Why Companies Must Merge Social and Financial Imperatives to Achieve Superior Performance

VALUE SHIFT

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McGraw-Hill
A Division of The McGraw-Hill Companies

0-07-141569-6

The material in this eBook also appears in the print version of this title: 0-07-138239-9.

TERMS OF USE

DOI: 10.1036/0071415696

In memory of

Geneva Welch Browning (1904–1978)

and

Robert Perry Teater (1898–1991)

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Preface

This book is about changing notions of corporate performance—what it is and how to achieve it. Although addressed principally to those who want to build high-performing companies—managers, executives, directors, entrepreneurs—its message has relevance for a much wider audience. Given the extensive role played by companies in the world today, corporate performance is something that concerns virtually everyone. And that fact, more than anything else, is driving the developments discussed in the pages that follow.

If readers take only one idea from this book, I hope it will be an understanding of what I believe to be an emerging new standard of corporate performance—one that encompasses both moral and financial dimensions. We are, I believe, in the midst of a fundamental value shift that is altering how companies are thought of and how they are expected to behave. The deep sense of betrayal provoked by the past year's revelations of misdeeds at Enron, Arthur Andersen, Worldcom, and many other U.S. companies is just one of the most recent and most visible indicators of this shift.

This book has grown out of my research, teaching, and consulting over the past 20 years. It is a description, an interpretation, an argument, and a guide to practice all rolled into one. It unfolds pretty much in that order. The first part describes what I term the "turn to values." By this, I mean the growing emphasis on values, culture, ethics, stakeholders, citizenship, and so on that has emerged in many companies around the world during the past several decades. In this part, we will see what executives say about these topics and why they are embracing initiatives to promote them. The second part offers an interpretation of this phenomenon—how it is best characterized, what is motivating it, and why it is significant. Here I argue that the turn to values reflects an evolution in what has sometimes been called the "personality" of a corporation—the attributes that define its essential character. The third part then spells out the implications of this evolution for management practice. The final three chapters explore the implications for decision making, organizational design, and corporate leadership.

Chapters 4 and 5 present the intellectual underpinnings of the book's central argument, while Chapter 6 addresses the objections and counterarguments. These chapters place the contemporary corporation in historical context and show that companies today are being measured against a performance standard that is qualitatively different from past standards. Unlike traditional measures that have been purely financial in nature, the new yardstick is more complex. In order to excel under this new standard, companies must not only turn in superior financial results, they must also demonstrate moral intelligence in their dealings with their employees, customers, and other constituencies. Although this may sound like a modest requirement, I argue that it has profound implications for how companies are managed and led.

The book traces the emergence of the new standard to the corporation's expanding presence and growing stature in the wake of the great movements of the past century, and particularly of recent decades. Liberalization, privatization, globalization, advances in knowledge and technology—all these have simultaneously heightened the corporation's importance and given rise to new expectations for its performance. Once thought of as little more than a convenient device for pooling capital, the corporation has come to be viewed as itself an actor on the social stage.

Today's leading companies are expected not only to create wealth and produce superior goods and services but also to conduct themselves as "moral actors"—as responsible agents that carry out their business within a moral framework. As such, they are expected to adhere to basic ethical principles, exercise moral judgment in carrying out their affairs, accept responsibility for their deeds and misdeeds, be responsive to the needs and interests of others, and manage their own values and commitments. Contrary to theorists who for centuries have declared the corporation to be an entirely amoral creature and thus incapable of such behavior, society today has endowed the corporation with a moral personality.

Evidence of this development is all around us. Corporate reputation studies, best-company rankings, employee commitment surveys, polls of citizens worldwide, expanding investor concerns, the daily news—all these indicate that employees, customers, citizens, and even some investors are using both ethical and economic criteria to evaluate the companies they deal with. Even if it is profitable to conceal product risks, misreport earnings, evade the law, or rely on suppliers who use forced labor, these practices are increasingly viewed as unacceptable and unworthy of a leading corporation. Even more striking is the growing body of evidence pointing to the positive benefits of an ethical orientation—benefits that flow not only from better risk management but also from improved organizational functioning, increased market attractiveness, and better relations with the public and public officials at large.

To build companies that can deliver sustained performance under this new standard, managers will need to go well beyond the ethics programs, values initiatives, and stakeholder activities that have become *de rigueur* add-ons in recent years. They will need instead to build new organizational capabilities and embrace new ways of thinking and managing. As I argue in the chapters that follow, the superior performers of the future will be those that can satisfy both the social and financial expectations of their constituencies.

