Embedding Ethics in Business and Higher Education:

From Leadership to Management Imperative
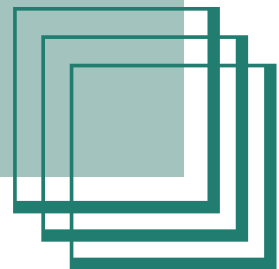
June 2005

Business-Higher Education Forum

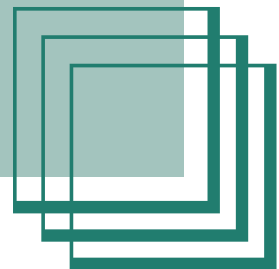2025 M Street, NW, Suite 800, Washington, DC 20036

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Embedding Ethics in Business and Higher Education:
From Leadership to Management Imperative

By Edward Soule, CPA, Ph.D.

June 2005

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Preface

When members of the Business-Higher Education Forum (BHEF) met for their 2003 winter meeting, they held a discussion—led by William J. Pesce, President and Chief Executive Officer of John Wiley & Sons, Inc.—on ethics and integrity. Troubled by reports of corporate corruption and unethical conduct on college campuses, BHEF members resolved to contribute to their respective communities and the public-at-large something meaningful. They asked, *"What would it take for us to embed ethics in our businesses and institutions of higher education?"* They committed to developing substantive ideas and practical strategies to improve their organizations and to share those ideas with the leaders of other organizations. At the BHEF 2004 winter meeting, members formalized the Ethics Initiative.

The Initiative required leadership from co-chairs representing both sectors of the BHEF, as well as a similarly representative working group. We agreed to lead the Initiative and engaged Ed Soule of Georgetown University to frame the effort, serve as its principal investigator, and write this report. In that capacity he brought to bear the findings from a range of academic literatures—from organizational behavior to criminology—and designed and supervised research to validate the ideas advanced in this report.

As co-chairs of the Initiative, we are pleased to present this report as the culmination of this phase of our work. We have rejected easy or quick fixes in favor of enduring improvements—the kind that require conviction, persistence, and a willingness to learn from experience.

The report was framed around aspirations expressed by the BHEF membership in terms of three objectives:

1. Diagnose the problem of corporate corruption. *What went wrong and why?*

2. Explain the available options. *What are the strengths and weaknesses of existing approaches to the management and oversight of organizational ethics?*

3. Identify and develop high-impact strategies for improved ethical performance. *What would it take to embed ethics in the daily activities of an organization?*

A fourth objective emerged as the Initiative proceeded:

4. Apply that strategy to the moral development goals of higher education. *How could colleges and universities improve the ethical conduct of their students and influence their character?*

Professor Soule presented answers to these questions at the June 2004 BHEF meeting. This report took form from the feedback received at that session and subsequent discussions among members of the working group. In

order to address readers' special interests, it has been organized into five more or less standalone chapters and an Introduction:

- **Chapter 1. The Enron Era: Myths and Misunderstandings** introduces the defining characteristics of recent corporate scandals and reviews their most widely circulated explanations. We question the plausibility of these accounts of what went wrong and explain why they hinder efforts to defend against ethical misconduct.

- **Chapter 2. The Enron Era: Lessons Learned** offers an alternative explanation that is anchored by evidence and expressed in terms of three lessons from these scandals.

- **Chapter 3. A Strategy for Managing Ethical Performance** introduces a novel strategy, rooted in the proactive management of ethical culture.

- **Chapter 4. Ethics and Higher Education** applies this strategy to an objective of many college and university leaders: the ethical development of their students.

- **Chapter 5. A Proposal for Moving Forward** consists of a brief proposal for further developing and systematizing our strategy.

For the benefit of international readers, we wish to note that we follow the Anglo-American convention of using "ethics" and "morality" interchangeably. In the words of University of Kansas scholar Richard T. DeGeorge, both terms will refer to "the rules that ought to govern human conduct, the values worth pursuing, and the character traits deserving development in life."[1] We favor this interpretation because it aligns closely with the popular understanding of business ethics. Also, "ethical performance" will refer to the conduct of organizations and the extent to which that conduct meets the ethical expectations of society.

Finally, we recognize that significant differences between universities and businesses give rise to distinct challenges, ethical and otherwise. However, their similarities and overlapping interests are great enough to address them both under the heading of "organizational ethics" without loss of meaning or value to either constituency.
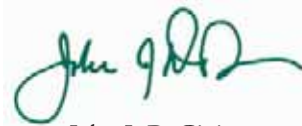
The BHEF membership brings unique resources to the challenge at hand. Their collective experience covers a wide range of ethically hazardous activities, from corporate accounting to intercollegiate athletics. They lead private- and state-sponsored not-for-profit organizations, as well as privately held and publicly traded businesses, and their institutions serve diverse constituencies.

Notwithstanding these differences, BHEF members are united by a common interest: students. As future employees, educators, citizens, parents, and leaders, the values by which they choose to live are of critical concern. University and business leaders have opportunities to influence their choices through the priorities and examples they set. Our overarching hope is that this report spurs a different way of thinking about organizational ethics, one in which ethics is elevated to the level of mainstream organizational functions and, accordingly, systematically managed.

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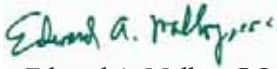
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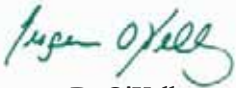
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Introduction

Although recent episodes of corporate corruption triggered an avalanche of commentary and analysis, several vexing questions remain: What exactly went wrong and why? How extensive is the problem and how (if at all) is it related to the widespread instances of unethical conduct on college campuses? What needs to be fixed and what deserves to be abandoned? How much relief can we realistically expect from the recently enacted regulatory reforms?

Of course, we found no shortage of answers to these questions—many have been proposed but their proponents are not all of one mind. Thus, the first objective of this report is to clarify and make sense of this tumultuous time we have dubbed the "Enron Era." Without an accurate diagnosis, we are unlikely to find a cure.

The second goal is to gain a better understanding of how organizational ethics is currently managed. By examining the strengths and weaknesses of existing strategies and oversight mechanisms, we hope to identify opportunities for improvement.

Our third objective is to develop and test a means of weaving ethics into the fabric of an organization, a strategy that would incline members of an organization—students or employees—to meet or exceed the ethical expectations of society. This strategy involves proactively and systematically managing organizational culture and taking the stance that doing so should be a fundamental responsibility of leadership. Therefore, we detail what would be required to discharge that responsibility, and how individual leaders of businesses and universities could be held accountable for their performance.

The preceding three objectives are designed to improve the ethical performance of organizations—businesses and schools alike. However, many colleges and universities have a distinct commitment to further the moral development of their students, the future generation of organizational leadership. We address that commitment with our fourth and final goal: to develop and test an application of our strategy for managing organizational ethics to the moral bearing of student bodies on college campuses.

In the course of pursuing these objectives, the following observations and conclusions will be explained and defended:

Clarifying the Enron Era

The Enron Era is not always understood with the clarity it deserves. Explanations of the scandals run the gamut: from a debased national culture to a flawed or feckless regulatory regime; from perverse executive incentives to weak gover-

nance mechanisms; from overbearing equity analysts to unrealistic investor expectations. Or perhaps it simply boils down to a few bad apples. Any and all of these factors may be true and it is fair to say that each of them was a proximate cause of some significance. It is also fair to say that the variety of corruption on display lately cannot be explained adequately by any or all of these commonly cited factors.

Moreover, confusion surrounds the financial fallout from Enron Era scandals. On one extreme is the widespread belief that they precipitated a "crisis of investor confidence." On the other, these episodes are believed to be historically unexceptional or "business-as-usual." We reject both characterizations. To trivialize what we have witnessed is to overlook what needs fixing. To sensationalize the Enron Era is to mislead by obscuring a looming risk. If U.S. commercial history is any indication, present conditions are ripe for a genuine crisis of investor confidence.

To adequately explain individual instances of corporate corruption and properly characterize their consequences, we call attention to three lessons the Enron Era stands to teach. The first concerns the central importance of organizational culture. Isolated instances of unethical conduct are an unfortunate fact of organizational life. But with rare exception, they do not persist and grow in virulence as they did at Enron or WorldCom unless the culture lets them. With a function akin to an immune system, organizations with strong ethical cultures tend to self-correct from errant misbehavior and fortify against future encroachments—organizations whose members "get it under their skin" that they are working or attending school at a place where personal integrity, ethics, and playing by the rules really matter.

The second lesson concerns the unique operating dynamics that characterize present-day organizations: their unprecedented scale and global reach; their heightened instability from an increase in mergers, acquisitions, downsizings, spin-offs, and split-ups; their innovative management techniques, including less hierarchical structures and decentralized decision-making; and their widespread use of communications and information technology.

These routines and practices are the cumulative result of incremental but relentless changes spanning decades. It is now apparent that this transformation had the effect of transforming ethical misconduct into a far more menacing phenomenon than in years past: a relatively small band of pirates can now plunder in ways that used to require military force. Contemporary operating condi-

tions do not cause unethical conduct, but they make it far more difficult to prevent and considerably more punishing when it does occur.

The third and final lesson concerns conventional ethical safeguards: legal sanctions; internal controls, and an array of compliance mechanisms and programs. All such devices suffer some imperfection, but one particular defect undermined the efficacy of the whole lot: conventional safeguards are designed to ride herd over organizational arrangements as they exist, not as they might present in the future. Present-day safeguards, designed with an older generation of operating dynamics in mind, have been eclipsed by prevailing conditions. They can be retooled for today's setting, but because static controls cannot anticipate future changes, conventional safeguards are resigned to playing a game of catch-up, falling farther and farther behind as the pace of change accelerates.

What went wrong and why?

We reject sensational and trivial characterizations of the Enron Era and we caution against assuming that the worst is over in terms of investor confidence. We emphasize three factors in explaining recent episodes of corporate corruption: **operating dynamics** that increased the likelihood and amplified the severity of unethical conduct; **ethical safeguards** that were eclipsed by the conditions there were designed to guard; and **ethical cultures** that accommodated, and sometimes encouraged, deviant activities.

The Enron Era spurred a number of regulatory reforms, but based on our analysis, they do not address "what went wrong and why." That is not to say that these initiatives are without merit, but that something else is needed. In our view, the factors that explain Enron Era corruption cannot be addressed through legislation, they require a fundamentally different approach to the management of organizational ethics.

Managing Ethical Performance Today: "Implore but Verify"

Present-day operating dynamics bear little resemblance to those of 30 years ago, with (at least) one notable exception: the management of organizational ethics. It remains a leadership function first and a compliance function second. The Enron Era was a wake-up call that something is sorely lacking in this approach. At a time when all manner of stakeholder preferences and demands are routinely satisfied, some otherwise capable organizations utterly failed to meet the ethical expectations of society.

What did the Enron Era have to say about our approach to managing ethics? As mentioned above, it confirmed our worst fears regarding ethical safeguards. We knew there were no fail-safe systems of internal control and we knew that outside gatekeepers were fallible. But we did not appreciate how easily the entire spectrum of protective measures and institutions could fail, and remain in a failed state indefinitely.

Secondly, evidence suggests that tougher laws or more muscular controls alone are not going to be sufficient. Documented accounts of recent scandals reveal systemic flaws in the entire range of ethical safeguards. For instance, we rely primarily on passive controls—systems that respond to unethical conduct after it has occurred. After-the-fact notification is sufficient if the risk is not overwhelming, but in the present environment, it is "too little too late."

Moreover, it is widely recognized that safeguards are only as effective as the culture in which they operate, what auditors refer to as the "control environment." But there is no formal oversight of organizational culture, no reporting mechanism that sounds an alarm when degenerate values take hold. Rather, responsibility for fostering a healthy culture falls to leadership. This division of labor between leadership and compliance leaves a monumental gap in coverage, one that can easily undermine the effectiveness of properly designed internal controls.

While acknowledging the importance of strong leadership, we contend that it is woefully insufficient. Leadership is not a substitute for systematically managing ethical performance because it lacks the necessary ingredients for accountability: performance objectives and periodic evaluation.

This inadequacy rears its ugly head in the aftermath of serious ethical lapses. Some of these episodes are complete surprises and assigning responsibility for the failure can be a time-consuming and frustrating exercise. Breakdowns in functional areas of organizations do not pose similar difficulties. Outside investigators are not needed to fix responsibility for, say, a marketing failure because someone was responsible for achieving explicit results and their performance was periodically evaluated. Such goals are not always met, but where there is a system of accountability, there is transparency—objective indicators that afford opportunities to rectify deficiencies before they become catastrophes. The need for a similar protocol applicable to the management of organizational ethics could not be more pressing.

> ### What are the strengths and weaknesses of present-day approaches to managing organizational ethics?
>
> Present-day approaches to managing ethical performance are primitive in comparison to the techniques employed elsewhere in organizations and woefully inadequate in relation to the risk. There is a lack of explicit accountability for ethical performance and there is a lack of transparency as to the ethical condition of organizations.
>
> Ethics is an area in which today's best management practices may not be good enough.

A Systematic Approach to Managing Ethical Performance

The BHEF Ethics Initiative was motivated by the question, "What would it take for us to embed ethics in our businesses and institutions of higher education?" We urge the answer, "Manage it with the same diligence and urgency that you would any other vital aim of your organization." To advance that cause, two obstacles must be overcome. The first is conceptual: the impression that ethics is not the sort of thing that can be systematically managed. The second is practical: a detailed strategy for doing so.

The conceptual impediments to systematically managing organizational ethics are strikingly similar to the ones

confronted by early stage quality management initiatives. For instance, quality had been thought of in the same way we currently think about ethics: as an intangible and subjective factor that is hard (if not impossible) to measure. Moreover, the difficulty in measuring quality stemmed from the same factor that we associate with ethics: quality was thought of as a characteristic of individual people, their conscientiousness, pride in craftsmanship, and attention to detail.

Based on these similarities, it is not surprising that quality had historically been managed more or less identically to the present-day approach to managing organizational ethics: first, as a duty of leadership and second, as a compliance or "quality control" function. That methodology was adequate until it was eclipsed by the size and complexity of the production process. Total Quality Management and Six Sigma programs evolved as a result. From all indications, ethics has arrived at a similar point and is in need of a similar transformation. To outline how that transformation might proceed, *Figure 1* lists four key elements in managing quality systematically and their ethical counterparts.

Figure 1

Four Key Elements in Managing Quality Systematically and Their Ethical Counterparts

Quality Output	Ethical Performance
1. From a focus on the performance of production workers and post-production flaws, attention expanded to encompass the entire organization and the origin of factors affecting the quality of goods and services.	1. From a focus on deviant activities of individual employees, attention should be paid to the environment and the ethical culture in which they work.
2. Every element of the organization that impacted quality— every discrete activity, process, procedure, and policy— was identified, analyzed, and to the extent possible, modified with a view toward defect-free production.	2. Understand the environmental and cultural influences on the choices employees make: • How is the environment structured in terms of goals, incentives, and rewards—does it entail any morally corrosive practices or pernicious conflicts of interests? • What are the operative values? • What "really matters?"
3. Metrics were devised for continuously monitoring discrete activities throughout the organization.	3. Periodically assess the ethical culture by documenting what the members of an organization perceive to be the operative values, the informal rules stipulating appropriate conduct, the importance accorded to playing by the rules, and other indices of ethical culture.
4. Managers were assigned responsibility for those metrics and held accountable for the results.	4. Vest responsibility for maintaining or improving ethical culture with those already accountable for operating performance. Senior leaders should set unambiguous objectives, provide the necessary resources and appropriate incentives, and hold operating managers accountable by periodically evaluating their performance.

