Ethical Challenges in Human Resources

By way of introduction, let me state my most fundamental belief about organizational ethics: Ethics is not about answers. Instead, ethics is about asking questions. It's about asking lots of questions and, maybe, if you're lucky, even asking the right questions every now and then. In my experience, ethical organizations don't shy away from asking potentially embarrassing questions, ones that might disturb the status quo.

The need and value of doing so was brought home clearly in the Enron/Arthur Andersen scandals. Those were two organizations where, apparently, no one dared ask the tough questions that might actually have saved the companies. Now, thanks to those and related scandals, the good news is that corporations are routinely asking tough questions about financial reporting. Today, we're all terribly conscious of the risks to the organization if we fail to question the numbers. Almost all of you are in the firing line in that regard, so there's very little that I can tell you about the importance of assessing financial risk.

I don't have the level of knowledge that you have about financial accounting, but I do have some related experience that I'm going to draw on in my remarks today. As you know, I'm a professor of management, but today I am drawing on my experience as a member of the board of a NASDAQ company for some ten years. I served as a chairman for the Audit Committee until they actually required that you know something about auditing. Now I am on the Compensation and Governance Committee. I am proud of the record of our little company: We have been squeaky clean from day one. As a matter fact, when we went public 10 years ago, we had little buttons that we all wore that said, "We be clean." This is because we had a member of the board named Robert Townsend, the man who created the Avis Corp., and he was not only one of the great management thinkers but also one of the most ethical business leaders this country has known. He insisted upon spotless ethics in everything we did, and it became part of the culture of the company. If there was a nickel on the books that was in question, we have always interpreted accounting rules in the most conservative way. We have never had anyone question our numbers and I hope to God we never will.

But the story doesn't stop there. Recently our board undertook a thorough audit of the human resources function of our organization. The recent negative exposure that companies like Nike and Levi-Strauss have experienced concerning working conditions in their plants in Asia convinced us that consumer products companies run considerable risk in this arena. There was a bit of resistance to undertaking this audit. In fact, as at most companies, the eyes of our HR people glazed over whenever we used the word *ethics*. We are a small company, so we don't have somebody who was an ethics officer per se, so it fell to the board to raise these questions.

Questions for the Compensation and Governance Committee

Once we started to do so we quickly came to realize that there was an entire raft of HR-associated issues that we had to monitor if we were to assure our shareholders we had done adequate risk assessment in the organization. Our board members are not experts in this arena, but we realized that we had to be able to assess risks in all the corporation's major human-capital management systems: selection and recruitment processes, training policies and programs, performance appraisal systems, executive compensation, sales and other forms of incentive compensation, base pay and benefit determination, talent management systems (including manpower and succession planning), labor relations, and so forth.

We had to ask if there were appropriate methods and analytical programs in place that monitor for age, sex, and gender discrimination; employee attitudes and morale; talent procurement and retention? We wondered to what extent potential employees saw our company as a great place to work. We started having to pay attention to health and safety, termination and downsizing policies, demographics about who gets promoted, raises, bonuses, and turnover.

As we went on, we increasingly sought to discover the extent to which the company was on top of liabilities in those areas from a measurement and analytical perspective. With regard to all major HR systems, our board began to ask the following kinds of questions: Is there a formal system or process in place? Has the system been validated? Is it clearly understood and communicated? Has the system had unintended effects? Has it been analyzed for adverse effects, for example, possible discriminatory impact on legally protected groups?

Each time we asked questions, we had to go back to learn more, we had to ask more sophisticated questions. Some questions we asked with regard to leadership development and talent management were things we thought the board would never get involved in. We started asking if there was a formal assessment of the key capabilities/talents needed in the company. We asked if retention rates were monitored? Did the monitoring include an analysis of criticality? Did it include competitive practices, capabilities, and performance? To what degree was the expertise of key people captured by the organization? Were there non-compete agreements with key technical people? Does our reward system lock key contributors into the organization?

We didn't have a clue what answers we were looking for. This was a matter of constantly asking every possible question that we could think of. For example, when we looked at the succession planning system, we asked if the system was formal, who was involved, and how it was related to business strategy. We asked what metrics were used and were they related to assessment of needed capabilities? How do we monitor for derailment? Is there a system of mentoring and coaching? Is it see as effective and fair?