Writing this book has presented a number of challenges. One of the most vexing has been the problem of language. Part of this problem is captured in an experience I had almost 10 years ago when I was invited to present a seminar for key executives from a leading financial services company. Although the group wanted to hear about my research, I was told they would prefer that I not use the word "ethics" in my presentation because it made people feel "uncomfortable."

Such a request might seem bizarre, but from the vantage point of traditional corporate theory, it is quite normal. If you have been acculturated to think of the corporation as an amoral entity to be run as if it were an efficient machine, then it can be awkward and difficult to begin thinking about questions of values in the context of your professional role. It's really not so different from asking doctors who have been taught to think only about patient needs to begin thinking about health-care finance.

Recognizing the "discomfort" problem but also believing that a new era in thinking about corporate management is upon us, I have freely used terms such as "ethics," "values," and "morality." As a purely practical matter, I am not sure how I could avoid using such words, given my subject matter. Still, I have tried to be reader friendly, and I hope that readers who feel challenged by this language can brace themselves for a brief journey that may at times take them outside their comfort zone.

Another aspect of the language problem has to do with the generality of many words in this domain. Language is laden with philosophy, and the words we use in everyday discourse have widely varying meanings depending on the context in which they are spoken. The word "social," for example, has many different uses and connotations—some appealing and some not so appealing. It can often substitute for "societal," "civic," "moral," "ethical," "sociable," "shared," "communal," "deriving from society," "owed to society," and so on. Thus, the phrase "corporate social responsibility" can be used as an expansive category encompassing the many types of corporate responsibility that derive from societal arrangements—financial, legal, civic, functional, environmental. In some circles, however, "social responsibility" has come to be understood as a narrower category and made to contrast with financial, legal, moral, civic, or environmental responsibility.

After trying to construct a precise and consistent lexicon of terms to use in writing this book, I found that the price of precision was excessive awkwardness in expression, so I abandoned the effort. I also found it difficult to maintain the boundaries I had tried to set up in this artificial language system—which perhaps says something about the fluid nature of reality. In the end, I opted for ordinary language with all its inherent ambiguity. However, I have usually chosen to use the term "social responsibility" as an all-purpose category for nonfinancial responsibilities. If I were a language czar, I would favor the more expansive usage that treats financial responsibility as a subcategory of social responsibility. This usage would more accurately reflect the grounds of corporate financial responsibility, but it would not reflect what I take to be mainstream contemporary usage.

Developing a comprehensive picture of the corporation's role and how it is changing around the world also proved challenging. Libraries contain studies of large corporations, multinational corporations, privatized corporations, commercialized corporations (formerly nonprofits), corporations in this or that industry, and so on. However, aggregate data on corporations in general is in short supply. The picture I sketch in Chapter 4 is thus highly impressionistic and far from complete, but I believe that the essential features are correctly drawn. The increasing reliance on for-profit companies to carry out the work of society—in contrast to government, nonprofit, and noncorporate organizations—is a clear trend in a significant number of regions.

Finally, my own limitations have made it inevitable that this work will contain errors. In attempting to address an issue that cuts across many domains of knowledge, I have necessarily had to go beyond the bounds of my formal academic training and experience. And in my efforts to sketch the big picture, I have undoubtedly overlooked important details and gotten some things wrong. But here again, I believe the overall argument to be sound in its essentials.

Readers looking for answers to substantive moral questions facing today's companies will not find very many in this book. While there are some ethical basics—as found in the emerging set of "generally accepted ethical principles" for business—many of the moral questions confronting companies are complicated. Just as developing a traditional corporate strategy or a business plan requires careful consideration of particular facts and circumstances, finding workable answers to many moral questions requires research, analysis, and creative thinking. For the most part, however, companies have not thought it important to apply themselves to such questions. This book will explain why they must now endeavor to do so and how they can begin going about it.

To the extent that the book succeeds in making sense of the complex and changing corporate world, it is largely because so many have contributed to the ideas presented here. Over the years, I have benefited from opportunities to work with executives and managers from many companies and many parts of the world on issues discussed in the text. Teaching in the MBA and executive education programs at the Harvard Business School for the past 12 years has given me a unique laboratory for testing and exploring these ideas. I am particularly indebted to the executives who have allowed me into their companies as a researcher and case writer. Whether studying their successes or their mistakes, I have been impressed by their willingness to share their experiences and humbled by the awesome responsibilities they bear.

The school's Division of Research provided funding not only for the book itself but also for the many case studies and preliminary papers on which it is based. Without the school's financial support and its unique research environment, this book could not have been written. Dean Kim Clark provided me with the gift of time to launch this project. In allowing me to step down from my duties as head of the General Management unit, he opened up the space I needed at a crucial time in the creative process. Much of the writing was carried out during my tenure as a Novartis Fellow from 1999 through 2001. The school's Henry B. Arthur Fund for business ethics has also provided funding for my work.