Each of the above four elements of quality management were forged in corporate production environments, but migrated easily to the service sector, as well as to not-for-profit organizations and units of government. As a result, in expressing their ethical counterparts, we made no effort to distinguish between organizational types or industries. Moreover, these elements are intended to serve as general or guiding principles in a process, not as a set of rules to be strictly followed.

To determine the feasibility of this protocol, we tested two key assumptions:

1. whether ethical culture can be objectively assessed for these purposes

2. whether it is possible to fashion a performance objective for maintaining or improving the ethical culture of an organization, one that seasoned managers would be willing to implement without diluting its effectiveness.

Both tests were positive, suggesting that it is realistic to hold managers accountable for the ethical culture within their span of authority. However, more experience and documentation is needed to produce a refined and replicable version of this approach. This report contains a proposal for gaining that experience, the object of which is a template to manage ethical performance systematically.

Since our proposed approach to managing organizational ethics is patterned after the management of quality, the early history of that initiative bears mention. Its progenitors, W. Edwards Deming and Joseph M. Juran, confronted considerable skepticism that lingered until their ideas were proven in practice—initially in Japan before gaining international acceptance.

Our proposed approach to managing ethics can be expected to confront similar resistance regarding its feasibility and advisability. There are always theoretical objections to something that has yet to be tried and they cannot be addressed without tangible results. What is needed is the same thing that sparked the quality initiative: courageous and creative leaders with a willingness to experiment, to learn from doing, and to share what they learn.

What else could be done to embed ethics in organizations?

The many similarities between ethics and quality recommend using Total Quality Management and Six Sigma methodologies as guides for designing a similarly sophisticated approach to the management of organizational ethics—one that does not abandon compliance efforts but builds on them by inclining organizations to conduct their affairs ethically in the first place.

The polestars of a quality-based strategy for managing organizational ethics are:

• explicit accountability for the ethical performance of an organization

• increased transparency or the ability for those with a stake in an organization to assess its ethical condition.

The success of this strategy depends on whether it motivates individual managers and leverages their ingenuity. To that end, we propose four time-tested devices: explicit objectives; proper incentives; periodic evaluations; and the necessary support and resources.

Ethics and Higher Education

The ideas expressed thus far apply to the operational aspects of large organizations, businesses and institutions of higher education alike. Although college and university leaders grapple with some ethical challenges that their corporate counterparts do not (and vice versa), our strategy for managing ethical performance should be adaptable to their areas of greatest concern: intercollegiate athletics; medical centers; and commercially sponsored research and development. But colleges and universities have non-operational purposes as well, many of which fall under the heading of "student moral development" and include promoting academic integrity, encouraging responsible behavior in campus social life, instilling ethical values, and otherwise preparing students for the ethical challenges they will encounter in their careers. These goals and objectives deserve special attention.

Although colleges and universities devote significant curricular and extracurricular resources to these moral development objectives, recent corporate scandals
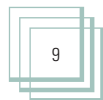
prompted calls for improving the ethical bearing of college graduates. In response, a great deal of work has been done and more is underway. It would be presumptuous for us to endorse any particular pragmatic tactic because colleges and universities differ so widely in terms of their priorities, commitments, resources, and student demographics. Our contribution consists of two ideas for managing student moral development objectives more systematically.

First, we encourage college and university leaders to consider applying our strategy for managing ethical performance to high-risk areas of their organizations. A university will not have the standing to further the moral development of its students unless it is seen as making every effort to conduct its own affairs with integrity—unless the institution is viewed as a moral exemplar. Second, we recommend expressing moral development aspirations as explicit goals, and managing them systematically or in much the same rigorous manner as a high-risk operational area.

We outline what the systematic management of a university's moral development objectives might entail, emphasizing the need to understand the university's culture from the students' point of view: the assumptions; values; and informal rules that guide their choices, govern how they study and play, and tell them what *really* matters. Perhaps of equal importance is to understand how they came to believe as they do—the specific sources of their cultural messages. Such information stands to serve three purposes:

1. To illuminate defects in the culture and ethically corrosive policies and practices.

2. To provide an empirical basis for judging the effectiveness of existing programs and for targeting resources as efficiently as possible.

3. To guide remedial actions and hold someone accountable for the results.

We challenged the feasibility of this protocol by testing its key assumption: that a distinct ethical culture is alive and operative within student bodies. We enlisted the help of some students in this test: 90 first-semester business school seniors attending a four-year residential college. Working in small groups or on their own, they provided detailed descriptions of their campus culture, the specific sources for their understanding of this culture, and recommendations for improving the ethical culture in which they have been immersed for the past three and a half years.

The results of this admittedly unscientific test suggest that a distinctive ethical culture exists on this particular college campus. Students had no difficulty identifying the operative values and shared beliefs among their classmates, and they did so with remarkable consistency. Students also cited similar sources for their cultural beliefs and assumptions—they more or less agreed on how they came to acquire their understanding of "what really matters around here," what constitutes acceptable behavior, what crosses the line, and so forth.

The consistency of their responses suggests that the culture of a student body is something that can be managed systematically. Another aspect of their responses suggests that the need for doing so is pressing: students indicated that the ethical culture of this particular campus functions as efficaciously on students and the choices they make as the culture of an organization operates on employees—it tends to override formal policies.

Notwithstanding the results of this experiment, there are many reasons to doubt whether institutions of higher education can play a meaningful role in the moral development of their students. We examined those reasons and did not find any of them compelling. However, the challenge should not be underestimated. We reviewed some sobering evidence of the ethical habits and attitudes of incoming freshmen. Dismal as that evidence is, there is cause for hope: other evidence depicts these young people as fully capable of and open to moral growth. We concluded that colleges and universities have a genuine and realistic opportunity to make a positive difference in the character traits of their graduates. Furthermore, we believe they can—they have a model of success in a closely related area.

Colleges and universities have worked diligently to inculcate a respect for diversity in their students—to accept others without regard for differences of race, religion, gender, ethnicity, etc. The evidence suggests that their efforts have been successful: college seniors accord significantly greater importance to diversity than the norm. If colleges and universities can influence attitudes regarding this vital civic value, then they would seem to be capable of achieving similar results with ethics. We borrow key elements from their model for instilling a respect for diversity to formulate a strategy for improving the ethical behavior of college students and their characters upon graduation.

How might colleges and universities improve the ethical conduct of their students and influence for the better their characters upon graduates?

We offer leaders of higher education institutions a strategy for systematically managing this objective. Derived from our approach to managing ethical performance systematically and strongly emphasizing the proactive management of ethical culture, it is patterned after the achievements of colleges and universities in a closely related area: instilling a respect for diversity in their students. An ethical equivalent of that model stands to boost the moral bearing of future college graduates.

Concluding Comments

Eighteenth-century philosopher and economist Adam Smith marveled at the social benefits that derive from individuals freely pursuing their self-interested ends. He also believed that commercial life had a civilizing effect—that the rewards for fair and honest dealing brought out the best in human nature: honor; integrity; and, most of all for Smith, a sense of justice. Recent events call into question the wisdom of this otherwise prescient thinker. Was he wrong?

We believe Smith was right: the market does reward ethical conduct and punish the scofflaws—eventually. The problem we face is that some of the gale force market winds that batter an organization may seem like gentle breezes to some of its members. It was irrational in the extreme for Arthur Andersen to compromise its integrity and jeopardize a multi-billion dollar franchise for a $50-million fee, but evidently, that reasoning was not compelling to the individuals responsible for the Enron account.

Market forces are alive and well, but organizations can act as barriers and mute some of their most socially attractive features. Our proposal for managing organizational ethics takes seriously the diminished efficacy of market forces within large organizations and seeks to recreate it in the form of a management imperative. We would compel integrity by holding individual managers accountable for explicit goals and rewarding or punishing their performance, as markets do under ideal conditions. If successful, the same force that restored the quality of American production will be marshaled to the cause of organizational ethics: the resourcefulness of managers given clear objectives, appropriate incentives, and adequate resources to succeed—and held to account.

Our strategy for managing ethical performance may strike some readers as complex, cumbersome, and costly. We believe it can be streamlined, but nonetheless, this is not an "easy fix." We assumed that the low-hanging fruit in the orchard of organizational ethics has long-since been picked and we calibrated our strategy to the difficulty of the remaining challenge, the stakes involved, and the checkered results of past attempts to make a lasting difference. Also, the major cost of this strategy is in documenting ethical culture such that a management responsibility can be formulated in respect of it, and that documentation has value in its own right. Recalling any of the recent scandals, the information that would have sounded a clear warning sign of trouble ahead is one of the least transparent aspects of contemporary organizations: their cultures. Bearing in mind that culture will tend to drive conduct, we pose two questions:

- **What is it worth to know the operative values of an organization—what its members believe really matters, the importance they accord to playing by the rules and following the law, and the conduct they believe is condoned and rewarded?**

- **Is there a better starting point for improving organizations from a moral point of view?**

The Enron Era:
Myths and Misunderstanding

Bad News Comes in Threes

Rarely do the activities of a particular company appear outside of the business sections of major daily newspapers. Even more rarely do they stay there for weeks on end. The exception is something of keen interest locally, and even those stories are buried during times of national security upheaval. Such was the case after Sept. 11, 2001, when it was inconceivable for company-specific news to compete for coverage with terrorism and an impending war in Afghanistan.

But that is precisely what happened on Dec. 2, 2001, when the bankruptcy of a Houston-based company garnered front-page, above-the-fold placement in daily newspapers across the country, lead coverage on nationally televised newscasts, and considerable mention in the international press. The fact that Enron had not been a household name outside of Houston made this coverage all the more remarkable. In contrast, widely recognized Kmart declared bankruptcy on Jan. 22, 2002, slashing a multiple of the jobs that were lost at Enron. And yet, it attracted only a small fraction of the Enron coverage.

The infatuation over this astonishing failure was in large part a function of the dazzling success that preceded it. One year before its demise, Enron featured prominently in *Fortune* magazine's annual listing of the world's most admired companies. In an article headlined, "How do you make the Most Admired list? Innovate, innovate, innovate," Nicholas Stein encapsulated the legend as follows:

> *"No company illustrates the transformative power of innovation more dramatically than Enron. Over the past decade Enron's commitment to the invention—and later domination—of new business categories has taken it from a $200-million old-economy pipeline operator to a $40-billion new economy trading powerhouse.*[2]

How was it possible for this highly vaunted engine of innovation and prosperity—a company ranked seventh from the top of *Fortune's* list of the 500 largest U.S. companies—to implode so abruptly?

Enron's precipitous fall from grace raised questions of another kind: How was it possible for a handful of its executives to reap such extravagant wealth while destroying the jobs and investments of innocent bystanders? Where were the auditors, the directors, the credit rating agencies, the government regulators? How could something of this magnitude have evaded every safeguard? What was the role of the commercial and investment bankers, the securities analysts, and the attorneys? Did they knowingly enable this deceitful scheme? Were they complicit in it?
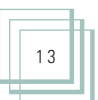
These questions reflect the deep sense of betrayal and moral indignation over Enron's wreckage. As the search for answers got underway, two other business failures jumped to the front page. Enron's record-setting bankruptcy had barely been filed when it was eclipsed. Reeling from revelations of more than $9 billion of fraudulent accounting, WorldCom petitioned for protection on July 22, 2002. Separated by only eight months, these shocking failures bracketed a third: Arthur Andersen, the independent auditor for both Enron and WorldCom, succumbed to allegations of professional compromise and an indictment for obstruction of justice.

Since Enron's collapse, ethical breakdowns have roiled other companies in a number of different industries—securities, insurance brokerage, and print media to name three. But Enron, WorldCom, and Andersen deserve a special place. Without this trio, both houses of Congress would not have focused single-mindedly on capital market regulation in the immediate aftermath of 9/11. Compressed in time and emblematic of the same egregious betrayal of public trust, they define a distinct chapter in U.S. commercial history. Call it the "Enron Era" for the sake of brevity.

A measured response to the Enron Era requires a clear-eyed understanding of what went wrong and why. Gaining that understanding is easier said than done since some misunderstandings must be cleared-up first, including at least one that has achieved the status of well-received truth.

Characterizing the Enron: a Crisis of Confidence?

American Enterprise Institute resident fellow, Peter J. Wallison observes, "It is an article of faith among financial commentators and policymakers that the Sarbanes-Oxley Act was necessary to restore investor confidence…."[3] For instance, *Business Week* writer Louis Lavelle refers to the period as one in which "Investor confidence was at an all-time low."[4] Likewise, the following characterization is contained in a Public Company Accounting Oversight Board (PCAOB) publication:

"Corporate leaders and advisors failed. People lost their livelihoods and their life savings. The faith of America and the world in U.S. markets was shaken to the core."[5]

What should be made of these and other references to a breakdown in trust? Obviously, some people lost confidence in the stock market and in corporate America generally. How widespread were those sentiments?

As for corporate leadership, consider the Harris Poll that has been measuring confidence in leaders of major institutions since 1966 (No. 18, March 10, 2004).[6] Early in 2001, pre-Enron, 20 percent of Americans had "a great deal of confidence" in the "people in charge of running major companies." One year later, post-Enron but pre-WorldCom and Andersen, 16 percent felt that way. And early in 2003, when the Enron Era was in full bloom, only 13 percent did.

Those results would appear to chronicle significant fallout, but it is just as likely that they reflect employment trends and stock market performance. Indeed, they conform to the pattern of an earlier economic cycle. Before the 1987 stock market crash and the difficult investment climate and employment conditions that followed, 21 percent of Americans had a great deal of confidence in corporate leaders, a reading that would not be approached again for seven years. In two of the intervening years, 1990 and 1991, the results were a paltry 9 percent.

The notion that confidence in business leaders ebbs and flows with employment trends tracks with another research finding: when members of the public are asked to evaluate business conduct they do so from their personal perspective as a consumer or an employee. One study found that "protecting workers from layoffs" was treated as a "crucial moral consideration" of management.[7] If that attitude is at all representative, it makes perfect sense that confidence in business leaders would closely parallel national employment trends.

Similarly, some commentators seized on the findings of an ABC/Washington Post Poll finding that only 23 percent of Americans had either a "great deal" or "quite a lot" of confidence in large corporations in late June of 2002, while 33 percent reported having "very little" confidence and 42 percent had some. However, when these results are compared with the findings from earlier polls, it is difficult to discern any direct impact from the Enron Era. (See *Figure 2*.)

