PART 1

Background

CHAPTER 1

Human Nature and Unethical Behavior in Organizations

After reading this chapter, you will be able to:

- Explain the competitive advantages of creating and maintaining an ethical organization
- Describe some common types of unethical behaviors that occur in all types of organizations—for-profits, nonprofits, educational institutions, and government
- Appreciate that unethical behaviors can occur in all organizational operations
- Understand that unethical behaviors can be very costly to organizations
- Discuss human nature in terms of people being pleasure-seekers who can choose to do good or bad

Businesses, nonprofit organizations, and government agencies significantly improve the quality of life on Earth by providing goods and services that fulfill consumer needs.

Look around. A business built the house you live in, the alarm clock that wakes you up, the bed you sleep in, the clothes you wear, the newspapers you read, the chair you sit in, the food you eat, the music you listen to, and the car you drive to work. Providing goods and services that enrich the quality of life, and employment, are very ethical endeavors.

Ethics should permeate all aspects of organizational operations. Unfortunately, due to human nature and inappropriate management control systems, many organizations are ethically challenged.

This chapter discusses why managing ethics is essential, moral imperfection among human beings, and the nature and negative ramifications of unethical activities within organizations. Almost every decision made every day has ethical ramifications. Managing ethics appropriately leads to superior financial performance.

Daily Occurrence of Ethical Dilemmas

When an organization employs someone, that individual brings to work not only unique job skills, but also his or her ethics. Ethics is the set of principles a person uses to determine whether an action is good or bad. Ethics permeates every stakeholder interaction involving owners, customers, employees, lenders, suppliers, and government officials.

People experience a multitude of ethical dilemmas on a daily basis, beginning with whether to get out of bed or hit the snooze button when the morning alarm goes off. Almost every decision and action a person makes the rest of the day has an impact on other people, beginning with arriving at work on time and ending with unfinished tasks at the end of the day. Each decision and action is subject to ethical analysis.

An action sequence consists of the motivation behind the act, the act itself, and the consequences of the act. An ideal ethical situation is one in which a person has good motives and the act results in good consequences. The most unethical situation is one where a person has bad motives and the act results in bad consequences.

Is it ethical for you to inform a subordinate about next year's business plan? It depends. If you have permission to share the information and doing so improves the subordinate's performance, then it is very ethical. However, if sharing the information violates a confidentiality agreement and the subordinate is likely to misuse the information, then it is very unethical.

On the ethics continuum, some situations fall between the two extremes. Sometimes, good motives can generate bad consequences. For instance, trying to help a colleague perform one task might distract the person from meeting an important deadline. Sometimes, bad motives can generate good consequences. Your selfish refusal to support a colleague in need of assistance may result in the colleague obtaining even better support from someone else. When evaluating these less-than-ethically-ideal situations, some people place greater ethical weight on having proper motives, while others place greater weight on achieving favorable consequences.

Without having been trained in philosophy, few managers realize that almost every business decision has ethical ramifications. For instance, in 1985, Ken Lay, chief executive officer (CEO) of the regional Houston Natural Gas (HNG) company, had to decide whether to accept a merger offer from InterNorth, which owned North America's largest natural gas pipeline (see *In the Real World*). The ethical implications of this business decision are profound. Lay's decision would impact all InterNorth and HNG shareholders, all HNG employees and their families, and the cities of Houston, Texas and Omaha, Nebraska.

IN THE REAL WORLD

Merger Opportunity—1985

In 1985, corporate raider Irwin ''The Liquidator'' Jacobs proposed a hostile takeover of the financially troubled InterNorth, an Omaha, Nebraska firm that operated the largest national gas pipeline in North America. InterNorth's CEO contacted Ken Lay, the CEO of a regional company called Houston Natural Gas (HNG), about a potential merger. InterNorth proposed purchasing HNG's $47 stock at $70 a share, for a total price tag of $2.4 billion, much of it borrowed money. Jacob's hostile takeover of InterNorth would be prevented because, even if he sold all the newly combined company's corporate assets, Jacobs could not profitably pay off its huge debt.