Among the many colleagues who have contributed to the ideas presented here, I am especially indebted to the more than 30 who have been part of the teaching group for Leadership, Values, and Decision Making, a required module for MBA students that I have taught for the past 12 years. Perhaps my greatest debt, however, is owed to Joe Badaracco and Tom Piper, the two colleagues with whom I have worked most closely on issues of leadership, values, and corporate responsibility. Joe's writing on individual decision making and Tom's ideas about ethics and financial performance have had an enormous impact on my thinking, as will be apparent to anyone who knows their work. In this book, I have drawn liberally on some of Tom's insights—particularly his use of Venn diagrams as an explanatory

tool—though I hasten to add that the ideas presented here do not necessarily reflect his views.

My debt to the late R. M. Hare will be apparent to anyone familiar with his work on moral thought. As a graduate student at Oxford University many years ago, I benefited as much from Dick's insistence on clear thinking as from his tutorials on moral reasoning. If I have managed to make the argument here clear and understandable, it is largely because of Dick's influence. He thought that business, among all the professions, presented the most challenging moral questions, and he was a firm believer in the power of reason to illuminate the way toward answers in this domain as in others.

To the extent that this work reflects distinctively Asian ideas and concerns, it is the direct result of interests sparked when I spent a year in Asia as a Luce Scholar during graduate school. That year, I discovered the rich traditions of Chinese thought from which I draw at several points in my argument. For that extraordinary experience, I will be forever indebted to the Henry Luce Foundation and especially to Hank Luce, the Luce family, and the many friends and colleagues affiliated with the foundation's activities.

I am particularly grateful to other friends and colleagues who have taken time to read and comment on parts of this manuscript as well as on earlier papers, presentations, and case studies that have fed into it. In addition to Joe Badaracco and Tom Piper, I also wish to thank Connie Bagley, R. Bhaskar, Sissela Bok, Laura Nash, Joshua Margolis, Hank Reiling, Kathy Spear, Guhan Subramanian, Sandra Sucher, Richard Tedlow, Dennis Thompson, Ken Winston, Per Molander, Marian Radetzki, and Claes Lundblad. I have also benefited from discussing the ideas presented here with members of the school's Ethics, Law, and Leadership group. In addition to the members already mentioned, Rohit Deshpandé, Ashish Nanda, Mike Wheeler, and Mihir Desai have enriched my thinking on many of the central topics addressed in the text.

Many others have gone out of their way to help track down important sources and points of information. In particular, I would like to mention Chris Coulter, Marc Drizin, Nien-hê Hsieh, Bill Laufer, Carolyn Mathiasen, Bill Megginson, Trex Proffitt, Mike Sharp, and Heidi Welsh. The Caux Round Table has generously allowed me to include in the appendix an assessment tool I developed based on the Round Table's 1994 Principles for Business. The nine principles of the Global Compact announced by the United Nations Secretary-General at the World Economic Forum in 1999 are reproduced in the appendix with U.N. permission.

Invaluable help has been provided by Kim Bettcher, my research associate, who has worked tirelessly in challenging the ideas presented, filling in data gaps, tracking down facts, and wrestling inconsistencies to the ground. Jeff Cronin and Erika McCaffrey, analysts with the Harvard Business School research services group, have also provided essential research support at various points along the way. And Trudi Bostian, my administrative assistant, has not only assisted with research, citation checking, and manuscript preparation but also kept everything else running smoothly while the book has been in progress.

Thanks also to my agents Rob McQuilkin and Ike Williams, and to my editor Mary Glenn at McGraw-Hill.

Finally, I would like to acknowledge those who have assisted me with the case studies on which parts of the book are based. These include colleagues Karen Hopper Wruck, Michael Watkins, Prompilai Khunaphante, Louis B. Barnes, and Eiji Mizutani as well as former doctoral students and now colleagues Mihnea Moldoveanu, Michael Santoro, Li Jin, Sarah Mavrinac, and Bronwyn Halliday. Carin-Isabel Knoop and Ann Leamon, both accomplished case writers with the Harvard Business School Division of Research, have helped with various projects, as have many outstanding research associates who have worked with me on the case studies that inform the book: Michele Lutz, Harold Hogan, Suma Raju, Robert Crawford, Jennifer Gui, David Kiron, Howard Reitz, Charles Nichols, III, Jane Palley Katz, Sarah Gant, Lexanne Abbott, Albert Choy, Chris Paige, and Andrea Strimling.