Figure 2
Confidence in Large Corporations

	Great deal/Quite a lot	Some	Very little
June 26-30, 2002	23%	42%	33%
1991	22%	45%	31%
1981	26%	40%	31%

The findings of a recent *Los Angeles Times* poll (March 27-30, 2004) revealed similar attitudes. In response to the question, "How much of the time do you think you can trust the executives in charge of major companies?" one percent said "always;" 22 percent said "most of the time;" 52 percent said "some of the time;" 23 percent said "hardly ever;" and two percent said they "don't know."

Finally, a Gallup poll of American workers was conducted at a particularly noisy point in the Enron Era (between July 29 and Aug. 25, 2002). Randomly selected employees were asked about the honesty and ethics of the people in charge of U.S. companies. Although only 51 percent registered either a "great deal" or a "moderate amount" of trust in corporate leaders generally, 81 percent moderately or greatly trusted those in charge of their own companies. And 85 percent responded similarly when the question focused on the "the people who run their companies' finances." These data are not *indicative* of a population that has lost faith in corporate leadership.[8]

Enron Era scandals would appear to have had a similarly benign impact on investors. For instance, consider the "Confidence Index," one of the Yale School of Management Stock Market Confidence Indexes™ that economist Robert Schiller has tracked since 1987. This indicator tracks the percent of U.S. individuals and institutional investors that expect the Dow Jones Industrial Average to increase during the next year. As the following chart indicates, investor confidence was seemingly unaffected by the spate of corporate scandals. (See *Figure 3*.)

Behavior often deviates from expectations based on polling data, but not in this case. Investment patterns in the wake of Enron, WorldCom, and the others do not resemble those of past breakdowns in confidence. According to The Investment Company Institute, a mutual fund industry association, net purchases of stock

Figure 3
One-Year Confidence Index

▼ **Confidence (%)**

Stock Market Confidence Indexes (c) 2001-2005
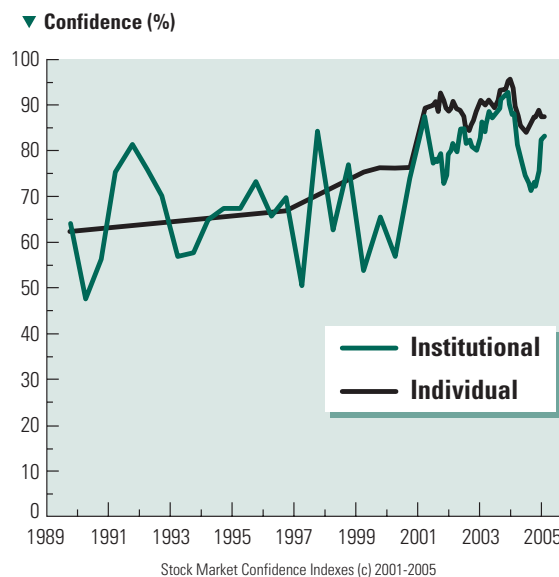
Source: International Center for Finance, Yale School of Management. Reprinted with permission.

and hybrid mutual funds (a proxy for individual activity in equity securities[9]) during 2003 totaled $185 billion.[10] This was less than the bull market peak of $ 266 billion in 2000, but more than the $175 billion that was invested in 1999. Likewise, 53 million U.S. households owned mutual fund investments in 2003, a decline from the peak of 56 million in 2001, but on a par with the pre-Enron level of 52 million in 2000.

Perhaps the most compelling evidence that investor confidence had suffered is the fact investor redemptions from stock and hybrid mutual funds exceeded purchases by $19.2 during 2002. However significant this may seem, it represented the tip of a $2.893-trillion financial iceberg, less than one percent and far below crisis levels. Also, if these withdrawals were indicative of a crisis of confidence,

Figure 4

Redemption Rates* of Equity Funds, 1985-2003

▼ **Percent of Assets**

* The redemption rate is calculated as the sum of redemptions and exchange redemptions for the 12 months ending in the month plotted, divided by monthly total net assets averaged during the same period.
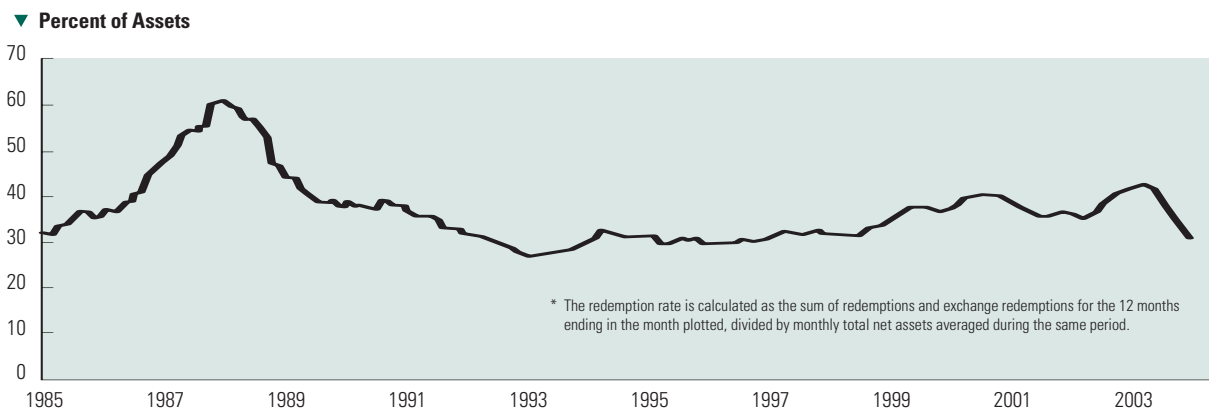
Source: 2004 Mutual Fund Fact Book, Copyright by the Investment Company Institute (www.ici.org). Reprinted with permission.

it was an exceedingly short one: investors replenished what they withdrew during all of 2002 in the first quarter of 2003.[11]

To place Enron Era investment patterns in their appropriate perspective, Figure 4 isolates equity mutual fund redemptions (i.e., it ignores purchases) over a period that includes the seriously jarring events of 1987.

It bears noting that corporate scandals were not the only confidence-rattling events during the Enron Era. Investors also had to contend with two wars, one recession, a prolonged bear market following the bursting of a market bubble, continued threats of terrorist attacks, and a U.S. dollar that fell below parity with the Euro for the first time. In retrospect, it is a wonder that investor confidence held up as well as it did.

In summary, the Enron Era was a lot of things, but based on poll results and investor activity, a crisis of investor confidence was not one of them. This matters because by assuming that a crisis occurred, we are apt to believe that the necessary repairs have been made—after all, the investment climate seems to have improved somewhat. That reasoning is evident in a recent *Business Week* article in which the authors claim that the Sarbanes-Oxley Act provided a "…boost to investor confidence that has helped bring life back to U.S. markets…the reforms have helped renew investor confidence in companies' reports"[12] We will later explain that provisions of the Sarbanes-Oxley Act offer some much needed reform but the core Enron Era

malady remains untreated. Meanwhile, as its episodes fade from memory, evidence suggests that focusing on a putative crisis in confidence has led us astray.

Consider the record of the House and Senate investigative hearings of early 2002: thousands of pages of testimony that are liberally sprinkled with moral terminology. Words like "trust," "ethics," "principles," "ideals," and "values" appear hundreds of times. Those hearings culminated in the Sarbanes-Oxley Act and the legislative authority for the PCAOB. Two years later, the PCAOB released what is arguably the most substantive reform measure to date. The quote at the beginning of this section was from the preamble of that release, a 211-page document in which the word "ethics" appears only once (page 42 in connection with a code of conduct), and the words "trust," "values," and "integrity" are used only twice each in their moral connotations.[13] It would appear that our collective attention may have shifted from an unambiguous concern over egregious ethical abuses to the finer points of corporate governance and internal controls.

One hopes that the worst is behind us but if history is any indication, a full-fledged crisis of confidence remains a lively possibility. Previous such periods were not triggered by stunning events. The loss of investor confidence that began in the Great Depression and continued for over a generation thereafter was not caused by the Crash of October 1929. History teaches that investor confidence recovers fairly quickly from sudden ruptures, regardless of their magnitude, but is undermined by an incessant

stream of bad news. Recent revelations of unethical conduct in the insurance industry should serve as a reminder that we are not out of the woods. Alternatively, to characterize the Enron Era as a crisis of investor confidence that has since been remedied is to promote a false sense of security.

Explaining the Enron Era: Looking for Immorality in All the Wrong Places

A number of explanations purport to make sense of the Enron Era. As will be seen shortly, the enlightening ones are the result of painstaking analysis of individual scandals. Far more common are explanations based on impressions or suppositions. The latter style deserves scrutiny and not simply because they have gained traction in the public imagination or for reasons of idle criticism: flawed diagnoses and disappointing remedies have been known to go hand-in-hand with one another in the past.

National Social and Cultural Factors

Can organizational corruption be explained in terms of a culture of greed, hyper-competitiveness, excessive individualism, or some similarly bleak social pathology? Not with much illumination. The vast majority of American companies are decent corporate citizens—not perfect, but unlike Enron or WorldCom, few of them operate on the brink of an ethical disaster. And since they are all a product of and operate within the same general societal conditions, those conditions cannot be very important factors in explaining the aberrations.

Moreover, is it true that American social ties grew weaker in recent years? Some people think they have, but their burden of proof is overwhelming. A good example is Robert Putnam's effort in *Bowling Alone: The Collapse and Revival of American Community.* The thesis of this book is that the fabric of community in America ("social capital") has seriously frayed. Although Putnam cites a vast amount of data, his critics counter with a mountain of contradicting evidence.[14]

With regard to the ethical bearing of today's college students, much has been made of the increased incidents of academic dishonesty. But some scholarly research tells a different story: some forms of cheating are on the rise, but the overall level is not.[15]

Perhaps social and cultural conditions are contributing factors as opposed to outright causes of corporate corruption. Fair enough, but this weaker form of explanation simply raises other questions. If some element of the national culture explains what transpired at Enron, then what was it about Enron that magnified its perniciousness and why were other organizations able to keep it in check?

Here is another reason to steer clear of these explanations: they leave little opportunity for constructive remedies. Entrenched cultural defects are notoriously resistant to change—barring illiberal reforms, they tend to evolve slowly and of their own accord.[16] Thus, a diagnosis of cultural degeneracy is a prescription for inaction.

Institutional Factors

Can unethical conduct be explained in terms of flaws in the institutional framework, such as an overly permissive regulatory regime or feckless law enforcement? Explanations of this kind tell a coherent story, but one that is inherently fragile unless the conduct is pervasive. If it is not, then an assumption must be made that although "everybody did it," just a few were caught. In the case of organizational corruption, that assumption should not be accepted on face value. An illustration is in order.

Among the troubling practices that came to light in the wake of Enron's failure, one was of immediate concern: an extravagant interpretation of the accounting rules governing special purpose entities (SPEs) had obscured its precarious financial condition. This revelation focused attention on the rather lax accounting standards that govern these devices—veritable invitations for abuse. Insofar as SPEs are used by most large companies, a hunt commenced for similar abuses. After all, most chief financial officers (CFOs) had the *ability* to do what had been done at Enron and they had the same *incentive*: improved balance sheet ratios without having to repay loans or raise equity capital. But the search came up empty-handed.

The fact that no other company followed in Enron's footsteps may seem unimpressive, since some of its activities are the subject of criminal complaints. But a less flagrant and legally tamer approach would have achieved many of the same results. The point is that many accounting rules

can be interpreted advantageously or "structured around" with impunity. And although games are played, the game played at Enron was in an entirely different league. This was not a case of burnishing results, but of financial statements that took leave of economic reality. Given the flexibility in the rules and the rewards for bending them, why was Enron playing in such an exclusive league?

In summary, Enron Era scandals highlighted regulatory flaws but those flaws do not explain the episodes. Indeed, such explanations will tend to raise as many questions as they answer.[17]

Bad Practices

Earnings pressure is another factor that is often mentioned in the context of corruption. But consider that the same analysts tend to follow the same companies within any given industry. The pressure to hit quarterly earnings estimates is more or less the same. And yet, many companies take their lumps, some engage in mild forms of accounting chicanery, and a select few resort to wholesale fabrications. Is it fair to say that earnings pressure explains, much less causes, unethical conduct?

WorldCom epitomized one of those select few companies just mentioned. During a dreadful operating environment in the telecommunications industry (third quarter of 2000 through the first quarter of 2002), it managed to report consistently strong earnings, with an emphasis on "managed." Without a fraudulent misstatement of $9 billion of expenses, it would have come in with the same abysmal results as its competitors. Under those circumstances, earnings pressure may come into play as an after-the-fact excuse or justification of one's transgressions, but it does not explain why WorldCom management resorted to one course of action while the vast majority of financial managers pursued another.

The same thing could be said of executive incentives tied to short-term results. Undoubtedly, stock option plans can encourage managers to fabricate earnings. But because such plans were (and are) ubiquitous and fabricated earnings are not, this factor sheds little light on the phenomenon of organizational corruption.

Corporate governance has also been cited as a cause of organizational corruption. After all, for every scandal there was a board that failed to intervene. Although this is true, there is nothing distinctive about the governance structure of Enron or WorldCom. Nor can the members of these boards be distinguished on the basis of their independence or expertise from the universe of people occupying similar positions. If anything, they were better than many.

As was the case with explanations based on social and cultural factors, those rooted in bad practices may counsel ill-advised remedies. Recall that the practices earnings pressure, incentive stock option plans, and the governance arranges in place today were in place during the 1990s. And at least the last eight years of that decade have been heralded by politicians and economists alike as among the most successful of the 20th century—not simply in terms of absolute prosperity, but in the distribution of wealth as well.[18] Those that advocate the radical overhaul of these practices should be cognizant of their benefits and careful to distinguish between exceptional abuses and systemic defects.

Perhaps the most apt characterization of these suspect practices is the one given to earnings pressure by the 103rd American Assembly: a "catalyst."[19] As such, they do not produce a pernicious result unless other factors are present. Those other factors will receive attention shortly, after considering the most popular explanation for organizational corruption.

"Whether one's behavior is going to be ethical or unethical is, to a large extent, situational. It is not the result of an inadequate understanding of ethics, or of fault lines within one's character…."

Bad Apples

Some would point to a few miscreants or character-flawed individuals as the cause of organizational scandals, "greed" being the most oft-cited vice.[20] However, a little reflection suggests that such explanations are tantamount to explaining violent crime in terms of basic weaponry. While it is true that physical injuries are caused by the sharpness of blades and the velocity and hardness of projectiles, those factors contribute little to our understanding of violent crime and nothing to our efforts to reduce it. Likewise, references to human character do not deepen our understanding of organizational corruption and they can frustrate our efforts to curtail it.

Most of us are neither archangels nor moral degenerates, but something comfortably above the latter and far short of the former. But *everyone* is capable of behaving badly under certain circumstances. As management professor Saul Gellerman notes, "Whether one's behavior is going to be ethical or unethical is, to a large extent, situational. It is not the result of an inadequate understanding of ethics, or of fault lines within one's character…."[21] And as John Della Costa, author of *The Ethical Imperative: Why Moral Leadership is Good Business*, explains, "Ethical and legal lapses are the stuff of average people who know better," not genuinely "sinister" characters.[22]

The foregoing observations are buttressed by a wealth of social psychology[23] to the effect that "information about people's distinctive character traits, opinions, attitudes, values, or past behavior is not [as] useful for determining what they will do as is information about the details of their situation."[24] Since we can safely assume that every organization is populated by more or less the same distribution of character types, the significance of this literature cannot be overstated. Rather than attribute the phenomenon of organizational corruption to a few bad apples, we should focus attention on the circumstances within some organizations. What is it about an organization that brings out the worst in people? What is it about another one that inclines its members to avoid temptation and play by the rules?

