Corporate Culture and Codes of Ethics

by Sophia

WHAT'S COVERED

In this lesson, you will learn more about the role of ethics in corporate environments. Specifically, this lesson will cover:

1. Observations on Corporate Culture

A corporation is a "person" capable of suing, being sued, and having rights and duties in our legal system. (It is a legal person, not a natural person, according to our Supreme Court.)

Moreover, many corporations have distinct cultures and beliefs that are lived and breathed by their members. Often, the **corporate culture** is the best defense against individuals within that firm who may be tempted to break the law or commit serious ethical misdeeds.

What follows is a series of observations about corporations, ethics, and corporate culture.

TERM TO KNOW

Corporate Culture
The shared values, interests, standards, and beliefs that naturally evolve among the members of a corporation; the culture is influenced by the group's shared goals and experiences.

1a. Ethical Leadership Is Top-Down

People in an organization tend to watch closely what the top managers do and say. Regardless of managers' talk about ethics, employees quickly learn what speech or actions are in fact rewarded.

If the CEO is firm about acting ethically, others in the organization will take their cues from him or her. People at the top tend to set the target, the climate, the beliefs, and the expectations that fuel behavior.

1b. Accountability Is Often Weak

Clever managers can learn to shift blame to others, take credit for others' work, and move on before "funny numbers" or other earnings management tricks come to light.

Too often, we see that the manager is often an agent for himself or herself and will often act more in his or her self-interest than for the corporate interest.

This is not much different in politics, however, where we see elected officials**self-deal**.

TERM TO KNOW

Self-Dealing

In business, a departure from a duty of loyalty to another in favor of oneself. For example, an officer of a corporation who is a fiduciary with a duty of loyalty to the corporation would be guilty of self-dealing if he or she set up a side business that competed with the corporation.

1c. Killing the Messenger

When organizations no longer function properly, some employees are inevitably unhappy. If they call attention to problems that are being covered up by coworkers or supervisors, they bring bad news.

Managers like to hear good news and discourage bad news. Intentionally or not, those who told on others, or blew the whistle, have rocked the boat and become unpopular with those whose misdeeds they report on and with the managers who don't really want to hear the bad news.

In many organizations, "killing the messenger" solves the problem.

EXAMPLE James Alexander at Enron Corporation was deliberately shut out after bringing problems to CEO Ken Lay's attention. When Sherron Watkins sent Ken Lay a letter warning him about Enron's accounting practices, CFO Andrew Fastow tried to fire her.

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2. Ethics Codes

Without strong leadership and a willingness to listen to bad news as well as good news, managers do not have the feedback necessary to keep the organization healthy.

Ethics codes have been put in place— partly in response to federal sentencing guidelines and partly to encourage feedback loops to top management. The best ethics codes are aspirational, having an ideal to be pursued, not legalistic or compliance driven.

EXAMPLE The Johnson & Johnson ethics code predated the Tylenol scare and the company's oft-celebrated corporate response. The corporate response - to sacrifice corporate profits and take the tainted product off the shelves, recall the products, and offer free replacements - was consistent with that code, which was lived and modeled by the top of the organization.

It's often noted that a code of ethics is only as important as top management is willing to make it. If the code is just a document that goes into a drawer or onto a shelf, it will not effectively encourage good conduct within the corporation.

The same is true of any kind of training that the company undertakes, whether it be in racial sensitivity or sexual harassment. If the message is not continuously reinforced, or (worse yet) if the message is undermined by management's actions, the real message to employees is that violations of the ethics code will not be taken seriously, or that efforts to stop racial discrimination or sexual harassment are merely token efforts, and that the important things are profits and performance.

EXAMPLE The ethics code at Enron seems to have been one of those "3-P" codes that wind up sitting on shelves— "Print, Post, and Pray." Worse, the Enron board twice suspended the code in 1999 to allow outside partnerships to be led by a top Enron executive who stood to gain financially from them.

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3. Federal Sentencing Guidelines

The federal sentencing guidelines were enacted in 1991. The original idea behind these guidelines was for Congress to correct the lenient treatment often given to white-collar, or corporate, criminals.

The guidelines require judges to consider "aggravating and mitigating" factors in determining sentences and fines. While corporations cannot go to jail, their officers and managers certainly can, and the corporation itself can be fined. Many companies will claim that it is one bad apple that has caused the problem; the guidelines invite these companies to show that they are in fact tending their orchard well.

They can show this by providing evidence that they have:

- A viable, active code of ethics
- A way for employees to report violations of law or the ethics code
- An ethics ombudsman, or someone who oversees the code

In short, if a company can show that it has an ongoing process to root out wrongdoing at all levels of the company, the judge is allow\ed to consider this as a major mitigating factor in the fines the company will pay.

DID YOU KNOW

Most Fortune 500 companies have **ethics hotlines** (a way to call in ethics violations anonymously, avoiding any risk of "killing the messenger") and processes in place to find legal and ethical problems within the company.

TERM TO KNOW

Ethics Hotline
An identified telephone number or other mode of communication that provides a confidential means for employees or other stakeholders to report unethical conduct.

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4. Managing by the Numbers

If you manage by the numbers, there is a temptation to lie about those numbers, based on the need to get stock price ever higher.

EXAMPLE At Enron, "15 percent a year or better earnings growth" was the mantra.
Jeffrey Pfeffer, professor of organizational behavior at Stanford University, observes how the belief that "stock price is all that matters" has been hardwired into the corporate psyche. It dictates not only how people judge the worth of their company, but also how they feel about themselves and the work that they are doing. And, over time, it has clouded judgments about what is acceptable corporate behavior.

An example of this phenomenon can be seen in the case below.