That led us into questions about training policy: Who participates? What are the purposes of the programs? How are they evaluated? How are they related to business strategy? How do these programs deal with ethical and legal issues? Are there unintended gender, race, or age biases in who attends? Then, we started looking at selection procedures: Did we use validated instruments for identifying the "right" people? How were these related to business strategy? What methods were used? To what extent is an effort made at branding our company as a great place to work? Finally, we looked at retention policies: the retention packages for key personnel, how we are monitoring satisfaction, whether the packages are tied to system performance appraisal, what metrics are used to identify key personnel, and so on.

Is Legal Compliance the Same as Ethical Behavior?

I recite this list of questions, not because I think it's rigorous or exhaustive, nor because it's exemplary. In fact, we are a very small company, and no one on the board is an expert in any of these areas. But it's quite obvious to us that risk assessment in these areas is necessary for legal compliance today. But more important, we have to ask ourselves a more basic question: to what extent in the HR arena is legal compliance a sufficient standard for ethical behavior? That is, if our companies can answer the questions I just cited and find that we uphold the law, can we then pat ourselves on our backs and say that we're doing a good job with our human resources? Or, must we go further than that? Are there other, perhaps tougher, questions we have to be asking ourselves? In essence, what is required of us before we can say truly claim that the behavior of our business organization is ethical?

For example, in my on-going organizational research I have been following the fortunes of a large financial services company that has doubled its sales and halved its workforce over the past three years. You might say that's an indicator of great productivity, and a sign that it can keep up with foreign competitors who have lower wages. But, significantly, this company does not have foreign competition; it's in a domestic industry. The way it halved its workforce was through domestic outsourcing or selling off divisions and then contracting for the services of their former employees. In essence, their policy is to find ways to pay people less for doing the same work without benefits and with fewer legal obligations. What is interesting about this company is that, as far as I can tell, no one in the organization-- no one in HR, no one in top management-- has this policy as an ethical issue. It is simply considered the way in which one succeeds at business.

This example goes beyond narrow ethical issues having to do with the personal effects on employees. There are also questions having to do with the impact of the policy on the culture of the corporation itself. For example, Nancy Austin talks about the value to a company of spontaneous and accidental conversations among workers: she argues that innovation happens when people who are working closely have a chance to talk about things and compare notes, which enables an organization to change in positive ways in response to customers. But such conversations are unlikely to occur with outsourced and contingent workers. So, in fact, the more a company moves in that direction, the less able it may be in the long term to respond to a constantly changing environment.

What I'm trying to get at is that there are many broad ethical questions having to do with human resources that go beyond the issues of compliance with which ethics officers are so concerned today. These questions are too complex and numerous to be addressed here today, so I would just like you to think about just two of them. The first is, What ethical responsibilities does a corporation have with regard to its employees? The second is, What is a just distribution of rewards in an organization? To further narrow our inquiry—to make it manageable—I'd like to explore these questions fully with reference to the insights of just one authority: Aristotle.

An Aristotelian Take on Business Ethics

Aristotle was the most practical and business-oriented of all philosophers who asked ethical questions. Now you may scoff at the idea that a person who's been dead for nearly 2,400 years has anything practical to say about the modern organizations in which you all work. But, let me see if I can give you an example of his doing so that will at least get your attention.

Aristotle tells us that acts are not ethical if they are accidental. What he means by this, in modern terms, is that, if I am driving drunk and I hit a water hydrant, knock it off its pedestal and cause a 20-foot geyser which, in turn, puts out a fire in an adjacent house, I cannot claim to have committed a virtuous act. To illustrate the ethical centrality of right motivation, Aristotle cites a fragment of brilliant dialogue from a lost play by Euripides,

Character A: I killed my mother, brief is my report.
Character B: Were you both willing, or neither she nor you?

It is difficult to set aside the relevance of this 2,500-year-old exchange to the current debate about the morality of physician-assisted suicide, but let's focus for a minute on why Aristotle cited it. He wanted to call our attention to the significance of motivation as a factor in ethical analysis. In this mini-case, Euripides implies three different situations, each quite morally distinct from the others: In the first situation a mother is murdered, as we would say "in cold blood" by her child. In the second situation, a mother's request for mercy killing is granted by an unloving child who is only too happy to comply. In the third situation, the mother, who is perhaps dying from some terrible disease, asks her child to end her pain and, in great sadness and reluctance, he grants his mother's wish. In Aristotle's terms, only the latter situation contains the possibility of ethical virtue. Although the moral choices we face in HR, thank God, are far less dramatic than these, Aristotle tells us that motivation is a powerful indicator of the degree to which virtue is present in all of our social acts.