Summary

In criminology and as a matter of common sense, deviant behavior, if an aberration, cannot be explained by a condition that applies uniformly to an entire population. So, for instance, WorldCom's bogus financial disclosures cannot be explained in terms of American culture, perverse incentives, lax regulation, or other external factors.

Moreover, while it is true that specific individuals perpetrated these crimes, it would be superficial to write-off the phenomenon of organizational corruption to individual character traits. For one, it may be wrong: some of them are known to be thoroughly decent people with no history of character-flawed behavior. More important, while it is easy to attribute character flaws to complete strangers in explanation of their actions, where does that explanation lead us? Knowing that a touch of greed and avarice are present in all of us, it does not explain why similar people in more or less identical circumstances behaved differently. Nor does it point us in the direction of realistic remedies unless remaking human nature is considered a viable possibility.

To begin digging a little deeper, imagine a neighborhood where the majority of young people are well-adjusted, but a few are not. The outliers suffer the full spectrum of social ills—they do not complete high school and their rates of teen pregnancy, drug addiction, and illiteracy are off the charts. To explain this phenomenon so as to do something about it, the neighborhood is probably the last place to look. Likewise, probing the moral constitutions of these individuals will at best confirm the obvious. Rather, contemporary criminologists would advise going inside their homes to see whether there are any common denominators that explain their aberrant behavior. Similarly, this investigation will look no further at the most commonly cited explanations of the Enron Era. Instead, it will probe on the inside of organizations.

The Enron Era:
Lessons Learned

In sharp contrast to breathless accounts of the Enron Era as a crisis of investor confidence and gloomy explanations rooted in cultural degeneracy or the like, business ethicist R. Edward Freeman takes a more sanguine view. He believes that "there is absolutely nothing new about any of [the Enron Era scandals]" and in at least one important sense he is right: the basic architecture of financial fraud is more or less timeless.[25] However, just the opposite is true with regard to the settings in which it occurs—organizations are inherently unstable places. Several characteristics of today's organizations have transformed unethical conduct into a considerably more menacing phenomenon than it had been in the past, more difficult to prevent and more punishing when it does occur.

To understand this transformation and its manifestation in recent corporate scandals, we call attention to three vital lessons of the Enron Era.

Lesson 1:
The Perils of Our New Ways

What Changed?

Consider a few of the features that differentiate today's organizations from those of the 1960s:

- Increased scale of operation

- Greater access to sophisticated information and communications technology

- Global reach

- Far more mergers, acquisitions, spin-offs, downsizings, and other forms of organizational restructuring

- Innovative management strategies, including less hierarchical structures, flexible planning, and decentralized decision-making

These and other changes came about for a reason: a knowledge-based economy places a premium on how effectively an organization can leverage individual effort, creativity, and ingenuity. In the words of Warren Bennis, founding chairman of the Leadership Institute

at the University of Southern California's Marshall School of Business, "the release and full use of the individual's full potential is the organization's true task." Efforts to accomplish that task got underway in the late 1970s, but accelerated rapidly in the succeeding two decades. What emerged are vastly more productive organizations that bear little formal resemblance to those of the 1960s.

How Did These Changes Alter the Ethical Equation?

Consider the dark side of releasing individual potential: the factors that leverage individual creativity are the same ones that stand ready to leverage the least attractive elements of human nature: deceit, selfishness, and so on down the list. Take for instance employee "empowerment," a relatively new management concept and one that represents a double-edged sword. Providing workers greater latitude to maneuver (for example, authority and access to resources) increases one of the primary predictors of deviance—opportunity.[26] Therefore, increased empowerment, desirable though it may be, increases the likelihood of unethical conduct. Self-made billionaire Warren E. Buffet does not exaggerate when he observes, "In looking for people to hire, you look for three qualities: integrity, intelligence, and energy. And if they don't have the first, the other two will kill you."

Likewise, mergers and acquisitions transactions can be beneficial or deleterious, depending on how they are managed. If not managed well, they can introduce an element of instability and an increased risk of ethical breakdowns. One of the few negative finding in the most recent Ethics Resource Center survey of American workers is noteworthy: "American workers feel increased pressures to compromise ethical standards at times of corporate mergers, acquisitions, or restructuring. In fact, employees in these transitioning organizations are almost twice as likely to feel ethics-related pressures as compared with their counterparts in both 2003 and 2000."[27] It is not surprising then that WorldCom and Enron were cobbled-together results of numerous investment banking transactions.

Finally, restructuring a bloated organization can mean the difference between competitive survival and extinction. But in some cases, ethical oversight has been a casualty of the quest to streamline, as it has from the transformation of controllership to "financial engineering."

And Why is This More Menacing than Before?

Unethical conduct is much easier to contain and correct within a hierarchical command and control structure where authority is not widely dispersed, technology is not generally available, operating units are relatively small and stable, and responsibility for ethical compliance is not blurred and compromised by other objectives.[28] The ethical risks of replacing that structure with its opposite should not be minimized. It has always been recognized that no defense is fail-safe against unethical conduct. Legal sanctions, market forces, and systems of internal control can only do so much. But it was less apparent that the entire spectrum of protective measures could be subverted, with relative ease within very large organizations.

In short, the Enron Era revealed something disconcerting about today's organizational setting: a relatively small band of pirates can plunder in ways that used to require military force. We have seen such bands succeed, several times thus far. And similarly, college students can plagiarize without opening a book and steal intellectual property without leaving their dorm rooms.

Lesson 2:
The Limits of Ethical Safeguards

The conventional approach to managing organizational ethics could be called "Implore but Verify." The first term of that characterization refers to a variety of imperatives and exhortations—from overarching values to fine-grained codes of conduct. The second refers to an array of safeguards (for example, audits, internal controls, and ethical compliance programs). Managers with responsibility for these endeavors are accountable for the nature and extent of various prescriptions, as well as the thoroughness and rigor with which protective systems and programs are designed and maintained.

The expectation of this arrangement is that saying the right things, when backed up by muscular controls, will minimize unethical conduct. That expectation is generally met—few organizations are ethical blowups just waiting to happen. What follows is not an appeal for less vigilant controls, but one for taking seriously their inherent limitations. It is intended to endorse and expand upon the following comments by the Ad Hoc Advisory Group on

the Organizational Sentencing Guidelines as it formulated recommended changes in the Federal Sentencing Guidelines for Organizations:

*"It is obviously unrealistic to expect that the organizational sentencing guidelines will deter **all** corporate crime. No set of sentencing incentives and penalties can, in every case, overcome the impact of corporate culture and individual greed, fear, or arrogance that drive corporate misfeasance. The fact of this misconduct, then, does not necessarily indicate that the organizational sentencing guidelines are deficient.*

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*What should be troubling, however, is the fact that much of this misconduct was perpetuated by senior management and was only belatedly discovered **despite the existence of auditing and other internal reporting systems.** (emphasis in original)"*[29]

The Enron Era is a study in compliance program flaws, but it also helps to explain why these flaws have proven to be so intractable. The following three factors have tended to hobble the best-laid compliance plans:

- **One Step Behind:** Because many controls are designed with previous instances of unethical conduct in mind, they do not fare well in the face of novel forms of malfeasance. A case in point is the Sarbanes-Oxley Act requirement that a Security Exchange Commission (SEC) registrant must publicly disclose when it changes or waives its code of conduct. Where did that come from? Well, the Enron fiasco was possible (in part) because Andrew Fastow, its CFO, served in an outside capacity that compromised his fiduciary duties to shareholders. Provisions of the Enron code of conduct prohibited (rightfully) such activities so in approving the arrangement, they were formally waived by the Board of Directors.

- **The Human Factor:** The efficacy of most safeguards is a function of how effectively they are managed. While it is widely recognized that collusion can neutralize the most brilliantly designed systems, other methods do not require cooperation. For instance, research indicates that whistleblowers are unlikely to share what they know if they fear retribution or if they doubt whether anything will come of it. As a result, properly placed coercion or incompetence can defeat the purpose of the most cleverly conceived hotline. This will be illustrated in the next section.

- **Too Little, Too Late:** Some of the most important safeguards (for example, internal and independent audits) are limited by their design to detecting ethical abuses. Although the possibility of being discovered is a potent deterrent to some deviant activities, investors in WorldCom and Enron would question whether complex financial fraud is one of them. Consider for instance the proposal of Luigi Zingales, a University of Chicago finance professor, to pay whistle-blowers a percentage of the fines assessed against offending companies and executives.[30] He estimates that Enron executive Sherron Watkins would have collected $2.3 million, little consolation for anyone except Ms. Watkins.

These are not new factors, but they have gained significance in the context of the prevailing management model previously discussed. Before the Enron Era, it may have seemed as though some organizations were not susceptible to a debilitating breakdown in their controls—one so serious as to preclude recovery outside of bankruptcy protection.

Today, it can no longer be assumed that organizational size or age matter—Andersen alone disproved both of those assumptions. Moreover, the Enron Era confirmed a pattern in the management of organizational ethics: one of increasingly sophisticated controls that fail in the face of increasingly egregious instances of ethical abuse.

This rather bleak assessment would brighten if innovative new safeguards were in the offing. But they probably are not. As evidence, consider the internal control provisions under Section 404 of the Sarbanes-Oxley Act. Some claim they are wrongheaded,[31] others believe they are reasonable and necessary.[32] But no one has used words like "innovative," "novel," or "ingenious" to describe these rules. The legislation requires scrupulous documentation of internal controls, but it does not recommend any new control mechanisms. Senior executives must attest publicly to the veracity of financial disclosures, but their responsibility for those disclosures is not new. More severe sanctions were enacted, but the law did not proscribe any significant activity that had been legal in the past. In other words, the legislation mandated marginal improvements in extant compliance protocols.

This observation is not intended to criticize the authors of the Sarbanes-Oxley Act for failing to brave any new paths. When it comes to internal controls, there are only so many paths and they were all braved before Enron erupted on the scene. Indeed, every known instance of Enron Era
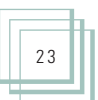
"It is important to note at the outset that the old WorldCom has already disappeared from the scene. In its place the new MCI is embarked on a journey…to establishing a very different corporate culture in which values of transparency and integrity are cornerstones of its renewal and rebirth."

misbehavior ran roughshod over at least one internal control mechanism that was supposed to discourage it. Moreover, Enron executives Andrew Fastow and Scott Sullivan, and lesser perpetrators will serve time behind bars for violating statutes that date back to the mid-1930s.

In conclusion, the Enron Era provided a much-needed wake-up call to tighten existing controls, but if that is all it accomplishes then one of its lessons will not have been learned. Just as there is no substitute for individual integrity, in the case of organizations, there is no substitute for an organizational culture in which morality matters and following the law is not negotiable.

Lesson 3:
The Central Importance
of Ethical Culture

SEC Chairman William H. Donaldson emphasizes the importance of culture in the following remark: "The most important thing a Board of Directors should do is determine the element that must be embedded in the company's DNA…. It should be the foundation on which the Board builds a corporate culture based on a philosophy of high ethical standards."[33] The phrase "most important" may seem hyperbolic, but recent events suggest it is not. The Chairman's sentiments were born out in a key finding of the Advisory Group to the United States Sentencing Commission. Based on careful examina-

tions of Enron Era scandals, the Group recommended amending the Federal Sentencing Guidelines for Organizations as follows:

"Emphasize the importance within the guidelines of an organizational culture that encourages a commitment to compliance with the law."[34]

Just exactly what is meant by "organizational culture" and why is so much importance attached to it? Organizational behaviorists describe it as a cluster of implicit assumptions, values, normative standards, and beliefs that are held by members of a group and that influence how they understand and react to their environment.[35] Linda Klebe Treviño, a professor of organizational behavior at Pennsylvania State University, isolates an ethical dimension of culture that is manifest in how employees understand what is expected of them, their limits in terms of "getting the job done," how they ought to treat other people, the importance they should accord to controls and safeguards, and so forth. As between ethical proclamations—codes of conduct, compliance manuals, or speeches—and the informal culture of the workplace, the latter tends to win out.[36]

Invariably, the culture of a scandal-plagued organization either failed to telegraph the importance of ethical behavior or drowned it out with a competing message, usually one that placed greater urgency on short-term profits. Either way, employees were not compelled to play by the rules or to pipe up when they were broken.

What is the relationship between the ethical culture of an organization and the culture of an entire society? Research

suggests that we compartmentalize. For instance, one study revealed that 86 percent of managers act at work based on moral standards that they perceive *in their workplace*.[37] Other research discovered that individuals are led to commit corrupt acts through a process of indoctrination that is peculiar to specific organizations and not a function of society writ large.[38] Those findings are in keeping with a stream of research in social psychology that began with famed social psychologist Stanley Milgram.[39]

Among other things, Milgram and his colleagues at Yale University wanted to understand our capacity to do evil. Through a series of experiments they demonstrated that the vast majority of people would abandon their moral commitments and inflict severe pain on an innocent person—with very little coaxing. Milgram's overarching conclusion was that most of us are inclined to obey authority if we regard it as legitimate. It is no wonder then that, in the context of a workplace, the dominant moral authority will be that of a local manager.

Ethical Cultures Gone Bad

A review of several well-documented Enron Era scandals illuminates the inner workings of ethical culture in considerably finer detail.

Starting at the top, Enron professed allegiance to all the right values, summed up by "RICE"—Respect, Integrity, Communications, and Excellence.[40] Contrast that with the testimony of William C. Powers, Jr., Chairman of the Special Investigative Committee of Enron's Board and co-author of the so-called Powers Report[41] as he addresses its fictitious accounting:

> "Let me say that while there are questions about who understood what concerning these many very complex transactions, there is no question that virtually everyone knew, everyone from the board of directors on down, everyone understood that the company was seeking to offset its investment losses with its own stock. That is not the way it is supposed to work…. As a result of these transactions, Enron improperly inflated its reported earnings... by more than $1 billion...more than 70 percent of Enron's reported earnings for this period were not real." [42]

Powers could have gone further in terms of who knew what. The following quotes are from rank and file workers:

> "I have heard one manager level employee…say, 'I know it would be devastating to all of us, but I wish we would get caught. We're such a crooked company.'"[43]

> "When I was there it was pretty obvious that most employees knew what was going on."[44]

In his investigative study of Enron, Powers enumerates the following causes for Enron's "accounting-challenged" financial disclosures:

> "[A] flawed idea, self-enrichment by employees, inadequately designed controls, poor implementation, inattentive oversight, simple, and not-so-simple, accounting mistakes, and overreaching in a culture that appears to have encouraged pushing the limits."[45]

Although culture made the list, it does not feature prominently. It should have, because Enron was among the more exotic specimens in the zoo of organizational cultures. And the other factors he cites are not unique to Enron. Many organizations have bad ideas and avaricious employees, many botch the execution of their plans, many operate with imperfect controls and lax oversight, and every organization makes its share of accounting errors. But rarely if ever do these factors prove fatal. To understand what transformed these commonplace factors into a calamitous implosion, it is necessary to focus on Professor Power's final factor, the Enron culture. In the words of Kirk Hanson from the Markkula Center for Applied Ethics at Santa Clara University:

> "In some ways, the culture of Enron was the primary cause of the collapse. The senior executives believed Enron had to be the best at everything it did and that they had to protect their reputations and their compensation as the most successful executives in the United States…. When some of their business and trading ventures began to perform poorly, they tried to cover up their own failures."[46]

The other factors mentioned by Powers played a role but they are best understood as proximate causes at best. As discussed earlier, the Enron board was willing to waive control mechanisms that got in the way. Actions of that kind are evidence of a deeper-seated problem, one that cannot be solved without fundamental cultural changes.