Managing by the Numbers: The Sears Auto Center Story

Most people want to be winners or associate with winners. As humans, our desire to associate with those who have status provides plenty of incentive to glorify winners and ignore losers. But if an individual, a team, or a company does whatever it takes to win, then all other values are thrown out in the goal to win at all costs. The desire of some people within Sears Auto Center to win by gaining higher profits resulted in the situation portrayed here.

Sears Roebuck & Company was a fixture in American retailing throughout the twentieth century. At one time, people in rural America could order virtually anything (including a house) from Sears. Not without some accuracy, the company billed itself as “the place where Americans shop.” But in 1992, Sears was charged by California authorities with gross and deliberate fraud in many of its auto centers.

The authorities were alerted by a 50 percent increase in consumer complaints over a three-year period. New Jersey’s division of consumer affairs also investigated Sears Auto Centers and found that all six visited by investigators had recommended unnecessary repairs. California’s department of consumer affairs found that Sears had systematically overcharged by an average of $223 for repairs and routinely billed for work that was not done. Sears Auto Centers were the largest providers of auto repair services in the state.

The scam was a variant on the old bait-and-switch routine. Customers received coupons in the mail inviting them to take advantage of hefty discounts on brake jobs. When customers came in to redeem their coupons, sales staffers would convince them to authorize additional repairs. As a management tool, Sears had also established quotas for each of its sales representatives to meet.

Ultimately, California got Sears to settle a large number of lawsuits against it by threatening to revoke Sears’ auto repair license. Sears agreed to distribute $50 coupons to nearly a million customers nationwide who had obtained certain services between August 1, 1990 and January 31, 1992. Sears also agreed to pay $3.5 million to cover the costs of various government investigations and to contribute $1.5 million annually to conduct auto mechanic training programs. It also agreed to abandon its repair service quotas. The entire settlement cost Sears $30 million. Sears Auto Center sales also dropped about 15 to 20 percent after news of the scandal broke.

Note that in boosting sales by performing unnecessary services, Sears suffered very bad publicity. Losses were incalculable. The short-term gains were easy to measure; long-term consequences seldom are.

This case illustrates a number of important lessons:

1. *People generally choose short-term gains over potential long-term losses.*

2. *People often justify the harm to others as being minimal or “necessary” to achieve the desired sales quota or financial goal.*

3. *In working as a group, we often form an “us versus them” mentality.* In the Sears case, it is likely that Sears “insiders” looked at customers as “outsiders,” effectively treating them (in Kantian terms) as means rather than ends in themselves. In short, outsiders were used for the benefit of insiders.

4. *The long-term losses to Sears are difficult to quantify, while the short-term gains were easy to measure and (at least for a brief while) quite satisfying financially.*

5. *Sears' ongoing rip-offs were possible only because individual consumers lacked the relevant information about the service being offered.* This lack of information is a market failure, since many consumers were demanding more of Sears Auto Center services than they would have (and at a higher price) if relevant information had been available to them earlier. Sears, like other sellers of goods and services, took advantage of a market system, which, in its ideal form, would not permit such information distortions.

6. *People in the organization probably thought that the actions they took were necessary.*Noting this last point, we can assume that these key people were motivated by maximizing profits and had lost sight of other goals for the organization.

The emphasis on doing whatever is necessary to win is entirely understandable, but it is not ethical. The temptation will always exist - for individuals, companies, and nations - to dominate or to win and to write the history of their actions in a way that justifies or overlooks the harm that has been done. In a way, this fits with the notion that "might makes right," or that power is the ultimate measure of right and wrong.

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5. Conscious Capitalism

One effort to integrate the two viewpoints of stakeholder theory and shareholder primacy is the conscious capitalism movement. Companies that practice conscious capitalism embrace the idea that profit and prosperity can and must go hand in hand with social justice and environmental stewardship. They operate with a holistic or systems view. This means that they understand that all stakeholders are connected and interdependent. They reject false trade-offs between stakeholder interests and strive for creative ways to achieve win-win-win outcomes for all.

The "conscious business" has a purpose that goes beyond maximizing profits. It is designed to maximize profits, but is focused more on its higher purpose and does not fixate solely on the bottom line. To do so, it focuses on delivering value to all its stakeholders, harmonizing as best it can the interests of consumers, partners, investors, the community, and the environment. This requires that company managers take a "servant leadership" role, serving as stewards to the company's deeper purpose and to the company's stakeholders.

Conscious business leaders serve as such stewards, focusing on fulfilling the company's purpose, delivering value to its stakeholders, and facilitating a harmony of interests, rather than on personal gain and self-aggrandizement. Why is this refocusing needed? Within the standard profit-maximizing model, corporations have long had to deal with the "agency problem." Actions by top-level managers - acting on behalf of the company - should align with the shareholders, but in a culture all about winning and money, managers sometimes act in ways that are self-aggrandizing and that do not serve the interests of shareholders.

Laws exist to limit such self-aggrandizing, but the remedies are often too little and too late and often catch only the most egregious overreaching. Having a culture of servant leadership is a much better way to see that a company's top management works to ensure a harmony of interests.

SUMMARY

In this lesson, you learned that common **observations on corporate culture** reveal that **ethical leadership is top-down**, **accountability is often weak**, and there can be a tendency to **kill the messenger**. To ensure that they are abiding by the law and acting responsibly, many corporations have instituted **ethics codes** as a response to **federal sentencing guidelines**, which place greater

regulations on businesses.

A downfall of many corporations is the tendency to **manage by the numbers**, which often results in prioritizing profits over all else, regardless of the legal or ethical consequences. The **conscious capitalism** movement advocates for considering profitability in conjunction with social justice and environmentalism rather than separately from them.

Best of luck in your learning!

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