How to Design an
# Ethical Organization

✒ AUTHORS
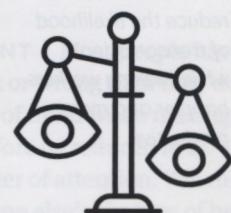
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ETHICS

THE PROBLEM
Unethical behavior ruins reputations, harms employee morale, and increases regulatory costs— not to mention damages society's trust in business. Yet corporate scandals are a recurring reality.

WHAT DOESN'T WORK
Compliance programs take a legalistic approach to ethics that focuses on individual accountability—but a large body of behavioral science research suggests that even well-meaning and well-informed individuals are ethically malleable.

A BETTER WAY
Leaders must design workplace contexts that encourage good behavior. Keeping prosocial values top of mind for employees as they make decisions will reduce the likelihood of transgressions while making workers happier and more productive.

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From Volkswagen's emissions fiasco to Wells Fargo's deceptive sales practices to Uber's privacy intrusions, corporate wrongdoing is a continuing reality in global business. Unethical behavior takes a significant toll on organizations by damaging reputations, harming employee morale, and increasing regulatory costs—not to mention the wider damage to society's overall trust in business. Few executives set out to achieve advantage by breaking the rules, and most companies have programs in place to prevent malfeasance at all levels. Yet recurring scandals show that we could do better.

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Interventions to encourage ethical behavior are often based on misperceptions of how transgressions occur, and thus are not as effective as they could be. Compliance programs increasingly take a legalistic approach to ethics that focuses on individual accountability. They're designed to educate employees and then punish wrongdoing among the "bad apples" who misbehave. Yet a large body of behavioral science research suggests that even well-meaning and well-informed people are more ethically malleable than one might guess. When watching a potential emergency unfold, for example, people are much more likely to intervene if they are alone than if other bystanders are around—because they think others will deal with the situation, believe that others are more qualified to help, or fail to recognize an emergency because others don't look alarmed. Small changes to the context can have a significant effect on a person's behavior. Yet people in the midst of these situations tend not to recognize the influence of context. In Stanley Milgram's famous obedience experiments, participants who were told by an authority figure to deliver increasingly powerful electric shocks to another person progressed to a much higher voltage than other people *predicted* they themselves would deliver. Context is not just powerful, researchers have learned; it is surprisingly powerful.

Pillars of an Ethical Culture
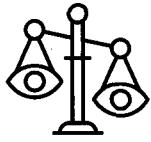
CREATING AN ETHICAL culture thus requires thinking about ethics not simply as a *belief* problem but also as a *design* problem. We have identified four critical features that need to be addressed when designing an ethical culture: *explicit values, thoughts during judgment, incentives,* and *cultural norms.*

EXPLICIT VALUES > Strategies and practices should be anchored to clearly stated principles that can be widely shared within the organization. A well-crafted mission statement can help achieve this, as long as it is used correctly. Leaders can refer to it to guide the creation of any new strategy or initiative and note its connection to the company's principles when addressing employees, thus reinforcing the broader ethical system. Employees should easily be able to see how ethical principles influence a company's practices. They're likely to behave differently if they think

the organization is being guided by the ethos of Mr. Rogers, the relentlessly kind PBS show host, versus that of Gordon Gekko, the relentlessly greedy banker in the film *Wall Street.* Indeed, in one experiment, 70% of participants playing an economic game with a partner cooperated for mutual gain when it was called the Community Game, but only 30% cooperated when it was called the Wall Street Game. This dramatic effect occurred even though the financial incentives were identical.

A mission statement should be simple, short, actionable, and emotionally resonant. Most corporate mission statements today are too long to remember, too obvious to need stating, too clearly tailored for regulators, or too distant from day-to-day practices to meaningfully guide employees. A statement can't be just words on paper; it must undergird not only strategy but policies around hiring, firing, promoting, and operations so that core ethical principles are deeply embedded throughout the organization. Patagonia's mission statement, for instance, is "Build the best product, cause no unnecessary harm, use business to inspire and implement solutions to the environmental crisis." Its Worn Wear initiative implements its mission by enabling employees to help consumers repair or recycle their products. Patagonia also developed a standardized metric, posted on its website, to evaluate the environmental impact of its entire supply chain. Zappos says its number one core value is to "Deliver WOW through service" to customers, according them respect and dignity. It implements this value by not measuring the average length of customer service calls (the industry standard), so employees can spend as much time with customers as necessary. Mission statements like these help keep an organization's values crystal clear in employees' minds.