The merger proposal made strategic sense for the regional HNG. The federal government was in the process of deregulating the energy industry and the combined entity would be a dominant force in the natural gas market. In addition, Lay and other executives could sell their HNG stock options at the premium price being offered by InterNorth.

But there were some potential negative merger ramifications for Lay to consider. The InterNorth/HNG entity would have to manage a daunting $4.3 billion debt. Also, it would be a merger of unequal partners. InterNorth, with $7.5 billion in revenue, was three times larger than HNG. Such a size disparity typically resulted in the smaller firm being taken over by the larger one. Bureaucratic redundancies would be eliminated to achieve cost reductions. Only one CEO would be needed, not two, and corporate control would transfer from Houston to Omaha.

DECISION CHOICE. If you were the CEO of HNG, would you:

1. Reject InterNorth's proposal to protect your job and keep HNG headquartered in Houston?
2. Merge with North America's largest natural gas pipeline company, although it meant the risk of managing a large debt, relocating corporate headquarters to Nebraska, and losing jobs due to redundancies?

Why?

Competitive Advantages of Ethical Organizations

Ethical organizations consist of ethical employees empowered to operate within a culture of trust. Research findings (and common sense) strongly suggest that, in the long term, ethical organizations financially outperform unethical organizations. Eight competitive advantages of achieving high integrity within a culture of trust appear in Exhibit 1.1.

If you were a *job applicant*, would you rather work for an ethical or an unethical organization?

An ethical organization attracts high-quality employees and leads to higher levels of employee satisfaction and loyalty. If the pay is similar, job candidates consistently choose the ethical organization rather than the unethical organization. Individuals only choose the

EXHIBIT 1.1

Competitive Advantages of Being Ethical and Trustworthy

Ethical organizations, compared to unethical organizations:

1. Attract and retain higher quality employees
2. Attract and retain higher quality customers
3. Attract and retain higher quality suppliers
4. Attract and retain higher quality investors
5. Earn goodwill with community members and government officials
6. Achieve greater efficiency and decision making, based on more reliable information from stakeholders
7. Achieve higher product quality
8. Need less employee supervision

unethical organization if pay and benefits are substantially higher. A survey of MBA students found that 94% of them would accept an average of 14% lower pay to work for an organization with a reputation for high ethical standards.[1]

If you were a *customer*, would you rather purchase products or services from an ethical or unethical organization?

A stellar ethical reputation is priceless marketing and leads to higher levels of customer satisfaction and loyalty. When product price and quality are similar, potential customers consistently choose the ethical organization over the unethical organization. In fact, consumers are willing to pay a modest premium for products and services supplied by an ethical company. They purchase from an unethical organization only if the price is substantially lower.

If you were a *supplier*, would you rather sell your products and services to an ethical or unethical organization?

An ethical organization attracts high-quality suppliers and increases supplier satisfaction and loyalty. Potential suppliers consistently choose to sell to the ethical organization that pays a fair price rather than the unethical organization. Suppliers depend on customers to pay their bills on time so that they can manage a smooth operation.

If you were an *investor*, would you rather do business with an ethical or unethical organization?

High-quality investors are attracted to ethical organizations, which leads to higher levels of investor satisfaction and loyalty. If anticipated return-on-investments are similar, potential lenders and investors consistently choose the ethical organization rather than the unethical organization.

If you were a *community leader* or *government official*, would you rather interact with an ethical or unethical organization?

Ethical organizations honestly communicate with stakeholders and pay their fair share of taxes. In return, ethical organizations earn the respect of, and gain access to, community leaders and government officials.

Lastly, if you were an employee, customer, supplier, investor, community leader, or government official, would you provide managers of an ethical organization with truthful or deceptive information?

We tend to treat others as they treat us. People who are treated fairly and truthfully tend to reply in a fair and truthful manner.

Managers can make better informed decisions when they know that the information supplied by others is trustworthy. The honest flow of ideas and the higher levels of employee loyalty, commitment, and satisfaction result in better quality consumer products and services and reduce the need for employee supervision.

