TOOL

The Ethical Leader's Decision Tree

Exposing conflicts between corporate actions and corporate ethics early can help head off bad decisions.

by Constance E. Bagley

The new focus on ethics in corporate America is laudable, but it's long on words and short on tools. Last spring, when the Business Roundtable exhorted directors and managers to "operate the corporation in an...ethical manner," it offered little practical guidance about how to do this. At the heart of the problem is the tension between directors' responsibility to maximize shareholder value and their responsibility to behave ethically. Sometimes these goals naturally align, as when a company like Merck generates goodwill and customer loyalty by providing drugs to poorer countries at a fraction of the retail price. But often they conflict, at least in the short term. And when they do, what is the right course?

To help business leaders navigate ethics questions, I propose the following decision tree. The questions and answers posed by the tree can be applied to any action a company contemplates, whether it's expanding operations in a developing country or reducing a workforce at home. But companies must both understand the law and have in place, at minimum, a statement of corporate values. Ideally, they will have a bona fide ethics policy.

Take a look at the decision tree in the exhibit, "What's the Right Thing to Do?" For any proposed action, leaders must first ask, "Is it legal?" This may seem obvious. But recent corporate shenanigans suggest that some managers need to be reminded: If the action isn't legal, don't do it.

If it is legal, then ask, "Does it maximize shareholder value?" Answering "no" doesn't stop the inquiry: Directors and company managers may believe that they are bound by corporate law to always maximize shareholder value. But the courts and many state legislatures have made it very clear that the directors' obligation is to manage the corporation "for the best interests of the corporation." In deciding what that is, the board may legitimately consider the effect a decision might have not only on the shareholders but also on the company's other stakeholders–employees, customers, suppliers, the communities where it does business, and, indeed, the larger global community. Sometimes, as we shall see, an action that doesn't directly optimize profits is still in the company's broader best interests for ethical reasons.

Consider, for example, a public U.S. corporation that's establishing a manufacturing facility in a country with much less stringent environmental laws. The company could save $5 million in building the facility and boost profitability if it does not install the pollution control equipment that's required in the United States but not in the new location. But, the company calculates, unscrubbed pollutants emitted by the facility could damage the local fishing industry, resulting in tens of millions of dollars in lost income, and cause health problems for local inhabitants.

Let's apply the decision tree to this problem. First, ask whether it is legal to build the plant without standard pollution control equipment. The answer is "yes," in this case. That leads to the question, "Does the proposed action maximize shareholder value?" Supposing that this country, unlike the United States, is unlikely to require companies to clean up their hazardous waste retroactively, the answer is also "yes." From this follows the question, "Is the proposed action ethical?"

Clearly, there's no universal standard of ethical behavior. But companies routinely develop values statements and even codes of ethics. Many companies, for instance, endorse principles of social accountability–a commitment to sell safe products, reduce waste, and minimize health risks, for example. In the absence of an established ethics policy, directors can turn to their