THOUGHTS DURING JUDGMENT > Most people have less difficulty knowing what's right or wrong than they do keeping ethical considerations top of mind when making decisions. Ethical lapses can therefore be reduced in a culture where ethics are at the center of attention. You might know that it's wrong to hurt someone else's chances of being hired but fail to think of the harm you cause to unknown applicants when trying to help a friend, a family member, or a business school classmate land a job. Behavior tends to be guided by what comes to mind immediately before

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engaging in an action, and those thoughts can be meaningfully affected by context. Should someone remind you that helping a friend necessarily hurts the chances of people you don't happen to know, you might think twice about whether your advocacy efforts are appropriate.

Several experiments make this point. In one, people were more likely to tell the truth when an honor code came at the *beginning* of a form—thereby putting ethics top of mind as they completed the form—than when it was posted at the end. In a large field experiment of approximately 18,000 U.S. government contractors, simply adding a box for filers to check certifying their honesty while reporting yielded $28.6 million more in sales tax revenue than did a condition that omitted the box. And in a simulation that asked MBA students to play the role of financial adviser, having them complete an ethics checklist before recommending potential investment funds significantly decreased the percentage who recommended what turned out to be the Madoff feeder fund. When ethics were top of mind, the students were more alert to the possibility that the fund was too good to be true.

As a counterexample, Enron was notorious for its constant focus on stock price, even posting it in the elevators. Reflecting on his own misdeeds, its former CFO Andy Fastow said, "I knew it was wrong…. But I didn't think it was illegal…. The question I should have asked is not what is the rule, but what is the principle." People working in an ethical culture are routinely triggered to think, *Is it right?* rather than *Is it legal?*

INCENTIVES > It is a boring truism that people do what they're incentivized to do, meaning that aligning rewards with ethical outcomes is an obvious solution to many ethical problems. That may sound simple (just pay people for acting ethically), but money goes only so far, and incentive programs must provide a variety of rewards to be effective.

Along with earning an income, employees care about doing meaningful work, making a positive impact, and being respected or appreciated for their efforts. In one experiment, hospital staff members were more likely to follow correct handwashing procedures when a sign above the sink reminded them of consequences to others ("Hand hygiene prevents patients from *catching* diseases") than when it reminded them of personal consequences. Nevertheless, managers may easily overlook the importance of

nonfinancial incentives. When asked how important such incentives were to employees, customer service managers at one *Fortune* 500 firm tended to dramatically underestimate what they meant to their reports.

In addition to aligning financial incentives with desired outcomes, ethical cultures provide explicit opportunities to benefit others and reward people who do so with recognition, praise, and validation. If, for instance, your employees are making people's lives meaningfully better in some way, pointing that out will encourage future ethical behavior. It may even improve performance, because the reward is aligned with ethical motivation. In one experiment, salespeople for a large pharmaceutical company performed dramatically better after participating in a prosocial bonus system, which encouraged them to spend a small award on their teammates, compared with a typical "proself" bonus system, in which they spent the award on themselves.

This approach to incentives may have ancillary HR benefits. People tend to underestimate both how positive they will feel about connecting with others in a prosocial way and the positive impact their behavior will have on others. In a field experiment with Virgin Atlantic pilots, a bonus system for increasing fuel economy was structured so that the bonus went to a charity of their choosing. The resulting increase in their job satisfaction was similar in magnitude to the effect of moving from poor health to good health. Companies that use prosocial incentives are likely to produce happier, more satisfied, and more loyal employees. An ethical culture not only *does* good; it also *feels* good.

CULTURAL NORMS > Most leaders intuitively recognize the importance of "tone at the top" for setting ethical standards in an organization. Easily overlooked is "tone in the middle," which may actually be a more significant driver of employees' behavior. Good leaders produce good followers; but if employees in the middle of the organization are surrounded by coworkers who are lying, cheating, or stealing, they will most likely do the same, regardless of what their bosses say. So-called *descriptive norms*—how peers actually behave—tend to exert the most social influence. In one field experiment conducted by a UK government agency, 13 versions of a letter were sent to delinquent taxpayers, including versions that referenced moral principles, the ease

of paying taxes, or financial penalties. The most effective letter compared the recipient's behavior with that of fellow citizens: "Nine out of ten people in the UK pay their taxes on time. You are currently in the very small minority of people who have not paid us yet."

