-forecast.com/PrinciplesofMoralLeadership.html), 15 November 2003.

<sup>3</sup> Toffler, B. M. 2003. Five ways to jump-start your company's ethics. *Fast Company*, 75 (October): 36.

<sup>4</sup> Hitt, M., & Ireland, R. D. 1999. Achieving and maintaining strategic competitiveness in the 21st century: the role of strategic leadership. *The Academy of Management Executive*, 13 (1): 43-57.

<sup>5</sup> Kotter, J. 1996. *Leading change*. Cambridge, MA: Harvard Business School Press; Kotter, J. 1995. Leading change: Why transformation efforts fail. *Harvard Business Review*, 73 (March-April): 59-67. Historical roots for Kotter's contemporary model trace to the pioneering work on planned change by Lewin, K., 1947. Frontiers in group dynamics. *Human Relations*, 1: 5-41.

<sup>6</sup> The largest bankruptcies 1980-present. Retrieved from [www.bankruptcy.com](http://www.bankruptcy.com), 22 November 2003.

<sup>7</sup> These failures are described in Jeeter, L. W. 2003. *Disconnected: Deceit and betrayal at WorldCom*. New York: John Wiley & Sons; McClean, B., & Elkind, P. 2003. *Smartest guys in the room: Amazing rise and scandalous fall of Enron*. New York: Portfolio; Toffler, B. L. 2003. *Final accounting: Ambition, greed and the fall of Arthur Andersen*. New York: Broadway Books; Watkins, S., & Swartz, M. 2003. *Power failure: The inside story of the collapse of Enron*. New York: Doubleday.

<sup>8</sup> Reingold, J. 2003. The women of Enron. *Fast Company*, 74 (September): 76ff.

<sup>9</sup> Paine, L. S. 1994. Managing for organizational integrity. *Harvard Business Review*, 72 (March-April): 106-117.

<sup>10</sup> Messick, D., & Bazerman, M. 1996. Ethical leadership and the psychology of decision making. *Sloan Management Review*, 37 (2): 9-22. This article is also reprinted in Dienhart, J. 2000. *Business, institutions, and ethics*: 39-56. New York: Oxford University Press.

<sup>11</sup> Waddock, S. A., Bodwell, C., & Graves, S. B. 2002. Responsibility: The new business imperative. *The Academy of Management Executive*, 16 (May): 132-147.

<sup>12</sup> Farrell, G. Andersen gets \$500,000 fine, 5 years probation. *USA Today Money*, 16 October 2002.

<sup>13</sup> Andersen gets \$500,000 fine and 5-year probation. *SRiMedia*, 17 October 2002.

<sup>14</sup> Public choice theory is an economic analysis of voting behavior in which voters demand political goods that their elected representatives try to supply. See Chapter 5, Dienhart, op. cit. for more detail and references to seminal work.

<sup>15</sup> For a discussion of regulatory influences on business behavior, see Stone, C. D. 1991. *Where the law ends: The social control of corporate behavior*. Prospect Heights, IL: Waveland Press, Inc.

<sup>16</sup> Data from a survey reported in Cone Corporate Citizenship Study. 2002. National survey finds Americans intend to punish corporate "bad guys," reward good ones. Retrieved from [www.coneinc.com/Pages/pr\\_13.html](http://www.coneinc.com/Pages/pr_13.html), May 2003.

<sup>17</sup> O'Neill, P. Values into action. Retrieved from [www.hbsworkingknowledge.hbs.edu/item.jhtml?id=3159&t=corporate\\_governance](http://www.hbsworkingknowledge.hbs.edu/item.jhtml?id=3159&t=corporate_governance), May 2003.

<sup>18</sup> Weick, K. E., Sutcliffe, K. M., & Obstfeld, D. 1999. Organizing for high reliability: Processes of collective mindfulness. In Staw, B., & Sutton, R. (eds), *Research in Organizational Behavior*, Vol. 21: 81-123. Greenwich, CN: JAI Press.