I have gone to Aristotle because he is particularly interested in defining the principles of ethical leadership. In his *Ethics* he sets out a series of practical and analytical ethical tests (or examinations), and at the end of these, he concludes that the role of the leader is to create the environment in which all members of an organization have the opportunity to realize their own potential. He says that the ethical role of the leader is not to enhance his own power but to create the conditions under which the followers can achieve their potential.

It was this point Jefferson was paraphrasing in the Declaration of Independence when he noted the goal of the new country being founded in 1776 was to provide conditions in which all citizens could pursue happiness. In Aristotle's terms, happiness means the realization of one's potential. Aristotle said a nation succeeds to the extent that its leaders create the opportunity and conditions under which its people can develop and grow.

Aristotelian Questions for Corporate Leaders

Of course Aristotle never heard of a large business or corporation. Nonetheless he did raise a set of questions that corporate leaders who wish to behave ethically need to ask themselves:

Am I behaving in a virtuous way?

How would I want to be treated if I were a member of this organization?

What form of social contract would allow all our members to develop their full potential in order that they may each make their greatest contribution to the good of the whole?

To what extent are there real opportunities for all employees to learn and to develop their talents and potential?

To what extent do all employees participate in the decisions that effect their own work? To what extent do all employees participate in the financial gain resulting from their own ideas and efforts?

If we translate Aristotle into these modern terms, he provides us with a set of ethical questions to determine the extent to which an organization provides an environment conducive to human growth and fulfillment. And, Aristotle would say, not only does an ethical leader create that environment but, he or she does do so consciously, and not coincidentally. Motivation is important. Miami hoteliers cannot claim credit for sunny days, and leaders in Silicon Valley get no ethical credit for providing jobs that are accidentally developmental. Just because working with computers may be an inherently a developmental task, one is not necessarily a marvelous employer for providing people with that opportunity.

Aristotle also asks the extent to which we as leaders observe decent limits on our own power in order to allow others to lead and develop. What he's saying is that leadership is inherently such a valuable thing in terms of our growth that, if leaders take all the opportunities to lead for themselves, and don't give others the chance to lead, they are denying their followers the possibility of growth. That's why he says leadership should be shared, rotated, so that everybody has the ability to participate in it. He says that too many leaders turn their people into passive recipients of their moral feats, and there is nothing inherently ethical about that.

In essence, here's the question that Aristotle asks leaders to ask themselves. To what extent do I consciously make an effort to provide learning opportunities to everyone who works for me? To what extent do I encourage full participation by all my people in the decisions affecting their own work? To what extent do I allow them to lead in order to grow? To what extent do I measure my own performance as a manager or leader both in terms of my effectiveness in realizing economic goals and, equally, in terms of using my practical wisdom to create conditions in which my people can seek to fulfill their own potential in the workplace?

Very few CEOs that I work with would be able to respond to those questions with positive self-assessments. Indeed, I think many successful and admired corporate leaders consciously reject such Aristotelian measures of performance as inappropriate, impractical, and irrelevant to the task their boards have hired them to do, which is to create wealth. They say their responsibility is to their shareholders, not their employees, and if the social responsibility of employee development interferes with profit-making then tradeoffs must be made.

Aristotle would answer that virtuous leaders have responsibilities to both their owners and their workers. If there's a conflict between the two, it is the leaders' duty to create conditions in which those interests can be made the same. He would remind us that while most potential leaders measure themselves solely in terms of their effectiveness in obtaining and maintaining power, virtuous ones also measure themselves by ethical standards of justice. He was talking about political leaders but, by extension, in the modern business context, it is appropriate that executives are evaluated not only in terms of their effectiveness in generating wealth for shareholders but also by the opportunity they provide for their followers to find meaning and opportunity for development in their workplaces.

The Distribution of Rewards in Organizations

Aristotle has much to say about the role of leaders in terms of the conditions of work they provide employees. He also raises useful questions about the distribution of rewards in organizations. Those of you in Silicon Valley will find it very interesting when you go back and read the *Ethics*, to find that he talks about the question of the just distribution of wealth created by a start-up organization: How much does the venture capitalist get? How much should go to entrepreneurs? How much to the managers and employees? It is fascinating that he would give thought to those questions in 400 b.c. He also tells us how to think about futures markets!

