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MAKING BUSINESS ETHICS A
COMPETITIVE ADVANTAGE

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INTRODUCTION

Anyone who regularly watches current affairs television in Australia, or reads the business press, will be aware of frequent calls for a restoration of ethical standards in business, government and society more generally. This call implies either that business is part of society or is subject to it. If business is a realm distinct from society, subject only to the law, as Nobel laureate Milton Friedman (1970) argues, and business decisions have no moral content then there is no ground from which to call for an ethical approach to business. Alan Wood has taken a similar view in a recent series of articles in The Australian (2001). This paper, however, consistently with the views of Ian Wilson (2000) and others, sees business as a part of society, ‘authorized by the larger society to act for specific … purposes’ (Werhane and Freeman 1999: 4) and to serve as a vehicle for the coordination of stakeholder interests. It explains how well-developed ethical standards and practice can be a competitive advantage in the global marketplace, and begins by asking how well equipped are business and business people to respond to the ethical demands that are being made of them.

These demands vary from industry to industry. In the Australian wine industry there are disputes over the definition of regional boundaries, revelations about the use of prohibited substances in wine production, and varying interpretations of the evidence about the impact of wine on health. How do wine makers and vigneron contribute to decisions about genetically modified foods?

How do engineers participate honestly and openly in discussions about oil spills, the nature of work in a control room on the night shift, decisions to flood an engine room with carbon dioxide to quell the fire and save the ship while killing those in the engine room, or quality assurance in food processing? Without input from managers and professionals the discourse will be less well informed, and society less well served.

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How is this to be achieved? To take part in the debate one must know the rules, the accepted structure of argument and the vocabulary. In my own profession of chemical engineering these include the laws of thermodynamics, the scientific method, linear programming, unit operations and unit processes. In the discussion of wider social and cultural matters, ‘ethics’ is the very practical activity of applying one’s chosen values to the issues at hand. As Scanlon (1982) has written, ethics is the ‘desire to be able to justify our actions to others on grounds they could reasonably accept’. It is not the imposition of someone else’s values on business or research but ‘the understanding of the foundations of business itself’ (1982: 128). If that understanding is to be implanted and nurtured in managers and professionals, both old and young, several factors need to be taken into account by those who seek to introduce an ethical component into the management of their business and by those responsible for the professional development of managers. The first of these is that a strong ethical culture can be a competitive advantage for a business. This paper discusses these factors and then proceeds to draw implications for management and professional development.

ETHICS CAN BE A SOURCE OF COMPETITIVE ADVANTAGE

The first feature to be understood is that ethics is not a ‘soft’ topic, unrelated to the ‘hard’ world of business. This may seem counter-intuitive, but many ethical commitments enhance the bottom line rather than dilute it (Bowie and Vaaler 1996: 162). Dow Chemical, Cadbury Schweppes and an entrepreneurial water engineer are the first companies mentioned by Mark Pastin in his book *The hard problems of management: gaining the ethics edge* (1986). These are, in his words, ‘heroes … high-ethics, high-profit firms’ (1986: xi).

The bottom line value of ethical behaviour can be demonstrated using traditional economics and rational decision-making models. Such an approach begins from the premise that honesty and trust reduce transaction costs, because fewer protective devices are needed if the firm has trustworthy agents and less time is spent in negotiation if initial claims are truthful. Thus the costs of an option based on these characteristics are lowered, so that it may become the preferred option, especially where transaction costs are high relative to other costs. Similarly, the strategic alliances so important to global manufacturing, virtual factories and the collaborative development of new products can only survive if there is cooperation between the parties. Where no such cooperation exists, effort is dissipated in bureaucratic wrangling or misdirected activity. In 2001, tyre maker Firestone ended its century-long partnership with the Ford Motor Company not because it was unprofitable but because the trust had gone out of the relationship (Romei 2001).

In the strategic resources model, long-term sustainable competitive advantage is the result of exploiting an enduring core of capability differentials in tangible and
intangible assets (Itami 1987). These capabilities or resources include brand names, efficient procedures, capital, in-house knowledge of technology, and people (Wernerfelt 1984: 172). As the speed of tangible assets accumulation and the pace of imitation quickens, the advantages of location and technology are being eroded and intangible assets are assuming an increasingly competitive significance in rapidly changing domestic and global markets (Prahalad and Hamel 1990).

The ethical commitments of an organisation are specific and valuable. Working for Exxon is different to working for BHP, and someone who has worked for or with Exxon would expect to find certain features in an Exxon company regardless of its geographical location or industry. As Bowie and Vaaler (1999: 163) note in an examination of the role of ethical standards in multinational companies, the ethical climate of a corporation is ‘knowledge-based, and embodied in individual employees or in organizational routines. As a result the ethical climate is rather difficult to duplicate and thus is a source of durable competitive advantage.’