Next, *Restoring Trust* is former SEC Chairman Richard Breeden's report as the special monitor of WorldCom.[47] His unabashed emphasis on culture is instructive:

"The board failed to understand WorldCom's risks— including Ebbers character and competence issues—or to design adequate risk control policies. Beyond that the corporate culture under Ebbers did not reward efforts to reinforce legal compliance, ethics, internal controls, transparency, diversity, or individual responsibility. Revenue growth and personal compensation were the exalted elements in the Ebbers corporate culture, and he demanded obedience above all other things." (page 41)

This report points WorldCom's governance in a useful direction, but over time these directional indications have to be embodied in the company's culture and all involved with it. (page 44)

"There is no 'silver bullet' that will make governance sound and reliable. Ultimately, the quality of governance depends on the quality, experience, determination, and attitudes of all senior members of management and the board. If there is a shared consensus on the importance of responsible and informed governance, and a willingness to act on these principles rather than merely talk about them, then the procedures in place will have real meaning. Without such a shared determination to live by standards of excellence, then no set of rules can guarantee success." (page 50)

"Board members have a critical role in helping set the culture of the company by actions or inactions of the board as to matters of ethics, integrity, transparency, and responsiveness to shareholder interests." (page 46)

"It is important to note at the outset that the old WorldCom has already disappeared from the scene. In its place the new MCI is embarked on a journey…to establishing a very different corporate culture in which values of transparency and integrity are cornerstones of its renewal and rebirth." (page 22)

"The new company is being built around a commitment to create a corporate culture based on transparency and integrity, and to establish a model of excellence in governance to replace the odious practices of the past." (page 18)

All told, Chairman Breeden makes 17 references to "culture" in the course of his investigative examination.

One other case that warrants mention is *USA TODAY* reporter Jack Kelley's serial fabrications, one of the more vivid examples of the force of a defective organizational culture. Unlike the Enron and WorldCom examples, this conduct took place within an operating unit of a subsidiary company and it was not ruinous. Nonetheless, it demonstrates why operating units should be the focus of managing ethical performance. The episode warrants mention alongside Enron and WorldCom because it involves perhaps the most serious form of unethical conduct in the context of a print media organization. And it illustrates how cultural forces make it possible for reckless behavior to take place in clear view of many witnesses without triggering a remedial response.

Former editors of *USA TODAY* asked, "Why did newsroom managers at every level of the paper ignore, rebuff and reject years of multiple serious and valid complaints about Kelley's work?" Following are four of their verbatim answers: [48]

"A virus of 'fear'—defined somewhat differently by different staff critics—clearly infected some staffers in the News section and inhibited them from pushing complaints about Kelley. Some staff members said they were scolded or insulted when they expressed concerns about Kelley to editors. We did not find that 'a culture of fear' blankets the entire newspaper or most of its departments. It is alive and sick in the News section." (page 3)

"Policies, rules, and guidelines in place at the newspaper, and beyond that, routine editing procedures, should have raised dark shadows of doubt about Kelley's work, had his editors been vigilant and diligent. They were not." (page 3)

"Kelley's ability to routinely abuse rules governing anonymous or confidential sources—and the trusting attitudes of his editors as he exploited their confidence in him—is a harsh reminder that policies drafted on paper are meaningless unless discerning editorial gatekeepers at every level apply them and enforce their roles as editors." (page 3)

"People in the newsroom who raised questions about Kelley say they were warned by peers "to just keep your heads down." One reporter, whose instinctive reaction to

a Kelley exclusive would have kept it out of the paper had she been an editor, described the reason she did not challenge it earlier: 'The culture tells you every day that you give your superior whatever he or she wants in order to look good.' (page 9)

It bears emphasizing that this case involved journalists, not a notoriously demure group of people. The fact that they were rendered mute and kept in their place by the culture of their workplace is a testament to its strength. Indeed, another force that could keep a group of reporters from acting on their instincts does not come readily to mind.

The case is also a reminder of the difficulty in actually managing organizational culture. By all accounts, the culture at the news division of *USA TODAY* was not representative of *USA TODAY* generally, its sister publications, or other media channels within the Gannett Company, Inc., its parent company. Regardless of the ethical tone that is set at the top, isolated rogue cultures are real possibilities.

Conspicuously absent from this discussion of Enron Era scandals is Arthur Andersen. Unlike WorldCom and Enron, Andersen was not the subject of a publicly available investigation by an independent third party. However, professor and consultant Barbara Ley Toffler provides a number of valuable insights from her tenure as partner-in-charge of a small Andersen division called Ethics & Responsible Business Practices. Among her observations, she emphasizes that the culture had strayed from its traditional moorings in integrity and public service to one "in which making money was glorified at the expense of anything else."[49]

Summary

A lesson to be gleaned from the Enron Era is the vital connection between the ethical culture of an organization and the conduct of its members. The lesson is a hopeful one because there are real opportunities for improvement: while the cultural milieu that produced a Scott Sullivan, an Andrew Fastow, or an incoming freshman with a taste for academic dishonesty cannot be changed by organizational leaders, the culture in which they work and learn can be shaped and conditioned. Specifically, it is possible to influence the importance that is accorded personal integrity and playing by the rules.
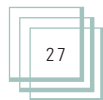
A Strategy for Managing Ethical Performance

Leadership and Ethical Culture

Based on the findings of organizational behavior and as a matter of common sense, the ethical tone of an organization begins with leadership. But although leadership is the starting point, that is all it is. Consider that ethical leadership is a stance, an expression through words and deeds that "morality matters around here." Leaders, however, must assume many stances, including one about the importance of earnings or budgets. Which stance will prevail when push comes to shove is not simply a matter of what the senior executive says or even the example that he or she sets.

One challenge in inculcating and maintaining a positive ethical culture is the manner in which cultural messages of any kind are transmitted: through a host of leaders at all levels of the organization. What ultimately inures in the values and beliefs of the workforce may be a distortion of the tone at the top. Another challenge is that culture is not immutable: it changes as people come and go, or as entire divisions come, go, and are restructured. Some of these changes can be imperceptible to those at the top. Indeed, research indicates that senior leaders may be the last to realize that the culture within an operating division has turned ugly.[50]

In short, leadership is a necessary, but not a sufficient, condition for inculcating and maintaining a positive ethical culture. In that sense, it is no different than most other organizational goals and objectives. Cases in which nothing more than inspired leadership galvanizes a workforce to achieve a goal are rare. Far more often, goals are not achieved unless leaders insist on them being managed by someone in particular and holding him or her accountable for the results. Considering its importance, organizational ethics warrants serious consideration as a well-defined management imperative.

Managing the Unmanageable

There are no formal indicators of organizational ethics. If there were, one of them might register the extent to which an organization meets the ethical expectations of society. Call it "ethical performance."

Often, when non-standard terminology appears, an incoherent idea cannot be far behind. But this is not one of those times. Ethical performance contemplates an appraisal of the practices and activities of an organization from a moral point of view. It formalizes an everyday practice: organizations routinely receive moral praise and blame. Moreover, it would not be the first indicator to venture into the realm of normative assessment. The Harris-Fombrun Corporate Reputation Quotient, *Fortune's* Most

Admired Companies, and several published evaluations of corporate social responsibility have done so already. So ethical performance may be new to the nomenclature, but it formalizes a familiar and lucid concept.

Over and above internal controls and other ethical safeguards, is there anything in the management arsenal that might significantly improve ethical performance? Many seasoned managers would doubt that there is, and their skepticism is not without reason.

Consider something as primitive as management by objectives. Why does that technique seem farfetched when it comes to ethics? For starters, the basis for a typical management objective is the productive activity of a group of people. But ethics is not an activity. Rather, it is an intangible characteristic of conduct and a peculiar one at that. At least in the short-term, the ethical dimension of behavior tends to go unnoticed unless it falls below a threshold of acceptability. Therefore, we have no straight-forward way to quantify and objectively measure ethical performance, formulate goals and objectives in respect of it, hold someone accountable for the results, or use it as the basis for incentives.

Another difficulty is this: whether an organization achieves exemplary or deplorable ethical performance depends in no small part on a highly idiosyncratic factor: people. Specifically, it depends on their values, character traits, and will power. No sane manager wants to be held accountable for the moral bearing of another human being, much less groups of them. For most of us, riding herd over our own ethical conduct is enough of a struggle. Suffice it to say that we face formidable obstacles to managing ethical performance systematically.

Pages From an Old Playbook

To see a possible way around those obstacles, consider the similarities between ethics and another intangible factor that warrants management attention: quality. Both are characteristics of something else: conduct in the case of ethics and output in the case of quality. And like ethics, quality is difficult to measure, as it can be overlooked in the short-term unless it fails to meet expectations. Finally, quality is also related to individual idiosyncrasies—conscientiousness, attention to detail, pride in one's work, etc.

Then, it is not surprising that quality had traditionally been managed along the same lines as ethics is currently managed: exhortations regarding its importance were reinforced with controls. Quality problems—defined as too many substandard products reaching the market—called for more diligent workers and beefed up quality control departments.

This approach was more or less adequate until the early 1970s, when the convergence of two forces made it unsustainable. One was the vastly increased scale of production: increasing the number of inspectors became impracticable when even miniscule error rates translated into hordes of unhappy customers. The other was the onslaught of high-quality imported goods that gave those customers a choice in the matter.

Motivated by this competitive threat, managers developed new strategies that shifted the emphasis from catching defects to producing quality goods and services in the first place. The quality control function was not displaced, but it was bolstered when attention was paid to stages of the production process in advance of identifiable failures. This entailed breaking the process down into its constituent processes, analyzing their impact upon quality, and developing metrics for monitoring performance along the way. Perhaps the most significant result of these strategies was to transform accountability. The ability to measure the factors that influence quality gave rise to objective standards—the basis for management responsibility. The result was a system for constantly improving quality.

Some may object that quality and ethics differ in at least one important way. Quality pays: it confers distinct competitive advantages. But ethics, well, unethical conduct can be expensive, but do ethical organizations enjoy a competitive advantage? Although there is an intuitive appeal to the notion that ethical organizations prevail in the long run, counterexamples come readily to mind.

That objection evokes the same skepticism that greeted early efforts to manage quality systematically. Strategies that we now take for granted (for example, Total Quality Management or Six Sigma) began as ideas that stirred considerable controversy.

Some doubted their feasibility: "craftsmanship" was considered a property of individuals—their attention to details and pride in their work—and, therefore, beyond objective measurement. Others doubted the business case for the

whole enterprise: the "prevailing wisdom" in some academic circles as late as the early 1990s was that improved quality required a tradeoff with either the cost or volume of production (or both).[51] No amount of abstract analysis or intuitive conjecture could settle the matter.

Eventually, the collective experience of progressive organizations turned this controversial idea into a commonplace practice.[52] There is every reason to believe that organizational ethics will follow a similar pattern.

How might our experiences managing quality and the lessons of the Enron Era be brought to bear on the management of ethical performance? Said another way, what would it take to incline an organization to behave ethically and to self-correct when it does not? Although a comprehensive strategy is not presently available, the quality initiative suggests a way to proceed.

Documenting Ethical Culture

Organizations measure and monitor all manner of operational activities, but ethical performance is not among them. A host of controls relate information of an ethical nature. However, they are all passive and reactive—they only respond after unethical conduct has occurred. The missing link is predictive information that can be proactively managed. Since the operative values of an organization are so influential, if not determinative of its long-run ethical performance, documenting what they are is a prerequisite to managing ethical performance systematically. Like any management metric, taking the ethical pulse of an organization does not guarantee exemplary performance. Contrary to popular belief, everything that gets measured does not get managed. However, if something is *not* measured, then it will usually not be systematically managed. Ethical performance is no exception.

To clarify what is being proposed, documenting ethical culture does not imply a numerical reading. Rather, it calls for a narrative assessment of whether the culture inclines its members to play by the rules, whether it is agnostic with regard to ethics and compliance, or whether it encourages deviant activities. There should be no illusion that this process would have reversed the direction of Enron's ethical death spiral. A more realistic expectation is that periodically assessing and managing ethical culture may have prevented Enron from becoming the organization it became. If not, at least those in a position to do something about it would have been alerted to its dangerous decline. And as explained in the following finding from a survey of CEOs and board members, such information would have significant value independently of whether it was actively managed:

> "Financial statements do not provide a complete picture of the soundness of a company. Indeed, in some instances, an excessive emphasis on hitting financial targets has not just blinded managers, directors, investors, and others to the underlying problems of the business; it has even exacerbated those problems…. Traditional financial measures fail on many fronts. They are not well designed to capture the quality of the company's relationships with such crucial constituencies as customers, employees, and suppliers. They shed little light on the key source of future revenue and profit in a firm: the state of product innovation. And they provide scant evidence of the effectiveness of the board and top management—that is, the efficacy of governance and management processes. The need for boards of directors, top executives, and the investing community to understand the vital signs of companies beyond those measured in monetary terms—call them the 'non-financial performance measures,' if you will—is paramount."[53]

Of course, organizational vital signs cannot be understood if they are not produced in the first place. We propose developing a vital sign indicating the ethical condition of organizations.

Can Ethical Culture be Measured?

A set of values is in place within every organization, and some employees are well-placed to reveal them. These tend to be the workers who actually do the work or perform the frontline service of the unit. They will not be among the ranks of senior management. In their *Guide to Assessing Ethical Culture*, attorneys Frank Navran and Edward Pittman offer the following questions for revealing the ethical culture of a workplace:[54]

- What are the values that control "how things really work around here?"

- To what extent is there pressure to commit unethical conduct?

- How common is it for employees to observe others engaged in unethical conduct? (In pursuit of company goals? For self interest?)

- Do employees trust that seeking guidance with regard to ethical questions will not result in retaliation and retribution?

- Do employees believe that the same ethical standards apply to all employees regardless of level, position, or connections?

- Are ethics and values part of performance appraisals/reviews?

- How confident are employees that senior leadership is committed to ethical standards as fundamental to the business? How about the employee's immediate superior?