But I would like to focus on the question of internal distribution of the wealth among employees and managers. Based on the ethical principle of rewarding people proportionate to their contributions, Aristotle raises a number of interesting ethical questions that have practical relevance for us today in organizations. For example, Disney's board compensated its CEO, Michael Eisner, with $285 million between 1996 and 2004. We can't pretend to have all the data required to decide how much Eisner deserves but, thanks to Aristotle, we have a questions that a virtuous member of the Disney board's compensation committee might ask in making that decision: *Is the C.E.O.'s proportionate contribution to the organization 10, (100), (1000) times greater than that of a cartoon animator at our Burbank studios, or the operator of the Space Mountain ride at Disneyland?* While asking such a question is practically unheard of in the boardrooms of giant companies, a few small—and medium—sized companies have done so and gone on to establish ratios a low as 20:1 between the compensation of their highest paid executive and average worker. While that may sound unrealistic, when you run the numbers it makes some sense. If the average worker makes $20 an hour, the CEO in even a "low-paying" company can make a million dollars. It only seems out of the question when you remember that the actual ratio in *Fortune 500* companies approaches 500:1.

Deliberation about the just ratio between the highest and lowest paid person in an organization is a good way for corporate boards and executives to begin including ethical analysis in their compensation discussions. Alas, I sincerely doubt the Disney board has ever examined the ethics of its pay policies in this way. They certainly were logically inconsistent in applying the policies they had: During good times they had accepted Eisner's argument that he was entitled to a fat paycheck based on the enormous amount of wealth he had created for shareholders; however, during the recent lean years they didn't then ask Eisner to pay the shareholders back for the wealth they lost. Disney is probably not much different from most large American corporations in using distributive compensation processes reflective more of employees' relative power than on objective and ethical analyses of their relative contributions. And it is hard to do such a just and objective analysis. I sit on the compensation committee of our small company's board and we spend considerable effort trying to define relative justice, much as Aristotle would have us do. Nonetheless, I regret we too often let *realpolitik* drive out principle: We are far more responsive to the need to create equity for the company's top executives than we are to questions of fairness for people down the line.

As Aristotle would be the first to recognize, employees must be paid market wages. However, it is untrue that markets determine the compensation of executives. In many cases, this particular market is rigged: the widespread use of compensation surveys allows executives to continually ratchet up their salaries. At the other end of the salary scale, board members understand that a company would price itself out of business if it paid its clerks as much as it pays managers, so they tend to skip over the issue of relative justice for lower-level workers, leaving the market to determine that. But the market doesn't work in quite the same way for workers as it does for top managers and skilled professionals. Because jobs are offered to lower-level workers on a take-it-or-leave-it basis, their conditions of employment often amount to exchanges of desperation. In contrast, professionals and managers may have other employment opportunities and, as a result, some bargaining power. Granted, that's the way of the world, and corporate executives and board members can't be expected to repeal the laws of economics. However, they are not without power to increase opportunities for even first-line employees to raise their own standards of living. For example, boards can distribute stock and stock options more broadly. While the late Sam Walton couldn't pay his Wal-Mart service workers much more than the minimum wage, he had the moral imagination to cut them into the upside by making them equity owners. C.E.O.s and boards tend to forget there are a number of well-tested methods for objectively and fairly linking rewards to relative contribution: profit sharing, gain sharing, ESOPs, and the like, all of which are consistent with the rules of the market.

Especially when times are bad, and hard choices have to be made, top executives often protect *their* fair share while cutting training budgets, decreasing employee benefits, and reneging on contributions to pension funds. During the 2001-03 recession, many American executives dealt with the problem of declining revenues by terminating large numbers of employees and, then, giving themselves big raises as rewards for their skill in reducing labor costs. As Aristotle notes, leaders will not pay attention to these injustices until and unless they are as concerned with what is as good for others as they are concerned with what is good for themselves. Sadly, in most corporate boardrooms, it is considered uncivil to raise issues of distributive justice, especially when these issues are unrelated to what is fair for *investors, executives, and directors themselves*. It is hard to imagine the board of a *Fortune 500* company engaging in the Aristotelian exercise of imaging themselves in the place of those in their company, in some cases the majority, who work for $35,000 a year, and less. Yet, it might be useful for board members and executives, some who spend multiples more on their second cars than their average employee makes in a year, to ask themselves what it would be like to live on the salary of an entry-level worker: What little luxuries would they have to forgo if they were making do on thirty-five thousand, before taxes? If that is asking too much, they might ask if it is indeed true that their CEO is the only qualified person in the world willing to do the job for $X millions, and options?

