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STRATEGIC PLANNING AS IF ETHICS MATTERED

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Ethics and the moral obligations of management were an accepted component in the planning process during the early development of Corporate Strategy as a field of study. It is proposed that ethics must be brought back into that planning process in order to build trust on the part of all of the stake-holders of the firm. Trust generates commitment. Commitment ensures effort, and effort that is cooperative, innovative and strategically directed is essential for success in a competitive global economy. Ethics should be central, not peripheral, to the overall management of the firm.

Ethics and the moral obligations of management were an accepted component in the strategic planning process during the early development of Corporate Strategy as a field of study. Barnard led the way here, as he did in so many other conceptual segments of the discipline. He described the functions of the executive as the need to: (1) maintain communication channels (2) ensure individual contributions and (3) formulate organizational goals. He then continued with the statement that this executive process 'is not intellectual; it is aesthetic and moral, involving a sense of fitness, of appropriateness, of responsibility (1938 : 257). Further, in a quotation that is too little remembered, he talked of the need for the executive to 'inspire cooperative personal decisions by creating faith in common understanding, faith in the probability of success, faith in the ultimate satisfaction of personal motives, and faith in the integrity of common purpose' (Barnard, 1938 : 259).

The integrity of common purpose was a common theme during much of the early work in corporate strategy. Simon certainly shared that view; he explained in his most famous work (1947 : 47) that administrative decisions in an organizational context always had an 'ethical as well as factual content.' Learned, Christensen, Andrews and Guth (1965 : 520) devoted a chapter to the 'the moral aspects of choice; the impact on the public good of the strategic alternatives.' Schendel and Hofer (1979) followed with a proposal for an enterprise strategy that would relate the organization to its social and political environment in much the same way that corporate strategy interfaced with the industry structure and the economic environment.

An excellent beginning, but where do we stand now? The *Strategic Management Journal* is certainly acknowledged as publishing the most advanced work in the discipline, yet over the past 3 years the term 'ethics' has never burdened the readers' understanding. Three articles with a semisocial benefit or stakeholder theme have been published. Bromiley and Marcus (1989) found that the equity market did not punish companies for product recalls in the American automobile industry during the 1970s. Weigelt and Camerer (1988) observed that a firm's reputation is an asset which can generate future

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rents, but stopped short of considering means of building that reputation beyond fulfilling industrial supply contracts. Kim and Mauborgne (1991) looked at the procedural justice of the strategic planning process, though justice in this instance was defined only as the openness of the communications between the head office and subsidiary units in a global firm.

The recent book publications in our field have paid equally little attention to ethics and the moral obligations of management. An examination of the indexes in Lorange (1980), Porter (1980), Quinn (1980), Ohmae (1982), Porter (1985), Hamermesh (1986), Prahalad and Doz (1987), Burgelman and Maidique (1988), Ghemawat (1991) and Mintzberg and Quinn (1992) omit any mention of the ethical and moral terms.

We certainly have to recognize Freeman (1984) who recommended negotiating with the various stakeholders as a part of the strategic management process. And certainly we should not forget Miles (1982) who studied the strategic adaptation of organizations to externally imposed stress in the tobacco industry. But, these recommendations and studies have remained peripheral to the main thrust of the conceptual development of the field. No one has followed through on the advice of Freeman and Gilbert (1988, xiii) that we learn to build corporate strategy on a foundation of ethical reasoning, rather than pretending any longer that strategy and ethics are separate and distinct and unrelated fields of study.

Freeman and Gilbert (1988), of course, took a major step in that direction with their admonition that if corporate strategy did not recognize the individual values and goals (or 'projects') of the members, both internal and external to the firm, then those members could not be expected to cooperate to achieve organizational goals. Ethical analysis, in the view of the authors, is the only means available to resolve conflicts in values, goals, and 'projects,' and consequently essential in the processes of corporate strategy. This same argument was expanded and then compared to 12 alternative strategic processes in Gilbert (1992) who concluded that all 12 neglected the essential concept of justice if one looked at the firm as a 'joint enterprise advancing the individual purposes of people inside and outside the organization' (Bauerschmidt, 1993 : 398). Both books are major works, but their impact has been, from an ethicist's point of view, less than might be desired. Let us try a somewhat different approach.

PURPOSE OF THE ARTICLE

This article will consider firstly whether it is possible to build corporate strategy on a 'foundation of ethical reasoning,' and secondly whether it is worthwhile in any sense beyond that of moral sensitivity and/or ethical smugness to do so. In short, this article will question whether the 'integrity of common purpose' should be included as an integral rather than a peripheral component in the strategic planning process.