- Are employees comfortable delivering bad news?[55]

These questions would be revealing of the ethical culture of a workplace, but with the exception of the last one. It is doubtful whether they would be answered honestly or accurately. For one, the word "ethics" means different things to different people. Of more significance is the reaction of most people to questions concerning their ethical behavior. Phrasing is crucial because, as a general rule, if a question causes a respondent to reflect on his or her ethical values or beliefs, we should be very skeptical of the answer. Dubbed the "holier than thou" syndrome by two leading social psychologists, the average person believes he or she is more virtuous than the average person:

"People believe they are more charitable, cooperative, considerate, fair, kind, loyal, and sincere than average but less belligerent deceitful, gullible, lazy, impolite, mean, and unethical."[56]

The upshot of this research is this: if we ask questions that trigger ethical self-assessments, then sanctimonious answers with little predictive value can be expected to follow. However, asking questions that trigger ethical assessments of others—so-called "social-assessments"—

and uncannily honest answers with significant predictive value can be anticipated. Thus, the process of documenting the ethical culture of an organization must proceed indirectly, by asking respondents to reflect on the behavior of their co-workers and not themselves.

In an effort to refine a process of documenting ethical culture, the BHEF Ethics Initiative enlisted the efforts of MBA candidates. The students received instruction in the relevant psychological and organizational behavior literatures, after which they were asked to draft a questionnaire for use within an organization whose business they understood.

The first draft was edited and refined by their professor before it was tested on their classmates with similar work experience in the target organization. The point of this step was to understand how the questions would be understood and to eliminate any confusion in the wording. Another round of changes took place before the questionnaire was administered. Below are a few examples of the interview questions that emerged from this exercise. They have been modified from the student-administered version based on the data generated and also based on comments received from Herbert Weisberg, Ph.D., Director of the Survey Research Unit of College of Social and Behavioral Sciences at The Ohio State University. Also, in the interest of confidentiality, they are presented generically—the actual questions were tailored to the industry and position of target respondents:

1a. Do your peers face any conflicts of interest?
 b. If yes, how do they contend with them?

2a. Company publications list honesty, integrity, cooperation…as the overarching values of the organization. Would your colleagues say that without exception, they do not violate those values?
 b. If no, please provide examples of the conduct they would have in mind.

3a. How common is it for you to observe peers, supervisors, senior management, or customers do or say something that violates the company's values or stated policies?
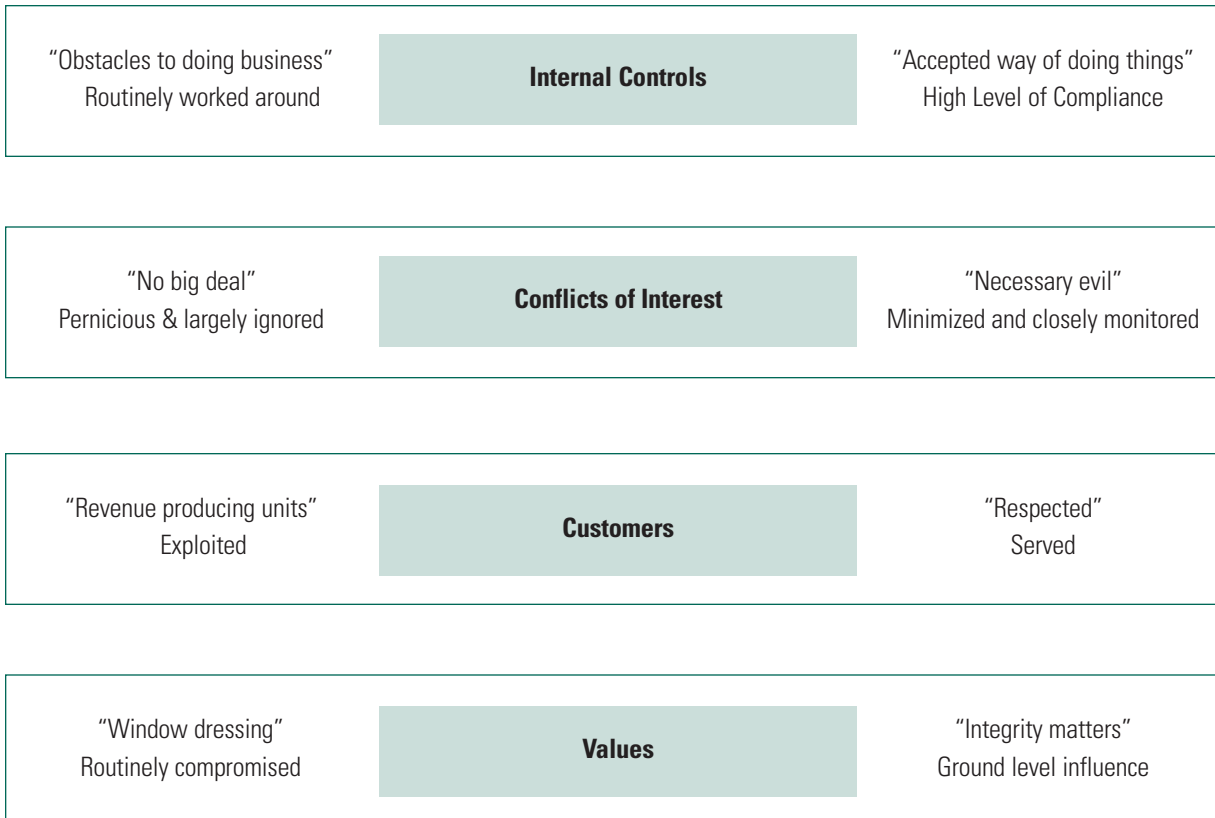 (0 = no answer, 1 = very infrequently, and 5 = routinely)
 b. If any is observed, please provide an example.

4. Do the policies, procedures, and rules of the organization apply equally to everyone?

5. How strongly do your peers believe that senior leadership is committed to maintaining the organization's values and following the spirit of company policies? (0 = no answer, 1 = not very committed, and 5 = very committed)

6. How, if at all, does ethics enter into an employees' performance appraisal?

7. How would your coworkers react if —hypothetically—the company were to be involved in a scandal of some sort? (1 = They would not be surprised at all, 5 = They would be quite shocked)

8. Would your peers agree with the statement that what really matters is getting the job done, regardless of the means?

The answers to these and many other similar questions cannot be reduced to a single score or rating without significant loss of insight. An investigation of this kind—an "ethics audit," if you will—pinpoints strengths and weaknesses of various aspects of an organization's ethical culture by documenting the assumptions and attitudes of a workforce and the patterns of behavior encouraged thereby. *Figure 5* illustrates a range of possible findings with regard to four key indicators of ethical culture.

This exercise produced several valuable findings concerning the process of assessing ethical culture. Bearing in mind that such assessments are intended to

Figure 5
Range of Possible Findings—Four Key Indicators of Ethical Culture

"Obstacles to doing business" Routinely worked around	**Internal Controls**	"Accepted way of doing things" High Level of Compliance
"No big deal" Pernicious & largely ignored	**Conflicts of Interest**	"Necessary evil" Minimized and closely monitored
"Revenue producing units" Exploited	**Customers**	"Respected" Served
"Window dressing" Routinely compromised	**Values**	"Integrity matters" Ground level influence

serve two purposes—control and management—a cookie-cutter approach or a one-size-fits-all template will not suffice. Although some ethical risks are universal, others arise from specific types of work, industries, and locations. The ethical risks of finance and marketing departments overlap, but they are not identical. And the marketing departments of organizations in disparate industries pose distinctive risks (for example, entertainment versus pharmaceuticals). It also matters whether the organizational unit is local, national, or global in scope. Overlooking these nuances runs the risk of not looking under the right rocks, and of producing useless or misleading management information.

In summary, we believe that ethical culture can be objectively characterized and documented. If so, then, in theory, it should be possible to formulate responsibilities in respect of it and hold managers accountable for the results. That theory was put to the test through a second exercise.

From Measuring to Managing Ethical Culture

Assessing ethical culture provides an objective metric, but nothing else. Accountability is a function of formulating a management responsibility for maintaining or improving future assessments and periodically evaluating performance against objectives. It is patently unfair and counterproductive to hold someone accountable for a performance standard unless they understood in advance what was required of them, how they would be evaluated, and the relative significance of that evaluation vis-à-vis their other responsibilities and performance metrics.

To gauge the feasibility of this protocol, we enlisted the help of a class of executive MBA students, many of whom occupy positions with operational authority. They were given a somewhat troubling assessment of the ethical culture of a fictitious operating unit and asked to formulate a performance object for the unit's leader, one that would hold him or her accountable for tangible improvements.

Working in small groups, the students were asked to specify the nature and extent of those improvements, to establish an evaluation process, to explain how this new objective would be incorporated into the managers other responsibilities, and to outline the resources that would be made available. All of this was to be contained in a short memorandum from a senior to a junior manager with one condition. To ensure that the protocol would be realistic, students had to be willing to occupy the role of either the junior or the senior manager. That is, they were asked to construct a responsibility that an operating manager would be willing to assume without reservation, but that senior managers could assign without concern for its effectiveness.

The results of this exercise confirmed the feasibility of this protocol and the prospects for managing ethical performance systematically. No sane manager would willingly accept responsibility for the ethical conduct of another human being and this protocol does not force the point. Rather, it would hold them accountable for the environment in which people work, something that is within their capacity to control. Student participants in this exercise did not find it a struggle to formulate a performance objective, to specify an evaluation process, or to integrate this objective into the manager's incentive compensation plan.

As preliminary as this investigation may be, there are reasons to be optimistic. The process is complex, but it harnesses a powerful force: assuming the appropriate incentives, managers are incredibly resourceful in achieving all manner of objectives if they understand the goal and receive the necessary support.

A good and analogous example is that of former Treasury Secretary Paul O'Neil's approach to managing workplace safety as the CEO of Alcoa. Upon assuming that role in 1976, the lost workday rate was below industry average, but not zero. O'Neil wanted zero serious workplace injuries. As explained by Terry Thomas, John R. Schermerhorn, Jr., and John W. Dienhart in an article titled "Strategic leadership of ethical behavior in business:"

> *"O'Neil 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 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."* [57]

Some might have scoffed at the possibility of achieving a near-zero rate of workplace injuries. O'Neil knew better because he understood what he was unleashing. There is every reason to anticipate a similar outcome in the case of

ethical performance because they are built on the same foundations of explicit expectations, proper incentives, and resolute accountability.

Strategic and Tactical Considerations of Managing Ethical Performance

Effectively managing quality required a thorough understanding of the downstream consequences of nearly every policy, practice, and activity—even those that are not directly related to production or delivery of a good or service. A similar effort would be required with regard to ethical culture. In addition to assigning responsibility for managing the results of ethical culture assessments, other factors deserve attention. These will change from organization to organization and from industry to industry, but to sketch what is involved, the following two areas warrant review:

How does a strategy affect ethical performance? Precious little has been written on this topic and ethics is not usually associated with strategic planning. Two areas in particular deserve high-level consideration. First, conflicts of interest are not naturally occurring phenomena. Many of the most pernicious conflicts are self-inflicted insofar as they result from strategic decisions. To illustrate the connection between strategy and ethical performance, consider the following quotes:

> "…the only legitimate purpose of any corporation is to benefit its customers…"

> "Every day, we effectively balance the interests of companies wishing to raise capital on the best possible terms, with those of investors seeking opportunities commensurate with their tolerance for risk."

These statements were made by two different CEOs in the financial services industry in defense of their strategies. The first company minimizes the most perilous conflicts of interest by serving a narrow (albeit large) range of customers. The second one caters to virtually every segment of the industry and in so doing, it places itself between the conflicting interests of various customer bases. Thus far, the first company has avoided the scandals that have rocked the securities industry; the second has either figured prominently or led the way in nearly every one. Although neither executive used moral terminology, their respective strategies have ethical consequences.

Organizational strategy is a logical place to begin thinking through the forces that influence ethical performance. Modifications might not be realistic in the same way that some organizational impediments to quality output cannot be changed. But in those instances, high-risk areas have been identified and increased management attention can be brought to bear.

What was just described is not unique. Revelations of customer abuse in the mutual fund industry prompted *Money Magazine* senior writer Jason Zweig to question "whether fund managers still retain enough basic integrity to deserve your trust."[58] Of course, many do and Zweig offers 10 factors that set them apart from the others. Among the handful of funds that satisfy all 10 is Longleaf, a relatively small fund family managed by Southeastern Asset Management Company. It therefore bears noting that this organization pursues an exceptionally unusual strategy.

For one, Southeastern provides money management services for its mutual fund investors—and nothing else. It does not provide ancillary services (for example, retirement plan accounting) to large employers, some of whom

might appear as a portfolio company in one of the Longleaf funds. And Southeastern personnel are prohibited from purchasing equity securities except shares of its funds. Consequently, the largest owners in each of the Longleaf funds are its managers. For these and other reasons, the interests of Longleaf shareholders are not in competition with the allegiance of Southeastern managers. As a matter of strategic design, such conflicts have been eliminated.

In addition, strategy influences the ethical culture of an organization because it represents one of the most formidable statements of organizational priorities. Thus, a set of strategic objectives that contemplates compromising customer interests, or trading off the interests of one group of customers with another, will speak volumes about the organization's commitments and priorities.

Organizational strategy is a logical place to begin thinking through the forces that influence ethical performance. Modifications might not be realistic in the same way that some organizational impediments to quality output cannot be changed. But in those instances, high-risk areas have been identified and increased management attention can be brought to bear.

Beyond strategy, everyday operational tactics influence ethical performance as well. There is far too much under this heading to do justice to each topic here, but the message is this: "Actions speak louder than words, and most every action has something to say." So it behooves us to understand how practices and policies throughout the organization affect ethical performance. Some will have a direct impact on the number and magnitude of ethical violations. Others will act indirectly, by either reinforcing or corroding the underlying ethical culture. And some will do both: ill-designed compensation plans, for instance.

Although formal practices and policies will occupy the bulk of this analysis, informal actions should not be overlooked, especially those in reaction to bad news. No organization is immune to ethical mishaps, but the way they are handled will say a great deal about "what really matters around here."

Consider, for example, the reaction of one university president to the death of a student during a fraternity pledge event at the Massachusetts Institute of Technology (MIT). Although not required to do so, MIT President Charles Vest publicly acknowledged that the school had failed the student and his family. In a heartfelt letter to the student's parents that is bereft of legal posturing or hand-wringing excuses, he accepted responsibility and pledged to take corrective action. A reader of this letter is struck by President Vest's deep commitment to student welfare and is left with the distinct impression that positive changes are just a matter of time.[59]

Summary

Washington Post columnist Jim Hoagland relates a poignant interchange between British Prime Minister Tony Blair and senior civil servant, Sir Richard Wilson. It begins with Wilson's broadside that, "Your problem is that neither you nor anyone else in Downing Street has ever managed anything." Mr. Blair counters that he has managed the Labor Party, to which Sir Richard replies, "No, you have led it." Hoagland observes that "the unspoken word that hangs in the air is that the young prime minister does not recognize the difference."[60] A similar criticism could be leveled in the area of organizational ethics: a failure to distinguish between leading and managing or simply conflating the two.