A third way to demonstrate the bottom-line value of ethics is to look at what the business press and business people have to say. Although the evidence is somewhat mixed, typical of many is an article in the Australian Financial Review headed ‘Companies are placing high values on ethics’ which gives examples where the sales and reputations of companies have suffered ‘because they ignored ethical standards’, and points to evidence that US companies where ethical standards prevail ‘have consistently outperformed the Wall Street norm’ (Marshall 1998). In a recent study by Arthur Andersen and the London Business School (2000) company secretaries and other senior executives of leading UK companies reported that business ethics activities had a positive influence on profit, winning new business, productivity, and business growth.

Lower transaction costs, the hard-to-copy nature of a company’s ethical culture, and the assessment by business people themselves all support the bottom-line value of ethical behaviour.

These ‘bottom line’ arguments do not exclude the adoption of ethics practices because the proprietor, board or managers believe that ethical behaviour is good for its own sake. That a piece of equipment is functional does not prevent it from being beautiful.

IMPLEMENTATION AND NURTURE

How is a strong ethical culture to be achieved in an individual business or industry? It requires an outward-looking culture, attuned to the real concerns of communities. This paper argues that an understanding of the place of values and ethics in the world in which business, managers and professionals operate, and of
the nature of cultural change, will assist in the successful implementation and nurture of that culture. Five factors are discussed below.

1 Many Australians are interested in ethics and values

The 1990s saw an ‘emerging interest in values, vision, meaning and purpose’ (Mackay 1993: 239). Concerns about social justice and the environment are part of this. So are the interest in New Age and Aboriginal spirituality, the popularity of Sophie’s world (Gaardner 1995), and the increasing number of Year 12 students completing rigorous units in religion studies.

Some argue that ethics, values and morals cannot be taught, ‘that it is a good upbringing, not a late-in-life college or corporate course, that teaches the difference between right and wrong’ (Solomon 1992: 4). However, whilst upbringing may provide a beginning, it is not the whole story. At least since Aristotle, people have recognised that the careful study and reflection of those whom we see as good is an important and effective means of individual moral development. (Today we might call this a ‘case study’, a device that is frequently used to teach practical ethics.) Lawrence Kohlberg (1983) and Carol Gilligan (1982) have provided frameworks that can be used to map and measure the stages through which individuals pass in this moral development process.

The effectiveness of ethics education has been extensively studied. There is overwhelmingly evidence (Rest 1988; Rossouw 1996) in support of the view that university students are especially receptive to education programs designed to foster the development of moral judgment. On the other hand, the empirical research also shows that traditional business ethics classes have little effect in changing students’ attitudes and behaviour (Treviño 1986). Reviewing the research, Rest (1988: 23–24) says:

> dramatic and extensive changes occur in young adulthood (20’s and 30’s) in the basic problem solving strategies used by the person in dealing with ethical issues, … [D]eliberate educational attempts to influence awareness of moral problems and to influence the reasoning/judgment process can be demonstrated to be effective.

Today, four problem-solving strategies are widely used in deciding what one should do, when applying the values one has chosen to the circumstances of daily life and work. The consequentialist or utilitarian view is that one should seek to maximise happiness. This is associated with the philosophers Jeremy Bentham and JS Mill, and is often used in decisions about the allocation of resources such as access to health and medical services. Alternatively, one may take the view that decisions should be based on what is right, as determined by natural law, duty to God, or reason. This is called a deontological system. While it is often based on a
set of rules founded in religious belief, such as the Ten Commandments, the philosopher Immanuel Kant showed that principles could be derived by reason alone (1991: 87). Neither rules nor calculation of happiness can determine what should be done in every situation – times change, new products are invented, new discoveries made and the best guide to action is a person of good character. In the third approach, it is the character of the individual that matters. The model of the manager is formulated in terms of moral virtues, moral excellence and corporate citizenship, and development of moral character becomes a necessity for good management (McCoy 1985; Solomon 1992). Such a system was expounded by Aristotle in pre-Christian Greece, and it has had a recent resurgence under MacIntyre (1985). Against these three can be set relativism, under which truth is whatever seems true for me at the time and there are no universal rules. This approach is often associated with postmodern thought. (A more extensive introductory coverage can be found in the opening chapter of most business ethics texts, or in Vardy and Grosch’s *The puzzle of ethics* (1994).)

2 **Contentious issues and dilemmas are not the only ethical problems in business**

The second feature has to do with the nature of ethical questions, and the extent to which discussion of values can be limited to certain well-defined ‘problem’ areas. Many would recognise that there are difficult ethical dilemmas in environmental management and medicine. There are also situations in which it is not decision making that is difficult but action – we know what is right or good, but fail to do it.