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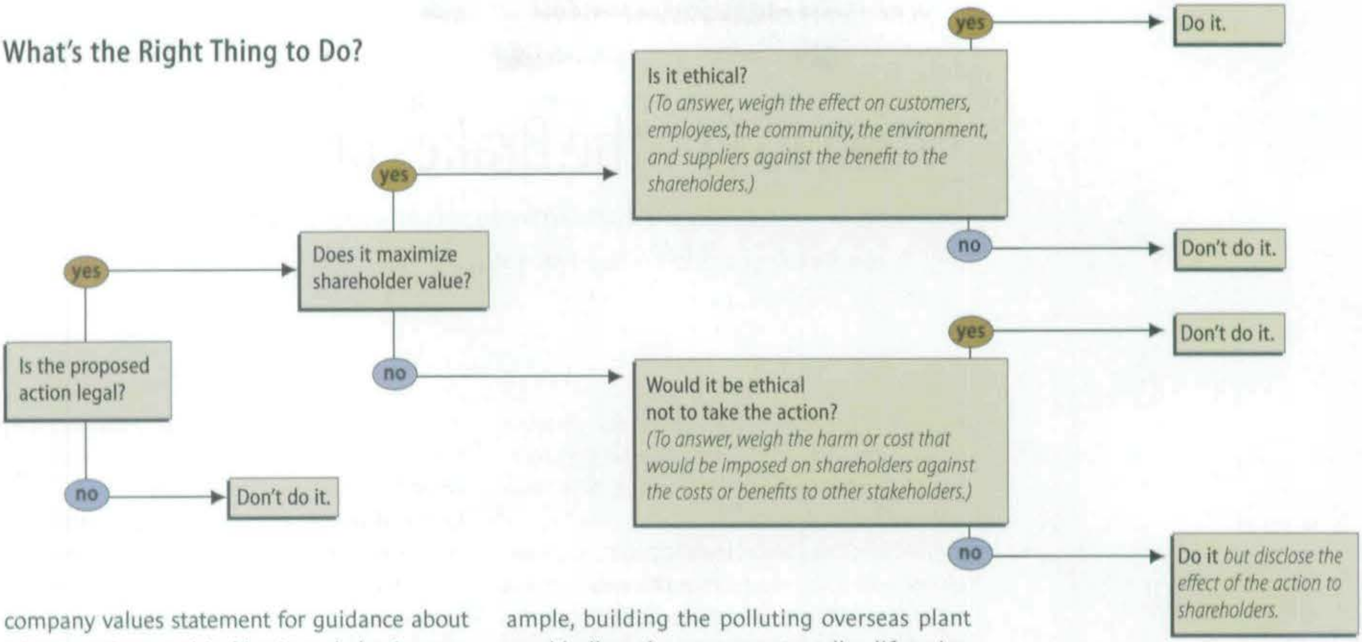
What's the Right Thing to Do?



company values statement for guidance about what constitutes ethical business behavior.

Faced with whether to proceed with the company's profitable-but-polluting overseas building plans, the directors would have to weigh their ethical responsibility to maximize shareholder value against their ethical obligation to protect the welfare of the communities and environment around the proposed plant. If the latter outweighs the former (in other words, if in the executives' best judgment the harm to the wider community of stakeholders will be of greater consequence than the loss in shareholder value), the response to the question, "Is the action ethical?" will be "no," and the decision tree will deliver the verdict: "Don't do it."

Now say the board proposed building a somewhat different plant, one with pollution controls, despite a negative impact on shareholder value. That decision would take us to an earlier branch of the decision tree and to the question: "Would it be ethical not to take the action?" If the answer is "no," the decision tree requires the board to go ahead but disclose the impact of its decision to shareholders.

For this company, then, all branches of the decision tree lead to the same conclusion: If the firm builds the foreign plant, it is ethically compelled to install pollution control equipment.

Of course, few ethics questions in business are so easily dispensed with. In the real world, a decision about the plant would involve weighing myriad financial, legal, and ethical considerations involving a broad spectrum of stakeholders from fishermen overseas to employees, shareholders, and customers at home. What if, for example, building the polluting overseas plant would allow the company to sell a lifesaving drug at lower cost around the world? The point of the decision tree is not to address every ethics question simply and formulaically but to provide a framework that business leaders can use for examining ethics problems.

It would be naive to think that devising a corporate ethics policy is easy or that simply having a policy will solve the ethical dilemmas companies face. Directors, managers, and employees need to exercise their own fundamental sense of right and wrong when making decisions on behalf of the corporation and its shareholders. There is a lesson in the story of the pension fund manager who was asked whether she would invest in a company doing business in a country that permits slavery. "Do you mean me, personally, or as a fund manager?" she responded. When people feel entitled or compelled to compromise their own ethics to advance the interests of a business or its shareholders, it is an invitation to mischief. Applying the decision tree to any initiative a company contemplates will expose such conflicts between ethics and profits early. This, perhaps, will help companies conduct their business in ways that reduce the negative impact of corporate decisions on those least able to bear it.

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