People often fail to appreciate the power of social norms. When researchers were interested in determining how best to encourage energy efficiency among a group of Californians, for instance, they first asked a group of nearly 1,000 residents to *predict* the effectiveness of various approaches, including appeals to environmental protection, personal

financial benefits, societal benefits, and social norms (what percentage of neighbors conserved energy by using fans). These residents expected that the environmental appeal would be most persuasive and the social norm appeal least persuasive. But when the researchers sent about 1,000 other residents one of the four appeals, the social norm had by far the biggest effect on reducing energy use.

Leaders can encourage an ethical culture by highlighting the good things employees are doing. Although the natural tendency is to focus on cautionary tales or "ethical black holes," doing so can make undesirable actions seem more

common than they really are, potentially increasing unethical behavior. To create more ethical norms, focus instead on "ethical beacons" in your organization: people who are putting the mission statement into practice or behaving in an exemplary fashion.

Putting Ethical Design into Practice

A LEADER DESIGNING an ethical culture should try to create contexts that keep ethical principles top of mind, reward ethics through formal and informal incentives and opportunities, and weave ethics into day-to-day behavior. Precisely how this is achieved will vary among organizations, but here are a few examples.

HIRING > First impressions are inordinately powerful. For many employees, an organization's values were revealed during the hiring process. Although interviews are typically treated as opportunities for identifying the best candidate, they also begin the acculturation process. At one *Fortune* 100 firm, for instance, interview questions are designed around a core value, such as putting customer needs first. In one interview script, candidates are told of this value and then asked, "Tell me about a time when you uncovered an unmet need of a customer that you were able to address." We don't know if this question identified people who are good at treating customers respectfully, but that's not necessarily the point. Highlighting values in the interview reveals their importance to the organization. It is one piece of a broader system that draws attention to ethics.

EVALUATION > Ethics can also be woven into the design of performance evaluations to highlight their importance to an organization as well as to reward and encourage good behavior. At Johnson & Johnson, for instance, each executive's 360-degree evaluation is built on the four components of the company's famous credo, which expresses commitment to customers, employees, communities, and stakeholders. In one version of the evaluation we saw, each executive was rated on items such as "nurtures commitment to our Credo," "confronts actions that are, or border on, the unethical," and "establishes an environment in which uncompromising integrity is the norm."

COMPENSATION > Aligning financial incentives with ethical outcomes may sound easy in principle, but it is tricky in practice. This is where a mission statement can help. Southwest Airlines has used an executive scorecard to tie compensation to its four core values: every employee matters, every flight matters, every customer matters, and every shareholder matters. Each value is demonstrated by an objective measurement—"every employee matters" by voluntary turnover; "every flight matters" by ontime performance. This scorecard highlights how well core ethical values align with business success, helps keep employees' attention on them, and suggests the behaviors needed to realize them.

Leaders can reward ethical actions by showing employees the positive impact of their work on others and recognizing their actions in presentations and publications. They can also create opportunities within the organization to behave ethically toward colleagues. In one recent field experiment, managers were randomly assigned to perform five acts of kindness for certain fellow employees over a four-week period. Not only did this increase the number of kind acts observed within the organization, but recipients were more likely than controls to subsequently do kind things for other employees, demonstrating that ethical behavior can be contagious. These acts of kindness improved well-being for those performing them as well as for recipients. Perhaps most important, depressive symptoms dropped dramatically among both groups compared with the control condition, a result that continued for at least three months beyond the initial one-month intervention.

Ethics, by Design

NO COMPANY WILL ever be perfect, because no human being is perfect. Indeed, some companies we've used as examples have had serious ethical lapses. Real people are not purely good or purely evil but are *capable* of doing both good and evil. Organizations should aim to design a system that makes being good as easy as possible. That means attending carefully to the contexts people are actually in, making ethical principles foundational in strategies and policies, keeping ethics top of mind, rewarding ethical behavior through a variety of incentives, and encouraging ethical norms in day-to-day practices. Doing so will never turn an organization full of humans into a host of angels, but it can help them be as ethical as they are capable of being. ⊚   **HBR Reprint** R1903K

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