<sup>19</sup> See Gini, A. 1997. Moral leadership and business ethics. *Journal of Leadership and Organization Studies*, 4 (4): 64-81.

<sup>20</sup> Aquino, K., & Reed, A., II. 2002. The self-importance of moral identity. *Journal of Personality and Social Psychology*, 83 (6): 1423-1440.

<sup>21</sup> See the overview of self-regulation by Mischel, W., Cantor, N., & Feldman, S. 1996. Principles of self-regulation: The nature of willpower and self-control. In Higgins, E. T., & Kruglanski, A. W. *Social psychology: Handbook of basic principles*: 329-360. New York: Guilford Books.

<sup>22</sup> Bandura, A. 1977. *Social learning theory*. Englewood Cliffs, NJ.: Prentice-Hall.

<sup>23</sup> Ibid.

<sup>24</sup> Two years after these events, British authorities closed the tax loophole.

<sup>25</sup> This example is from an interview with Richard Galanti, CFO of Costco, Inc., and conducted by John Dienhart.

<sup>26</sup> Rest, J. 1986. *Moral development: Advances in research and theory*. New York: Praeger.; Trevino, L. 1986 Ethical decision-making in organizations: A person-situation interactionist model. *Academy of Management Review*, 11 (3): 601-617; Haidt, J. 2001. The emotional dog and its rational tail: A social intuitionist approach to moral judgment. *Psychological Review*, 108 (4): 814-834. Rest and Trevino argue for what Haidt calls the Social Rational Model, which has set a standard for analyzing ethical decision-making and behavior for over 20 years. This model postulates a fixed order for ethical decision: awareness that there is an ethical issue, analysis of the issue, judgment about the correct behavior, ending with behavior. It is a rational model because rational analysis drives behavior. It is social

because the values used to make the decision are embedded in a social context.

<sup>27</sup> Case obtained by one of the authors in a personal interview with the featured individual; names and location changed to respect confidentiality.

<sup>28</sup> See Haidt, J., op. cit. Haidt argues for the Social Intuitionist Model of decision-making. This model places more emphasis on social context than the social rational model does. It asserts that our awareness of an ethical issue and a judgment about what we should do are nearly simultaneous. Our intuitions are culturally informed by training and past experience.

<sup>29</sup> See the discussion in Trevino, L., & Nelson, K. 1995. *Managing business ethics*, John Wiley & Sons, Inc.: 89.

<sup>30</sup> Carroll, A. B. 2001. In search of the moral manager. *Business Horizons* (March/April): 7-15.

<sup>31</sup> Paine.

<sup>32</sup> The 683 most dangerous workplaces in New York State. Retrieved from [www.nycosh.org/SIC-high\\_2000.html](http://www.nycosh.org/SIC-high_2000.html), May 2003.

<sup>33</sup> Trevino, L. K., et al. 1999. Managing ethics and legal compliance: What works and what hurts. *California Management Review*, 2 (Winter): 131-151.

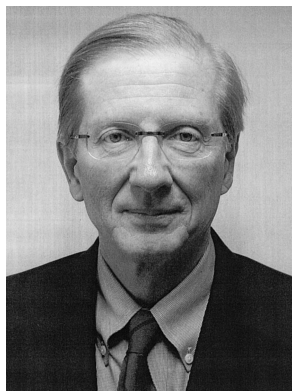
<sup>34</sup> Tyler, T. R. 2003. Creating an ethical climate in work organizations. Paper presented to the Northwest Ethics Network, Seattle. Tyler, T. R., & Blader, S. 2003. Rule following in work settings. Paper presented at the Shrontz Lecture on Business Ethics at Seattle University.

<sup>35</sup> Trevino, et al.

<sup>36</sup> Quote from discussion with Nancy Higgins of MCI Corporation by Terry Thomas.



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