These common sentiments are supported by survey research reported in 2007:[2]

- 94% of Americans believe it is "critical" or "important" to work for an ethical company.
- 33% of employees have left a company because they disagreed with its business ethics.
- 70% of Americans have decided not to purchase a company's product because of its questionable ethics.
- 72% of Americans prefer to buy higher priced products and services from companies with ethical business practices than lower priced products and services from companies with questionable business practices.

Tips and Techniques

Persuading Employees of the Importance of Being Ethical

Being ethical is the right thing to do, but telling that to someone who is not concerned about ethics, or is considering an unethical act, will likely fall on deaf ears. Instead, build a business case linking ethical behavior to profitability or other financial impacts. That usually gets the person's attention.

Begin by developing a list of reasons why being ethical is good for your organization's bottom line. Compelling reasons typically include customer retention, lower costs, higher product quality, and employee morale.

Managing Morally Imperfect People

Organizations are composed of people. The average human being is a very good person. But he or she is not a saint. Everyone has his or her own set of moral challenges to manage, such as greed, anger, envy, lust, and pride. Moral perfection is a moving target, always a few grasps beyond our reach.

The managerial challenge is to coordinate the transformation of inputs into products and services in a way that respects the dignity of owners, employees, customers, suppliers, the host community, and the natural environment. It only takes one unethical or illegal behavior to ruin an organization's reputation or result in damaging litigation.

Researchers have documented that the average person lies twice a day. That's actually pretty good when one considers the thousands of statements the average person makes every day. But those two times a day an employee, customer, or supplier are dishonest can be very problematic for organizations.

The dishonesty could be a big lie (e.g., a manager falsely claims that the organization has surpassed revenue targets) or a small one (e.g., a salesperson falsely tells an aggravated customer that the boss is not in the office today). The dishonesty could be a lie of commission (e.g., falsely telling the boss that the work is complete) or one of omission (e.g., not telling the boss anything about the incomplete work).

Due to human nature and the potential negative ramifications of unethical work-related activities on organizational performance, ethics must be managed.

What is the Extent of Unethical Behaviors at Work?

Although people are good most of the time, researchers report a rather high prevalence of unethical behavior at work:

- 67% of chief financial officers (CFOs) have been pressured to misrepresent corporate results.[3]
- 25% of middle managers have written a fraudulent internal report.[4]
- 75% of employees have stolen at least once from their employer.[5]
- 33% of employees calling in sick are really tending to personal needs or feel entitled to a day off.[6]

The Ethics Resource Center surveyed more than 3,000 employees in 2005 about ethical issues at work.[7] Of the respondents, 52% observed at least one type of misconduct in the workplace during the past year. Only 55% of these were reported to management; 48% of the misconducts violated the law.

The most common types of misconduct employees observed were abusive or intimidating behavior towards employees, lying, employees placing their own interests over organizational interests, safety violations, misreporting of actual time worked, illegal discrimination, and stealing.

As for our future business leaders, 56% of MBAs admit to cheating on a class assignment during the previous academic year.[8]

What Types of Organizations and Operational Areas Have Ethical Problems?

Ethical issues arise in every organization and throughout organizational operations.

Unethical discrimination based on race or gender can occur in dealings with suppliers, employees, customers, the government, or the public. They could occur in any department—accounting, finance, human resources, or marketing. They could occur at any level of the organization—Board of Directors, executives, middle managers, staff, or production employees. They could be engrained in an organization's job recruitment practices, job screening practices, terms of employment, job tasks, training opportunities, performance evaluations, or layoffs.

Ethical problems can arise in any organization, even the most admirable ones. Xerox has won many awards for their excellent diversity programs. Despite these efforts, Xerox was fined $12 million in 2008 for racial discrimination.[9]

Why Do Good People Behave Unethically?

Ethics would be easy to manage if simply a matter of detecting and dismissing evil people. But that is not the nature of organizational life.

Sometimes the unethical decision or outcome is not intentional. Unethical situations can arise when a good person has insufficient knowledge and awareness, inadequate job skills, or lacks prudence, judgment, or courage.[10] Ethical problems also result from management and organizational design issues, such as a misaligned management system, inadequate flow of information, perceived management indifference, inadequate legal and regulatory framework, and pressures from unethical customers or competitors.