In response to the standard understanding of ethics as a leadership function, we have asked, "What should organizational leaders be doing to ensure that the tone they set is heard and taken to heart in a thoroughgoing manner?" Our proposal involves oversight insofar as we contemplate routine measurements of ethical culture. But it marks a departure from typical compliance mechanisms and ethical safeguards: it harnesses the inherent resourcefulness of managers to the cause of ethical excellence.

Ever mindful of the costs of this proposition, we suggested that the information needed to manage ethical performance serves another equally vital purpose—it answers the following question: What additional information would reassure a director, an investor, or a senior manager that the representations of an organization have been made in good faith and that some potentially crippling revelation is not lurking just around the corner?

In other words, getting a fix on the ethical culture of an organization is a way of knowing whether it can be trusted. Just as there is no substitute for the integrity of individuals, there is no substitute for the positive ethical culture of organizations.

Ethics and Higher Education

Thus far, we have developed a means of embedding ethics in organizations, businesses, and institutions of higher education alike. Although college and university leaders grapple with some ethical challenges that their corporate counterparts do not (and vice versa), our strategy for managing ethical performance should be adaptable to their areas of greatest concern: intercollegiate athletics, medical centers, and commercially sponsored research and development.[61] Moreover, this strategy should apply to the management of a cluster of non-operational goals and objectives that fall under the heading of "student moral development," including promoting academic integrity, encouraging responsible behavior in campus social life, instilling ethical values, and otherwise preparing students for the ethical challenges they will encounter in their careers. In this section, we will address possible applications of our strategy to this dimension of higher education.

Although colleges and universities devote significant curricular and extracurricular resources to the moral development of their students, recent corporate scandals prompted calls for improving the ethical bearing of college graduates. In response, a great deal of work has been done and more is underway. Some of these efforts are referenced in the Appendix of this report, but we do not endorse any particular program or recommend any specific course of study. It would be presumptuous for us to do so because colleges and universities differ widely in terms of their priorities, commitments, resources, specialties, and student bodies. So while recognizing that the choice of tactics must be a school-specific decision, our contribution consists of two ideas for strategically managing objectives in the area of student moral development.

First, we encourage college and university leaders to consider applying our strategy for managing ethical performance to high-risk areas of their organizations. A university will not have the standing to further the moral development of its students unless it is seen as making every effort to conduct its operational affairs with integrity—unless the institution is viewed as a moral exemplar. Secondly, we recommend expressing moral development aspirations as explicit goals, and managing them systematically or in much the same rigorous manner as a high-risk operational area. We outline what this second recommendation entails after discussing the nature of the challenge and the realistic possibilities for success.

Real Needs and Realistic Possibilities

College and university leaders assume a serious responsibility and a huge challenge when they set objectives in the area of student moral development. In terms of undergraduates, their work begins where that of American high schools leaves off, not an ethical high-water mark, according to an exhaustive survey of 22,172 high-

and middle-school students by the Josephson Institute of Ethics in 2004.[62] Following are five of its more sobering findings:

- 62 percent admitted that they cheated on an exam at least once in the last year, 83 percent copied another's homework, and 35 percent copied an Internet documents for a classroom assignment.

- 27 percent admit that they stole something from a store at least once in the past 12 months, 22 percent from parents or relatives, and 18 percent from a friend

- 82 percent admit to having lied to a parent about something significant in the past year, 62 percent to a teacher.

- 59 percent agreed (or strongly agreed) with the statement, "In the real world, successful people do what they have to do to win, even if others consider it cheating."

- 42 percent agreed (or strongly agreed) with the statement, "A person has to lie or cheat sometimes in order to succeed."

Mercifully, the survey results were not universally dismal;

- 97 percent agreed (or strongly agreed) with the statement, "It's important to me that people trust me."

- 98% percent agreed (or strongly agreed) with the statement, "It's important for me to be a person with good character."

- 84 percent agreed (or strongly agreed) with the statement, "It's not worth it to lie or cheat because it hurts your character."

- 90 percent agreed (or strongly agreed) with the statement, "Being a good person is more important than being rich."

- 94 percent disagreed (or strongly disagreed) with the statement, "My parents/guardians would rather I cheat than get bad grades."

- Asked to rank the importance of various personal attributes, 19 percent thought it was essential or very important to be popular, but 84 percent felt that way about having a good moral character.

Is there a coherent interpretation of these disparate findings? The first five findings paint a bleak picture: high-school students lie, cheat, and steal at an alarming rate. But it would be wrong to extrapolate from that depiction and conclude that these young people are a lost cause because the second five findings are quite hopeful: they care about their character and how others perceive it.

The fact that this concern is not manifest in their behavior is disconcerting, but not all that surprising. As discussed earlier, several prominent criminologist claim that deviance is highly correlated with, and in large part caused by, low levels of self-control, and as any parent can attest, adolescents have pronounced deficits in the self-control department. Perhaps the most compelling interpretation of this study is that entering freshmen are in serious need of moral development, but they are equipped with the necessary ingredients—an intuitive sense of right and wrong and the desire to be worthy of trust. It is therefore safe to say that colleges and universities have an opportunity to play an important part in the character development of traditional undergraduate students.

What about "non-traditional" and graduate students? This question is particularly germane since 43 percent of undergraduate students were age 24 or older during the 1999–2000 academic year.[63] And 82 percent of these older students held part- or full-time jobs.[64] Thus, college is not necessarily the central focus for a large segment of undergraduate student bodies. Age and divided attention represent formidable obstacles to the university that aspires to contribute to its students' moral development, but they are not insurmountable. Although basic ethical sentiments of right and wrong are established at an early age, the capacity for moral reasoning continues to develop in adulthood. Likewise, values are challenged through a lifetime of experiences—some are confirmed, others revised, and others yet are rejected. So it would be wrong to assume that students of any age are incapable of ethical growth. Indeed, one scholar found that older may be better in terms of student receptivity.[65]

In summary, there is a pressing need and a realistic opportunity to further the moral development of college students. Unquestionably, some have already seized this opportunity, but there is reason to believe that the wider universe of colleges and universities can play an effective role—they have done so already in a very similar area.

Colleges and universities have worked diligently to inculcate a respect for diversity in their students—they have encouraged acceptance of others without regard for differences of race, religion, gender, ethnicity, and so forth. The success of their individual efforts is born out in internal student surveys. However, a nationwide study reveals their collective achievement.

The study conducted by The National Association of Scholars (surveys by Zogby and Gallup) asked graduating seniors to rank in importance a number of business practices. "Recruiting a diverse workforce in which women and minorities are advanced and promoted" ranked the highest. It was selected by 38 percent of students while other seemingly high-priority practices lagged far behind.

For instance, only 22 percent of the student-respondents gave the highest priority to "providing clear and accurate business statements to stockholders and creditors."[66] Although this survey was not administered to a control group, other polls and results from statewide referenda on affirmative action policies suggest that college seniors accord significantly greater importance to diversity. If colleges and universities can influence attitudes concerning this vital civic value, then they would seem to be capable of achieving similar results with the ethical variety.

Strategically Managing Moral Development Goals

Earlier in this report, we detailed a strategy for managing the ethical performance of organizations. We emphasized the proactive management of ethical culture to compensate for the inherent limitations of leadership, training, and compliance mechanisms, and in light of the dominating influence of organizational culture on individual behavior. That reasoning should be applicable to student moral development as well. As members of the university community, they stand to be influenced by its culture as much as and sometimes even more than university policies, programs, and pronouncements. Following is a brief sketch of how college and university leaders might go about employing this strategy to advance their moral development aims:

As discussed earlier, systematically managing the ethical performance of an organization requires an objective assessment of its ethical culture. Likewise, objectives in the area of student moral development are difficult to manage systematically without a thorough understanding of the ethical culture from the student point of view: the assumptions, beliefs, values, and informal rules that guide

their choices, inculcate their social and academic habits, govern how and when they study and play, and define in their minds "what really matters around here."

Perhaps of equal importance is an understanding of how they came to believe as they do—the source of the messages and cues that influenced their thinking and formed their impressions. Such information is the starting point for identifying problem areas and opportunities for improvement, for assessing the effectiveness of existing programs, and for targeting resources as efficiently as possible. Said another way, documenting the ethical culture of a student body is the necessary first step in systematically managing and continuously improving student moral development.

We challenged the feasibility and value of this protocol by testing its key assumption: that a distinct ethical culture is alive and operative within student bodies. It is not obvious that a well-defined culture exists on college campuses or, if it does exist, that it has the same potent influence on students as organizational culture has on employees.

We enlisted the help of some students in this test: 90 first-semester business school seniors attending a four-year residential college, evenly divided between two sections of a capstone course. Working in small groups or on their own, they were asked to respond in the form of a memorandum to the following questions:

1. **Describe the ethical culture of your university from the perspective of its senior class members. What are the values and beliefs that guide them in their daily academic and social activities and the choices they make? What do they believe "really matters around here?" Be specific and provide examples where necessary.**

2. **What is the source of this ethical culture? How did your classmates come to believe as they do? Be specific and provide examples where necessary.**

3. **Since the culture of all organizations can be improved, what changes would you recommend for the one impacting upon your classmates? Be realistic; explain how these changes could be brought about.**

Students were encouraged to be accurate in their assessments and creative in their recommendations, but were not otherwise constrained or guided.

The results of this admittedly unscientific test suggest that there is a distinctive ethical culture on this particular college campus. Students had no difficulty identifying the operative values and shared beliefs among their classmates and they did so with remarkable consistency. Of the 35 memoranda, a similar account could be abstracted from all but five or six. Also, students cited similar sources for their cultural beliefs and assumptions—they more or less agreed on how, over the course of the last three and a half years, they came to acquire their understanding of "what really matters around here," what constitutes acceptable behavior and what crosses the line, and so forth. Moreover, their responses indicated that the ethical culture of this student body is as efficacious with regard to individual students as organizational culture is with regard to typical employees. That is, it has an outsized influence on their conduct and the choices they make.

For illustration purposes only, these findings serve at least two useful purposes.

1. Assessing the effectiveness of existing programs. The Carnegie Foundation for the Advancement of Teaching sponsored an extensive investigation of university efforts to "prepare America's undergraduates for lives of moral and civic responsibility." Among its findings was the following:

> "Very few of these programs [for fostering students' moral and civic development] are being evaluated systematically, which means that we have only an impressionistic sense of which ones are engaging and effective. Likewise, it is rare for schools to assess formally curricular programs consisting of collections of courses such as general education programs with moral and civic goals or programs that enable the teaching of ethics across the curriculum.…This kind of assessment is extremely labor intensive and difficult to do well. We are not recommending that administrative leaders require assessment of these programs. Even so, we believe that high-quality program assessments can be very fruitful." [67]

Our quite rudimentary exercise suggests that although it is labor intensive to evaluate program effectiveness, it is not particularly difficult to identify ineffective programs. For instance, if the vast majority of seniors fail to mention a sophomore level course that is a part of the curriculum for mostly moral development purposes, and cannot recall its content after prompting, then it is probably not serving its purpose. And if a moral development program is mentioned in a cynical and disdainful manner then it is probably ineffective. We do not mean to imply that this exercise is a substitute for rigorous program assessment or cause for canceling courses or programs because it is not. The information must be properly managed and that may imply course modifications, programmatic changes, or the need to obtain a high-quality assessment. As previously stated, assessing ethical culture is but a starting point.

2. Identifying corrosive practices. "The ends justify the means" is one of the most pernicious factors that can infect an organization's culture. In corporate settings, it translates as "just make the numbers" or "just get the order," without regard for how the numbers are derived or how the customers are treated. In the academic setting, it is expressed as "just make good grades," without regard for academic integrity or whether any learning takes place. We know of no other way to confirm whether that attitude is operative on a college campus than to ask the students. Nor do we know of any non-speculative means of identifying the source of that attitude than individual students.

As would be expected, incentives and rewards have the same cultural significance in corporate and academic settings alike. Regardless of what is said, students are guided by their incentives—what is rewarded as opposed to talked about—to judge what really matters and behave accordingly. Another apt parallel between corporate and academic settings bears mentioning: systems of rewards and incentives have a habit of quietly consorting with other seemingly unconnected policies to produce ethically corrosive practices. Many of these practices go unnoticed because there is no obvious connection between, for example, a grading curve and practices that fall under the heading of "academic sabotage." The only way these practices can be rooted out is to ask. And not surprisingly, students can not only identify imperceptible, but nonetheless, corrosive policies and practices, they are a wellspring of creative remedies.

Assessing the ethical culture of a student body may strike some as a difficult and expensive proposition. We would not argue that point, but emphasize instead, that there might be no other way to gain the information for effectively managing moral development goals. We would also mention that colleges and universities already commit considerable resources to similar endeavors. Most maintain an Office of Institutional Research that surveys students and alumni and analyzes results across a multitude of different indicators, many concerned with satisfac-

tion levels but others focused on, for instance, "atmosphere." If it is worthwhile understanding whether the ambiance of the campus is perceived as "relaxed," "supportive," "friendly," or one of eight other descriptors, then it would not appear to be much of a stretch to enquire about the ethical environment.

A Promising Model

One way to conceptualize a systematic approach to manage objectives in the area of student moral development is to reconstruct the way universities have successfully managed diversity. If the object is to instill ethical values in college students then we might begin by asking, "How did schools succeed in inculcating a respect for diversity?" or "What are the key attributes of that model?" The answers to those questions should provide a pattern applicable to ethical values. We believe that pattern will closely approximate the approach we developed for managing ethical performance systematically and that we urge be applied to moral development objectives. To illustrate, three key elements of the diversity model and brief commentary as to their ethical equivalents follow:

1. Walk the walk. College and university leaders do not simply talk about their commitment to diversity, they manifest that commitment in the management of their organizations. For many, this commitment goes beyond a motivation to comply with the law, it represents a core value of the institution. To the student observer, this comes across in a multitude of ways, but none is as poignant as decisions to hire new faculty and to fill high-visibility administrative position.

It is inconceivable that the student body would take seriously what a university had to say about diversity if it was staffed entirely by white Protestant men or some similarly homogenous group. That is not to say that the faculty and administration must reflect the ethnic and racial mix of American society, which is an impossible standard. What is crucial is that every effort is made to operate inclusively—to create a platform of serious and sincere concern for diversity as a defining value of the organization.

Likewise, if institutions of higher education are to make any headway in instilling ethical values in their students, then they must work from a similar platform. As mentioned earlier, operating with the utmost of integrity is the foundation for such a platform. That does not imply ethical perfection, but it does require that every effort be made to minimize ethical lapses and to react assiduously when they do. It also may imply a higher standard than is usually associated with organizational ethics. Practices that may not be clearly unethical—borderline activities or gross hypocrisies—may nonetheless undermine the institution's standing as a moral exemplar. Within this category, perhaps nothing does more to deflate students' image of the university and its commitment to academic integrity than double standards.

2. Rewards, incentives, and celebrations. From the students' point of view and their intense focus on rewards and incentives, the university's commitment to diversity is unambiguous and sincere. One of the great accomplishments of their young lives is admission to college. When they observe how universities grant this cherished reward, they are inclined to accept the commitment to diversity as sincere. Students receive other reinforcing messages on campus and diversity is routinely celebrated in all manner of ways. But nothing telegraphs the point as boldly as the admissions policy and their defense in court. It is hard to imagine that other messages would be taken seriously if the student body was representative of but one race, religion, or gender.