Indeed, there are three sorts of ethical questions. In the first group are those situations where it is not immediately obvious what is the right thing to do. This is sometimes called a ‘problem of identification’ (Jackson 1996: 8) or an ‘acute dilemma’ (Nash 1990: 122). For example:

- What criteria should an accountant use when advising her employer that a project is not viable when termination of the project will lead to termination of her own employment?
- Should a lawyer prepare a contract for the supply of a refrigeration plant for a whale catching ship?
- When are the procedures for internal review of decisions ‘exhausted’, thus allowing a manager to make public statement about the profound implications for health, safety and the environment?
- Can mandatory reporting requirements ever be neglected in the interests of confidentiality, or because innocent parties may be harmed?
The second group includes those situations where the right course of action is clear, but actually doing it is personally difficult, what are sometimes called ‘problems of compliance’ or ‘acute rationalisation’, recognising that the agent will often find some ‘rational’ reason to avoid doing what had initially seemed to be the proper thing. Examples here are:

- passive acceptance of some long-standing practice that allows employees to access benefits over and above their formal entitlements;
- allowing important visitors on site without requiring that they comply with safety regulations;
- accepting an instruction to ‘go easy’ in a product safety review to allow the company to remain competitive.

These examples demonstrate the importance of human will in our actions. This is shown in models of ethical decision making, such as that of Rest (1994) which includes four stages: recognise moral issue, make moral evaluation, commit to action, take action.

The will is particularly important in the stages that come after the ethical evaluation has been made. Both the commitment to act (rather than leave the report or analysis to gather dust on the shelf) and acting itself are acts of will. Action does not always follow automatically from analysis and both effort and courage may be needed before ethical behaviour results (Harris 1999). These circumstances need to be acknowledged in any ethics and values program, just as much as providing skills in determining what is right or good.

The third type of problem deals with the choice of a value set. Some may choose to give over-riding priority to the preservation of the environment, while others may make personal happiness the determining factor. Some value sets may be abhorrent to large sections of the community, nevertheless the values of certain criminal elements, say, may be carefully and coherently expressed and rigorously applied using all the resources that ethics has to describe, explain and justify its decisions.
3 Employees face different ethical demands to sole practitioners

The third and fourth factors relate to the way in which the professions respond to matters of values and ethics. In the long-established professions of medicine and law, the professional has often been a sole practitioner and the rules that govern professional conduct have evolved in that context. The participants in any situation are the professional, the client, and the community, and the professional places the client’s interests above their own and in certain well-defined cases the community above that. For chartered accountants, architects and surveyors the situation is similar.

But most accountants, engineers, environmental professionals and marketing managers are employed by firms or governments. The employed engineer may be an ‘in-house consultant’ so that the employer is both client and paymaster, or an employee may be quite unsure whether the traditional concept of profession has any meaning in the circumstances.

Some professional groups, such as the Institutes of Chartered Accountants in England, Wales, Scotland and Ireland have produced distinct guidelines for employed members (Chartered Accountants Joint Ethics Committee 1996). Not all have done so and my own institution, the Institution of Chemical Engineers, makes but passing reference to the issue in its code (1992). Clearly the position of employed professionals needs to be addressed in any discussion of the role of managers and professionals in society.

4 Codes by themselves are not enough

Some may consider that the publication of a code of ethics, either by the professional body, the employer or some regulatory agency, is sufficient to ensure ethical behaviour, but the existence of professional codes, however well constructed, will not of itself bring about change in culture and behaviour. The vast majority of business firms and public sector organisations believe that their code of ethics is ‘useful but insufficient’ (Kernaghan 1993: 24). Empirical studies have shown that codes will be more effective if they are supported by a willingness to enforce the code with sanctions, by top management commitment and by training (Kernaghan 1993; Ford and Richardson 1994).

Codes may be of either an aspirational or a regulatory nature. The ‘tenets’ of the Institution of Engineers, Australia (IEAust) Code (2000) are positive statements of what an engineer should live up to, including aspirational statements such as:

Members shall act in order to merit the trust of the community…

Members shall act with honesty, good faith and equity.
An example of regulatory content in a code can be found later on in the IEAust Code, in a section called ‘general guidance for members’. This is much more detailed than the ‘tenets’, and contains prohibitions and detailed instructions for dealing with some situations. For example, members should not:

- falsify nor misrepresent their … qualifications, [nor]
- induce a client to breach a contract entered into with a duly appointed consulting engineer.

A recent survey of Canada’s top one thousand companies showed that twice as many companies considered that ‘aspirational’ was a better description of their code than ‘rules and regulations’ (KPMG Canada 1997).