Sometimes good people will occasionally behave unethically because of contextual reasons. A survey conducted by the Society for Human Resource Management and the Ethics Resource Center found that 24% of the respondents were pressured to compromise ethical standards either periodically, fairly often, or all the time. Of those feeling pressured, the top five organizational sources were:[11]

1. Following the boss's directives (experienced by 49%)
2. Meeting overly aggressive business or financial objectives (48%)
3. Helping the organization to survive (40%)
4. Meeting schedule pressures (35%)
5. Wanting to be a team player (27%)

What are the Costs of Unethical Behaviors?

Unethical behaviors can be very costly. The Equal Employment Opportunity Commission (EEOC) maintains an annual database of charges filed and resolved under various antidiscrimination laws, such as age discrimination or sexual harassment.[12]

EXHIBIT 1.2

EEOC Charges and Resolutions, 1997 and 2007

Type of Discrimination	Fiscal Year 1997 Number Cases Filed	Fiscal Year 2007 Number Cases Filed	Fiscal Year 2007 Number Cases Resolved	Fiscal Year 2007 Monetary Benefits Determined by EEOC (excludes other forms of litigation)
Race	29,199	30,510	25,882	$67.7 million
Retaliation on all EEOC-enforced statues	Not Available	26,663	22,265	$124 million
Gender	24,728	24,826	21,982	$135.4 million
Age	15,785	19,103	16,134	$66.8 million
Disability	18,108	17,734	15,708	$677 million
Sexual harassment	15,889	12,510	11,592	$49.9 million
National origin	6,712	9,396	7,773	$22.8 million
Pregnancy	3,977	5,587	4,979	$30 million
Religion	1,709	2,880	2,525	$6.4 million
Equal pay and compensation	1,134	818	796	$9.3 million

Exhibit 1.2 summarizes the totals for fiscal year 2007 and offers a comparison to fiscal year 1997. The discriminations are listed in order of the number of cases filed in 2007, with 30,510 racial discrimination filings leading the pack, followed closely by retaliation

filings. This represents only a portion of all alleged cases of workplace discriminations, as many go unreported.

What is Human Nature?

The survey results and costly penalties associated with all types of organizations beg the question: Are human beings born good or bad?

According to social philosophers, human beings are born neither good nor bad. Psychologically, human beings are born with a desire to experience happiness. Babies exhibit a natural tendency to pursue their own self-interests, which entails doing things that generate pleasure and avoiding things that generate pain. This tendency, supplemented by a concern for the well-being of others, continues throughout our lives.

Some of the ways we pursue pleasure are very ethical, such as being honest and helping others. Other methods are unethical, such as lying to avoid punishment. Among young children, behaviors praised by parents are considered good and those criticized by parents are considered bad. Being yelled at, or ostracized, causes psychological pain, which children then try to avoid.

As children age into adulthood, other moral influences include siblings, friends, media, teachers, religious authorities, colleagues, and the boss. Sometimes these multiple perspectives are in harmony, other times in conflict. When moral perspectives conflict in a meaningful situation, people apply reason to determine the right thing to do. Different people reach different moral conclusions. The end result can be an individual like Bill Gates donating his business fortune to solve social problems, or someone like Jeff Skilling leading Enron into unethical oblivion.

Summary

Human beings have a dual nature. We are primarily honest, but we also lie. We primarily care for our own welfare, but we also care about the welfare of others. We are kind to others, but we can also be cruel. Each person has his or her unique set of moral challenges. Everyone experiences moral successes and failures.

In the 1700s, Adam Smith conceptualized capitalism as an economic system morally superior to previous forms of economic arrangements, particularly highly regulated mercantilism. He argued that the wealth of a nation would be significantly enhanced if morally imperfect people were provided the freedom to pursue their own economic self-interests within a system of justice.

Chapter 2 explores the historical need for capitalism, and modifications made to, and within, the capitalist system to improve business ethics.

Notes

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