Examples of Aristotelian Business Leadership

By beginning their deliberations about compensation from the perspective of trying to create a non-arbitrary relationship between contributions and rewards, not only would directors serve the cause of relative justice, they might even begin to create a more virtuous and productive sense of community among workers, managers, and owners. Here are three examples of contemporary Aristotelian business leadership to illustrate how this can happen:

In 2000, Massachusetts businessman Charlie Butcher shared the proceeds of the sale of his company, to the tune of $18 million, with all 325 of his employees. He cut them into the deal proportionate to the length of their employment, giving a $55,000 check, on average, to each worker. (In contrast, and at about the same time, when Chrysler was acquired by Daimler Benz, Chrysler shareholders and executives got fat checks, but hourly workers got nothing, except reduced job security.) Over the length of his long stewardship of the company it appears Butcher had aimed to create a model work environment for employees, offering them high starting salaries, flexible workweeks, and the opportunity to switch jobs to find a personally fulfilling one. Finally, Butcher sold the company to S.C. Johnson & Co., even though he had higher offers from other companies, because the family-owned Johnson organization promised to continue the employee-friendly culture and job security he had created.

In late 1996, two Taiwan-born, high-tech entrepreneurs, David Sun and John Tu, sold the Silicon Valley business they founded, Kingston Technology, to a Japanese bank for $1.5 billion. Part of the deal was that Sun and Tu would continue to run the business, and reinvest a half-billion from the sale in the company to fund future growth. That was unusual, but what truly was surprising about the deal was that Sun and Tu divided $100 million of the remaining windfall, ten percent of the sale, among their 523 employees. Significantly, Sun and Tu had been sharing ten percent of the company's profits with employees all along. They also practiced a highly egalitarian and participative form of management in which all employees had a chance to contribute their full talents to the company. Why did they behave in such an unusually virtuous manner? "The issue is really not money," Tu told the *New York Times*, "it's how you respect people and how you treat them. It's all about trust, isn't it?" The story didn't end there. In 1998, just when the Japanese bank was due to make its last $333 million payment to Sun and Tu, there was more surprising news: The two asked the bank to forgo the payment because Kingston Technology had under-performed during the previous year. The deal was then restructured, and the postponed final payment was linked to performance measures. Why this Aristotelian display of fairness toward all stakeholders? Tu explained that profits follow in the long term when a company behaves ethically towards its partners, vendors, customers, and employees. Besides, he added, "how much money do you need?"

Hourly workers spend nearly every cent they earn to pay for food, clothing, to cover their rent or mortgage, and to send their kids to college. Those needs are unremitting and constant. That's why Aaron Feuerstein, C.E.O. of Malden Mills, kept paying weekly checks to his workers, out of his pocket, when his factory burned down in 1995 and there was no work to do for months while it was being rebuilt. Feuerstein saw the ethical difference between meeting needs and wants, and between the wealth he had in excess of what he needed and the much smaller margin between his employees' savings and their bankruptcy. So Feuerstein paid 'til it hurt, transferring most of his accumulated wealth to his employees until they could start to earn their own keep again. Sadly, for unrelated reasons, the company ultimately filed for bankruptcy in 2001. As Aristotle said, even virtuous people need good luck.

Aristotle doesn't provide a single, clear principle for the just distribution of enterprise-created wealth, nor would it be possible for anyone to formulate such a monolithic rule. He admits it's harder to distribute wealth than it is to make it. Nonetheless, here are some Aristotelian guidelines in the form of questions virtuous leaders need to ask themselves:

Am I taking more in my share of rewards than my contributions warrant?

Does the distribution of goods in the organization preserve the happiness of the community; does it have a negative effect on morale, or the ability of others to achieve the good?

Would everyone in the organization enter into the employment contract under the current terms if they truly had other choices?

Would we come to a different principle of allocation if all of the parties concerned were represented at the table?

Again, the only hard and fast principle of distributive justice is that fairness is most likely to arise out of a process of rational and moral deliberation among participating parties. Prescriptively, all Aristotle says is that virtue and wisdom will certainly elude leaders who fail to engage in rigorous ethical analysis of their actions. The bottom line is that ethics depends on asking tough questions.