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Organizational DNA Should Contain Ethics Component

In the September 2004 column, we questioned the conclusions of the prominent consulting firm Booz Allen Hamilton, which failed to mention any ethical factors in the findings from its research on the makeup of organizational DNA or corporate culture. These findings were published in Booz Allen's *Strategy+Business*. In the column, we reported that the Booz Allen research found four factors the firm believes are the building blocks of organizational culture:

- **Structure.** What does the organizational hierarchy look like?
- **Decision Rights.** Who decides what?
- **Motivators.** What objectives, incentives, and career alternatives do people have?
- **Information.** What metrics are used to measure performance?

We noted the striking absence in this analysis of any mention of ethics or core values as important determinants of an organization's culture.

We also suggested that it was unwise to ignore how important it is to an organization's success that its management can articulate and then infuse a set of core values and resulting ethical standards and code of conduct at all levels. Motivation springs from an environment of "soft" controls that unify an organization's ability to perform effectively. As stated in the Committee of Sponsoring Organizations of the Treadway Commission (COSO) principles, integrity and ethical values are critical to the establishment and maintenance of effective management controls. Effective management controls are the overarching keystones of superior performance and business success and result directly from the management style chosen.

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We had hoped that Booz Allen's reaction to these questions and comments would result in an indication that they understood that core values articulated by senior management and the board do in fact determine the motivators an organization chooses and that later versions of the research findings would point this out. Booz Allen's surprising response was published in a Letter to the Editor in the November 2004 issue:

"As we examined the organizational DNA of successful companies, we found values and ethics a company displays are actually an *outcome* of its Organizational DNA—not an input to it…. In terms of ethics or values, you'll get whatever the organizational environment will tolerate." [Emphasis added]

This analysis seems to defy the logic that ethical culture actually flows *downward* from the tone at the top rather than upward from the organization via "the grapevine" to management and the board. It also disagrees with the recent thinking of most scholars, management professionals, and other authorities. For example, the recently amended sentencing guidelines place particular emphasis on management's responsibility to develop and maintain an ethical culture. According to the Sentencing Commission, boards of directors and executives are now explicitly expected to assume responsibility for promoting an organizational culture that encourages ethical conduct. They should oversee and manage compliance and ethics programs by providing active leadership in defining the content and operation of the program.

Regulations issued in December 2004 directing federal government and quasi-governmental agencies to follow Sarbanes-Oxley-style reforms are found in a revised version of OMB Circular A-123. This rule states that organizational culture should be "defined by management's leadership in setting values of integrity and ethical behavior."

Prominent Harvard Business School Professor Lynn Sharp Paine mirrored this view when she wrote:

"Managers must acknowledge their role in shaping organizational ethics and seize this opportunity to create a climate that can strengthen the relationships and reputations on which their companies' success depends. Executives who ignore ethics run the risk of personal and corporate liability in today's increasingly tough legal environment" ("Managing for Organizational Integrity," *Harvard Business Review*, March-April 1994, pp. 106-117).

Financial managers are most familiar with the well-known COSO framework of internal control. COSO views the control environment as the most important component of management control. The AICPA audit guide on the subject of control states:

"Integrity and ethical values are essential elements of the control environment…and are the product of the entity's 'corporate culture' (i.e., ethical and behavioral standards, how they are communicated, and how they are reinforced in practice). These values include management's actions to remove or reduce incentives and temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts. These values also include the communication of entity values and behavioral standards to personnel through policy statements and codes of conduct and by example."

More and more companies are adopting an ethical framework for making all of their decisions. They are practicing a management philosophy of looking at the needs of customers, suppliers, and the community—in addition to those of the company and its employees. More and more academic research shows that good corporate citizens—those that look after the needs of all of their stakeholders—also bring superior returns to their shareowners.

This editor and others have provided significant research support over the years for the proposition that good corporate citizenship and social and environmental responsibilities are directly related to superior financial performance. In their article, "Corporate Social and Financial Performance: A Meta-Analysis" (*Organization Studies*, May-June 2003, pp. 403-441), authors Marc Orlitzky, Frank Schmidt, and Sara Rynes examined more than 50 published research studies on corporate social performance and corporate financial performance and found a "universally positive relationship" between corporate citizenship and financial performance.

In Lynn Sharp Paine's article, she also describes the characteristics of an organizational "integrity strategy," one that's based on the concept of self-governance in accordance with a set of guiding principles:

- The guiding values and commitments make sense and are communicated clearly.
- Company leaders are personally committed, credible, and willing to take action on the values they espouse.
- The espoused values are integrated into the normal channels of management decision making and are reflected in the organization's critical activities: the development of plans, the setting of goals, the search for opportunities, the allocation of resources, the gathering and communication of information, the measurement of performance, and the promotion and advancement of personnel.
- The company's systems and structures support and reinforce its values.
- Managers throughout the company have the decision-making skills, knowledge, and competencies needed to make ethically sound decisions on a day-to-day basis.

Bill George, former chairman of Medtronic, Inc., puts the need for new leadership as follows:

"We need *authentic leaders*, people of the highest integrity, committed to building enduring organizations. We have a need for leaders who have a deep sense of purpose and are true to their core values. We need leaders who have the courage to build their companies to meet the needs of all of their stakeholders, and who recognize the importance of their service to society."

The concept of managing a business in a way that it continues to grow and prosper is a concept as old as capitalism itself yet as new as the latest business school management theory. "Sustainability" is one of the latest buzzwords applied to companies by different audiences. To a stock trader, it means that management can be counted on to continue favorable earnings trends. To an investor, however, it describes a company that's committed to the triple bottom line and strives for superior performance in social and environmental terms as well as economic.

In summary, whether ethics is viewed as a determinant of compliance processes, as in the U.S. Sentencing Guidelines regulations, or as a component of sustainability, it definitely should be considered a critical factor in an organization's DNA. We hope Booz Allen will take note.

Letting an organization's environment determine how ethics will be practiced is a recipe for disaster in terms of performance and violates best management practice. It will also subject boards of directors and senior management to increased risk of criminal prosecution if the organization's choices of ethical values are discoverd to be based on greed and excessive self-interest. ■

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