We would urge leaders of colleges and universities to consider what it would mean to reward and celebrate ethics in a similar manner, so that students got it under their skin that ethics really matters around here. Recognizing that every practice and process affecting students—from pre-admission to graduation—is apt to transmit a cultural message, all of them deserve scrutiny. As matters stand for many students, there is but one tangible reward and but one form of serious recognition: their grade-point average upon graduation.

The challenge is to construct a more balanced system of rewards that does not necessarily diminish the importance of making good grades, but elevates the importance of those that express the university's commitment to ethical values. For example, most colleges and universities have councils for administering the school's honor code. Staffed by members of the faculty, administration, and students, they do everything from investigating and adjudicating violations to educating incoming freshmen. In many schools, student members of these committees receive precious little recognition for their efforts, and the student body knows it. Celebrating their efforts in a meaningful way is an opportunity for the university to telegraph the importance of this work and the value placed on academic integrity.

What might represent a meaningful reward for or celebration of student activities in support of the university's ethical objectives? For guidance, leaders might consider their experience with volunteerism and community involvement, a heavily studied area with documentation of what works and what does not.[68]

3. Measurement. Many, if not most, universities periodically survey student attitudes regarding diversity and scrupulously analyze the data several different ways. To not belabor the point, the effort is sophisticated and comprehensive. And it is a model of what is required for monitoring the ethical culture of a student body.

The upshot of these three factors was to create a culture of diversity or an environment in which students received consistent and unambiguous messages that people from all walks of life deserve their acceptance and respect. And as discussed earlier, they took it to heart. Whether a similar result can be achieved with regard to instilling ethical values cannot be determined in advance, it must be tried. For those willing to try, we conclude with a thought on the scope of such a project.

Although the Enron Era focused attention on schools of business, a plan to instill ethical values in students destined for a career in business should apply to the entire university. Simply put, business schools are not the only pipelines of corporate talent. According to estimates by the University of Nebraska, 80 percent of its 9,000 annual graduates pursue business careers, only 1,500 of whom graduated from its business school. Not surprisingly, business leaders hail from any number of academic disciplines.

In 2001, 23 percent of Fortune 100 chief executive officers (CEOs) had engineering degrees and only 34 percent of Fortune 700 CEOs held MBAs.[69] And consider that prominent CEOs Carly Fiorina (formerly of Hewlett Packard), Michael Eisner (Disney), Alan Lafley (Proctor and Gamble), and Meg Whitman (eBay) majored in medieval history and philosophy, English literature and theater, history, and economics, respectively. Perhaps most poignantly, CEOs Ken Lay (Enron) and Bernard Ebbers (WorldCom) majored in economics and physical education respectively, and neither man holds an MBA.

Summary

Without minimizing the unique ethical challenges of colleges and universities, we believe our strategy for systematically managing ethical culture can be adapted to their high-risk operational areas. We urge leaders of these institutions to seriously consider doing so. Serving in that capacity requires exemplary ethical performance and while no strategy can guarantee that outcome, the proactive management of ethical culture adds a strong layer of protection to the standard defenses of leadership, compliance, and training.

We also urge college and university leaders to seriously consider this approach for their moral development objectives. One of their greatest challenges in this area is the minimal amount of direct contact between university representatives and students. College students are rarely under a watchful eye and the compliance mechanisms to monitor their activities are few and far between. Under such circumstances, the only realistic way to influence students to the point of affecting their behavior is by embedding values in their culture. In the interest of more honorable behavior and ethical habits, we recommend assessing the ethical culture of student bodies to establish a baseline for continuous improvement.

A Proposal for Moving Forward

One of the findings of this Ethics Initiative is how little practical experience we have in systematically managing ethics as an organizational objective. This deficiency applies equally to the job of instilling values in students as it does to the ethical performance of organizations. This is not to say that efforts are not made, because they clearly are. But if the lack of transparency as to the ethical conditions and performance of organizations is any indication, stakeholders should not be satisfied with present-day methodologies.

Although the Enron Era was a wake-up call to get serious about organizational ethics, it did not come with any ready-made solutions. As of this writing, the easy fixes have been made and the theoretical frameworks have gone as far as they can. What is needed now is practical, hands-on experience in managing organizational ethics systematically. The BHEF Ethics Initiative took a significant step in that direction by validating that such an approach is feasible. But considerably more work is required. In particular, the assessment process must be refined and systematized before it can be deployed with ease. And the process of formulating management objectives in respect of ethical culture needs further development. Following

are four courses of action for taking what has been achieved thus far to the next level:

1. Assess the ethical cultures of a diverse universe of operating units and student bodies, present the results to a wide range of senior managers to assess their usefulness, and revise accordingly.

2. Translate the assessments into realistic management objectives and gauge the need for supportive resources.

3. Document the results of these activities and produce a formal protocol for managing organizational ethics systematically.

It should be emphasized that confidentiality will be strictly observed: none of the assessment results will be attributed and all work will be performed under the auspices of an academic research center.

Author's Note

This project has been professionally and personally grati-fying. But when first invited to participate, I worried that BHEF members might not endorse what for me is the hallmark of good scholarship: a willingness to suspend judgment and doggedly follow the evidence, wherever it might lead. My concerns proved unwarranted—our moti-vations were the same. Without limitation, everyone involved in this project was intent on discovering knowl-edge and devising practical strategies.

I am a college professor with some expertise in moral philosophy, management, and commercial regulation but my familiarity with this topic runs much deeper. Not too long ago I was a CFO in the securities industry, and before that a partner in a public accounting firm. There-fore, I have some firsthand knowledge of the difficult challenge of operating an organization ethically. Like the old saying that "Ethics is easy, life is hard," ethical organi-zations are easy to conceptualize but monumentally diffi-cult to create and sustain.

It is my belief that much of that difficulty stems from an understanding of ethics as somehow beyond the ken of traditional management techniques. This report was an attempt to overcome that attitude—to normalize ethics to the point that it can be systematically managed. It is my hope that this report provides enough ideas to point managers and scholars in that direction.

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About the Author

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Ed Soule is an Assistant Professor at the McDonough School of Business, Georgetown University where he has taught courses in managerial ethics and corporate social responsibility since 1999. In 2002 he was awarded the Joseph F. Le Moine Award for Undergraduate and Grad-uate Teaching Excellence.

Soule's research considers two facets of business from a moral point of view: management responsibility and government intervention in commercial life. His book, *Morality & Markets: The Ethics of Government Regulation*, was published in 2003 (Rowman & Littlefield Publishers, Inc.). His articles appear in leading scholarly journals such as *The Academy of Management Review* and *Business Ethics Quarterly* as well as in professional publications such as the American Bankers Association's *Trusts & Estates*.

Professor Soule's academic activities reflect his unlikely past—formal training in moral and political philosophy that followed a successful career in business. He served as the Chief Financial Officer of Edward Jones from 1986 to 1995. For the twelve years preceding that appointment he held several positions in public accounting, including Managing Partner of the St. Louis office of Main Hurd-mann (subsequently merged into KPMG).

Soule received his Ph.D. from Washington University in St. Louis in 1999. His studies were briefly interrupted when he was recruited to serve as the interim Chief Finan-cial Officer of TransWorld Airlines during the latter half of 1996; a particularly precarious period in the rambunc-tious history of that carrier.

Professor Soule and his wife, Donna, live in Potomac, Maryland with their daughter and their son attends college in California. Although his faith was put to a cruel test during the 2004 World Series, Professor Soule is a diehard fan of his home-town St. Louis Cardinals.

Appendix
Noteworthy Ethics Initiatives and Publications

1. **The Association to Advance Collegiate Schools of Business International**

   - Web-based Ethics Education Resource Center
     http://www.aacsb.edu/resource_centers/ethicsedu/default.asp

   - "Ethics Education in Business Schools"
     http://www.aacsb.edu/resource_centers/EthicsEdu/EETF-report-6-25-04.pdf

2. **The Aspen Institute**

   - Business and Society Program
     http://www.aspeninstitute.org/Programt2.asp?i=82

   - "Where Will They Lead: MBA Student Attitudes about Business & Society 2003"
     http://www.aspeninstitute.org/Programt2.asp?i=82&bid=947

3. **Business Roundtable Institute for Corporate Ethics**
   http://www.businessroundtable.org/pdf/CorpEthicsBrochure.pdf

4. **The Ethics Resource Center**
   http://www.ethics.org/

   - 2003 National Business Ethics Survey

   - Fellows Program: "Integrating Ethics and Compliance Programs: Next Steps for Successful Implementation and Change" by Joshua Joseph
     http://www.ethics.org/fellows/publications.html#integrating

5. **The Council for Industry and Higher Education**

   - Guide on Ethics for all Universities and Colleges
     http://www.cihe-uk.com/EthicsPR.htm

6. **World Economic Forum Global Corporate Citizenship Initiative**
   http://www.weforum.org/site/homepublic.nsf/Content/Global+Corporate+Citizenship+Initiative

   - CEO Statement and Framework for Action

   - CEO Survey on Corporate Citizenship

   - The Business Case for Corporate Citizenship

7. **Caux Round Table**

   • K-12 Ethics Initiative
     http://www.cauxroundtable.org/K12EthicsInitiative.html

   • Self-Assessment and Improvement Process
     http://www.cauxroundtable.org/resources.html

8. **Center for Ethical Business Cultures**
   http://www.cebcglobal.org/

9. *Cases in Leadership, Ethics, and Organizational Integrity: A Strategic Perspective* by Lynn Sharp Paine (Chicago, Illinois: Irwin, 1997)

10. *Value Shift: Why Companies Must Merge Social and Financial Imperatives to Achieve Superior Performance* by Lynn Sharp Paine (New York, New York: McGraw-Hill, 2003)

11. **Bentley College Center for Business Ethics**

    • The Raytheon Lectureship in Business Ethics
      http://ecampus.bentley.edu/dept/cbe/events/lecture_raytheon.html

    • Verizon Visiting Professorship in Business Ethics and Information Technology
      http://ecampus.bentley.edu/dept/cbe/events/lecture_verizon.html

12. **"Managing Ethics and Legal Compliance: What Work and What Hurts"** by Linda Klebe Treviño, Gary R. Weaver, David G. Gibson, and Barbara Ley Toffler, California Management Review, Vol. 1, No. 2, Winter 1999, pp.131-151

13. *Managing Business Ethics: Straight Talk About How To Do It Right* by Linda K. Treviño and Katherine A. Nelson (New York, New York: John Wiley & Sons, 1995)

14. **The GoodWork Project**
    http://www.goodworkproject.org/index.htm

    • *Good Work: When Excellence and Ethics Meet* by Howard Gardner, Mihaly Csikszentmihalyi, and William Damon (New York, New York: Basic Books, 2002)

    • *Making Good: How Young People Cope with Moral Dilemmas at Work* by Wendy Fischman, Becca Solomon, Deborah Greenspan, and Howard Gardner (Cambridge, Massachusetts: Harvard University Press, 2004)

Endnotes

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3   Peter J. Wallison, "Sarbanes-Oxley As an Inside-the-Beltway Phenomenon," American Enterprise Institute for Public Policy Research, June 2004. Available from: http://www.aei.org/publications/filter.,publD.20582/pub_detail.asp

4   Louis Lavelle, "Governance: Backlash In the Executive Suite," *Business Week*, June 14, 2004, p. 36.

5   Public Company Accounting Oversight Board, Release 2004-001, March 9, 2004, p. 2. Available from: http://www.pcaobus.org/Standards/Standards_and_Related_Rules.asp

6   Confidence in Leaders of Major Institutions Declines Modestly Since Last Year, The Harris Poll, No. 18, March 10, 2004. Available from: http://www.harrisinteractive.com/harris_poll/index.asp?PID=447

7   Steve Farkas, Ann Duffett, and Jean Johnson with Beth Syat, "A Few Bad Apples? Exploratory Look at What Typical Americans Think About Business Ethics Today," report for The Kettering Foundation from Public Agenda, January 2004, p. 7. Available from: http://www.publicagenda.org

8   Based on the cited Public Agenda research, business leaders were not so sanguine. They "strongly felt that CEOs had lost a great deal of public credibility and respect, and they were cognizant of the need to restore the public's trust." *The Gallup Management Journal*, Oct. 16, 2002, p.3. Available from: http://gmj. gallup.com/content/default.asp?ci=829

9   Daniel C. Indro, "Does Mutual Fund Flow Reflect Investor Sentiment?", *The Journal of Behavioral Finance*, Vol. 5, No. 2, 2004, pp. 105-115.

[10] Unless referenced separately, all data referred to in this and the next paragraph are either contained in or derived from the 2004 Mutual Fund Fact Book, 44th Edition. Available from: http://www.ici.org/stats/mf/index.html#Mutual%20Fund%20Fact%20Book

[11] Derived from monthly data provided by the Investment Company Institute, Trends in Mutual Fund Investing. Available from: http://www.ici.org/stats/mf/arctrends /index.html#TopOfPage

[12] David Henry and Amy Borrus, "Death, Taxes & Sarbanes-Oxley," *Business Week*, Jan. 17, 2005, pp. 28-32.

[13] PCAOB, Release No. 2004-001, March 9, 2004. Available from: http://www.pcaobus.org/Standards/Standards_and_Related_Rules.asp

[14] See, for example, Francis Fukuyama, "Community Cares," *The Guardian Weekly*, Vol. 162, No. 24, June 8–14, 2000, p. 34. Also, sociologist Claude Fisher provides an overview of this debate in a paper presented to "Author Meets Critic: Putnam, Bowling Alone" at the American Sociological Association, Anaheim, California, August 2001. Available from: http://sociology.berkeley.edu/Faculty_HTML/fischer/fischer_pdf/bowling_alone.pdf

[15] D.L. McCabe and L.K. Treviño, "What we know about cheating in college," *Change: The Magazine of Higher Learning*, January / February 1996, pp. 28-33; D. L. McCabe, L.K. Treviño, and K. Butterfield, "Cheating in academic institutions: A decade of research," *Ethics and Behavior*, Vol. 11, No. 3, 2001, pp. 219-232.

[16] Also, many of the measures that might change a culture are not in the repertoire of organizational leaders, they are inherently political in nature. For an example of what is involved, see David Callahan, *The Cheating Culture: Why More Americans are Doing Wrong to Get Ahead*, New York, New York: Harcourt, 2004.

[17] Another factor that is often pointed to in alarm is the increased number of accounting restatements. However, George Benston, Michael Bromwich, Robert Litan, and Alfred Wagnhofer argue that most of the increase stems from factors other than devious motives. See: *Following the Money*,Washington, D.C.: AEI-Brookings Joint Center for Regulatory Studies, 2003, p. 34.

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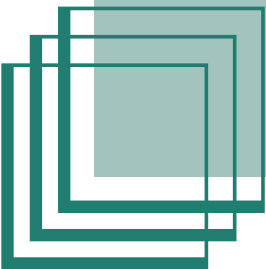
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