5 Cultural change is more effective when it begins with an acknowledgment of existing values

The final point again relates to the way in which education and personal development in values and ethics occur in individuals. The ethical behaviour of individuals is determined by their values and by how they think about ethical dilemmas (Treviño 1986). It is also influenced by the situation and culture within the organisation, be that classroom, factory or office. Many organisational change programs are based on the assumption that learning and change will be more effective if they build on existing knowledge, ‘guiding their learning in graduated steps’ (Robbins 1993: 113). If this is to occur, some information about the existing values and ethical understanding of the organisation’s members must be available to those to whom this aspect of education is entrusted. It also means that some understanding of the ethical preferences of the organisation is required. Learning will be less effective if the words and actions do not match, and some organisations conduct value surveys to obtain this information.

A number of instruments are available to obtain information about the values of an organisation or an individual. Some are designed to meet the needs and circumstances of specific organisations, but two instruments which have been widely used in many different organisations, countries and cultures are the Schwartz Value Survey used in a study of the values of Australian managers by James Sarros and his colleagues at Swinburne (Sarros, Densten and Santora 1999), and the instrument developed by Forsyth (1980). The ethical orientations of both organisations and individuals may be influenced by external or personal factors, but there will be many for whom the preferences are strongly held and stable.
SOME PRACTICAL EXPERIENCE

Three examples demonstrate how an understanding of the place of values and ethics in the world of teachers, students and employers can influence the effectiveness of cultural change.

The falling out between Ford and Firestone, mentioned above, shows the importance of intangible factors in business relationships among large, successful, long-established companies. Other big company examples include the greening of BP and Shell’s commitment to ‘profits and principles’ (Shell International 1998).

Small business can also value ethical behaviour above profit. In an article on successful small business in an Australian airline inflight magazine Young Business Woman of the Year, Amanda Stevens, makes ‘be driven only by what you are passionate about, rather than money’ rule number 2 (Litson 2001).

The importance of language and practice in the consideration of ethical issues is demonstrated by the continuance for more than seven years of a discussion group that provided a confidential forum to which managers and professional people could bring ethical issues from their work for consideration among peers. One feature of the forum (conducted by St Paul’s Centre in Adelaide) was the use of an agreed analytical and discussion format that allowed more time to be spent considering the issue itself and the possible courses of action open to the individual who brought the case to the group. Matters brought to the forum for consideration included both dilemmas and situations in which a manager was seeking support from colleagues before taking a difficult action in line with personal or corporate values.

IMPLICATIONS FOR ORGANISATIONS AND PROFESSIONAL DEVELOPMENT

Ethics and values as a distinguishing feature

Since the publication in 1982 of Deal and Kennedy’s book Corporate cultures (1982) and Peters and Waterman’s In search of excellence (1984) there has been growing acceptance that ‘the impact of values and beliefs on company performance was indeed real’ (Deal and Kennedy 1982: 7). It is this view that makes ethics important to organisations that seek to differentiate themselves in a global market. Organisations with clearly articulated beliefs and strong cultures are likely to be ‘outstanding performers’, according to Deal and Kennedy.

Returning to Bowie and Vaaler’s (1996) analysis of multinational companies, the ethical climate of an organisation is a knowledge-based asset that cannot be reduced to writing and that cannot be bought and sold. But it can be exploited by
the organisation in its dealings with clients, customers and employees. It is commercially valuable.

Discussions of ethics and values in organisations may be more authentic coming from this base than from one of personal piety (or academic indifference). The written policy statements of the overwhelming majority of companies will provide evidence on which such an approach can be based (KPMG Canada 1998).

The ability of an organisation to effectively undertake the development of values and ethics from this positive base will be hampered unless the ethical orientation of the enterprise is clearly discernible and there is a competitive advantage to it. When one’s own code of practice influences both what is taught and the teaching methods, a ready example is at hand, accessible to all irrespective of otherwise limited or differing experience. This is true both for internal activities and those conducted by external agencies.

Questions

A series of questions can be developed to determine the extent to which the factors that affect the effectiveness of moral education have been taken into account in any existing or planned activities. The questions can be applied to course material, the learning environment in the organisation, and to the circumstances in which continuing professional development takes place. The six questions are:

- Is the ethics component seen as integral or as an unbusinesslike appendage?
- Does it acknowledge that managers and employees may have a real interest in questions of meaning and philosophy?
- Does the program address both dilemmas and rationalisation?
- Does it recognise the particular dilemmas faced by employed professionals?
- Does it require intellectual and emotional commitment or rely solely on rules?
- Does it acknowledge the existing ethical orientations of the individuals and organisations involved?
CONCLUSIONS

Transaction cost theory, the strategic resources model, and the practice of many successful companies show that ethics can be a source of competitive advantage, while models of management decision making demonstrate that ethical problems are not limited to seemingly intractable dilemmas in medicine and the environment. Empirical studies have shown that many people in Australia today are interested in values and ethics, that skills in moral reasoning can be developed, that codes by themselves are insufficient to bring about changes in behaviour, and that ethical behaviour is influenced by organisational culture.

The business sector as a whole and individual firms within it will benefit from an understanding of business ethics in these terms.
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