I am deeply grateful to all these people and to my family. On the home front, my husband Tom has served as a sounding board, consulting wordsmith, graphic arts adviser, and indefatigable optimist whose relentless encouragement has been essential to my seeing the project through. My children's contributions—Sumner's critical reading of the manuscript, Mallory's expert tech support, and Lydia's buoyant spirit—have also been invaluable. An author could not wish for a more supportive family.

I conclude this project all too aware that it raises many more questions than it answers. But I look forward to exploring these new questions and hope others will join me in doing so. The quest grows ever more urgent. As this book goes to press, companies worldwide are facing an unprecedented level of scrutiny, and many, including some mentioned here that have heightened their emphasis on values in recent years, have been charged with serious misconduct. These developments, I believe, only reinforce the book's central thesis and indicate, as I suggest in the final three chapters, that most companies will need to do much more to achieve the higher standard expected of them today.

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The Turn to Values

Business has changed dramatically in the past few decades. Advances in technology, increasing globalization, heightened competition, shifting demographics—these have all been documented and written about extensively. Far less notice has been given to another, more subtle, change—one that is just as remarkable as these more visible developments. What I have in mind is the attention being paid to values in many companies today.

When I began doing research and teaching about business ethics in the early 1980s, skepticism about this subject was pervasive. Many people, in business and in academia, saw it as either trivial or altogether irrelevant. Some saw it as a joke. A few were even hostile. The whole enterprise, said critics, was misguided and based on a naïve view of the business world. Indeed, many had learned in their college economics courses that the market is amoral.

Back then, accepted wisdom held that "business ethics" was a contradiction in terms. People joked that an MBA course on this topic would be the shortest course in the curriculum. At that time, bookstores offered up volumes with titles like *The Complete Book of Wall Street Ethics* consisting entirely of blank pages. The most generous view was that business ethics had something to do with corporate philanthropy, a topic that might interest executives *after* their companies became financially successful. But even then, it was only a frill—an indulgence for the wealthy or eccentric.

Today, attitudes are different. Though far from universally embraced—witness the scandals of 2001 and 2002—ethics is increasingly viewed as an important corporate concern. What is our purpose? What do we believe in? What principles should guide our behavior? What do we owe one another and the people we deal with—our employees, our customers, our investors, our communities? Such classic questions of ethics are being taken seriously in many companies around the world, and not just by older executives in large, established firms. Managers of recently privatized firms in transitional economies, and even some far-sighted high-technology entrepreneurs, are also asking these questions.

Ethics, or what has sometimes been called "moral science," has been defined in many ways—"the science of values," "the study of norms," "the science of right conduct," "the science of obligation," "the general inquiry into what is good." In all these guises, the subject matter of ethics has made its way onto management's agenda. In fact, a succession of definitions have come to the forefront as a narrow focus on norms of right and wrong has evolved into a much broader interest in organizational values and culture. Increasingly, we hear that values, far from being irrelevant, are a critical success factor in today's business world.[1]

The growing interest in values has manifested itself in a variety of ways. In recent years, many managers have launched ethics programs, values initiatives, and cultural change programs in their companies. Some have created corporate ethics offices or board-level ethics committees. Some have set up special task forces to address issues such as conflicts of interest, corruption, or electronic data privacy. Others have introduced educational programs to heighten ethical awareness and help employees integrate ethical considerations into their decision processes. Many have devoted time to defining or revising their company's business principles, corporate values, or codes of conduct. Still others have carried out systematic surveys to profile their company's values and chart their evolution over time.

A survey of U.S. employees conducted in late 1999 and early 2000 found that ethics guidelines and training were widespread. About 79 percent of the respondents said their company had a set of written ethics guidelines, and 55 percent said their company offered some type of ethics training, up from 33 percent in 1994. Among those employed by organizations with more than 500 members, the proportion was 68 percent.[2]

Another study—this one of 124 companies in 22 countries—found that corporate boards were becoming more active in setting their companies' ethical standards. More than three-quarters (78 percent) were involved in 1999, compared to 41 percent in 1991 and 21 percent in 1987. Yet another study found that more than 80 percent of the *Forbes* 500 companies that had adopted values statements, codes of conduct, or corporate credos had created or revised these documents in the 1990s.[3]

During this period, membership in the Ethics Officer Association, the professional organization of corporate ethics officers, grew dramatically. At the beginning of 2002, this group had 780 members, up from 12 at its founding 10 years earlier. In 2002, the association's roster included ethics officers from more than half the *Fortune* 100.[4]