The article will start with a definition of moral problems, which are the harms caused to other people in ways outside their own control. It will then move on to the ethical principles, which are the means by which the decisions and actions leading towards those harms to others can be objectively judged to be 'right' or 'wrong,' 'just' or 'unjust,' 'fair' or 'unfair.' The 10 most basic or most widely accepted ethical principles will be described in some detail. The article will next discuss briefly the methods by which the ethical principles can be included in the strategic management process. The major discussion will be on the basic reasons they should be included. Ethics do pay, it will be the conclusion of that section, but in a much longer time frame and with a much wider organizational impact than previously considered. The article will then end with a specific proposal for a major change in the strategic management paradigm, and a very brief discussion of the research problems that will be encountered in any empirical effort to provide support for that proposed change.

Before moving on to the nature of moral problems, it may be worthwhile to consider why there has been so little work at the juncture between corporate strategy and managerial ethics since the early efforts by Barnard, Simon, Andrews, and others. There are, it would appear, two very basic causes and one very recent change.

Divergent conceptual frameworks

As long as corporate strategy was based upon a strengths-weaknesses-opportunities-threats approach (Andrews, 1971), and as long as managerial ethics was primarily concerned with the social responsibilities of successful corporations (Ackerman, 1965) there was at the least the possibility of an understanding on both sides. Both used simple analytical procedures. Both had generally similar terminologies. Both assumed benign competitive conditions. But, corporate strategy in the 1980s 'adopted the language and logic of economics.' (Rumelt, Schendel, and Teece, 1991 : 5). And, managerial ethics during the same time period moved from corporate social responsibilities to organizational decision processes (Epstein, 1987). Now, the analytical procedures were very different. The basic terminologies were very different. And, the benign competitive conditions no longer existed. The gap had become too large to bridge easily, while the attention of scholars in both disciplines was being focused on the special problems created by global competition.

Inherent conceptual misunderstandings

The two approaches to general management separated during the 1980s, but in addition there have always been misunderstandings between the two fields. Many persons active in the research and teaching of business management view managerial ethics as a matter of personal virtue, not corporate strategy. They believe that ethics is concerned with issues of insider trades, bribery payments, untruthful statements and dishonest acts. These are the ones who often claim that, 'you can't teach ethics because the morals of the students are fully formed by the time they reach college or graduate school.' See for example Kristol (1987), Vogel (1987), or Levin (1989). Conversely, many of the people active in the research and teaching of normative ethics have a deep distrust of business management, and accept a very basic microeconomic view of the firm that stresses profit maximization at the cost of human values. See Crisp (1987), Newton (1988), or Hoffman (1990). To elaborate on the previous analogy of the 'gap too large to bridge,' perhaps the foundations do not exist for the bridge supports.

Recent conceptual clarification

Why then is there beginning to be an effort now to connect managerial ethics and corporate strategy? This effort has been epitomized by the call of Freeman and Gilbert mentioned above to stop pretending that 'strategy and ethics are separate and distinct and unrelated fields of study,' and by the concern of Brady (1990 : v) that, 'Unless we connect ethical theory more closely with management practice we may be dressing our business curriculum windows with philosophical finery but failing to meet the urgent need for clarity of thought in management ethics.'

Perhaps it is the need for 'clarity of thought in management ethics' that has made the difference. The normative ethicists who previously were members of philosophy departments have now become applied ethicists teaching at business schools. They have been forced to deal with competitive issues in a global context. They have had to recognize that business management within that context is more than simply a matter of profit maximization under market, legal, and ethical constraints, and in which their only function was to stress those latter constraints. They have had to consider how to maintain a competitive posture and an ethical stance jointly.

There are some interesting things to be said and to be studied in combining competitiveness and ethics. In short, to continue the simple and by now perhaps annoying analogy, the foundations appear presently to exist for the proposed bridge on the side of the ethicists. Let us move on, then, to a discussion of the nature of moral problems, the principles of ethical analysis, and the benefits of integrating corporate strategy and managerial ethics, and see if equivalent foundations can be justified on the side of the strategists.

THE NATURE OF MORAL PROBLEMS

Moral problems are concerned with the harms caused or brought to others, and particularly with the harms caused or brought to others in ways that are outside their own control. A decision is made to move manufacturing operations to Mexico in search of lower wage rates, and x thousand people lose their jobs. A decision is made to eliminate emergency response teams at oil refineries and terminals, and y million gallons of crude are spread across the fishing grounds and recreational areas of Alaskan residents. Harms to specific individuals and groups in ways outside of their own control are the focal points of moral problems.

Moral problems in corporate management are particularly complex because the harms to some individuals and groups are inevitably associated with benefits to other individuals and groups. The movement of manufacturing operations to low wage rate areas in Mexico obviously harms the displaced workers in the United States, but equally obviously benefits the new employees in Mexico and the existing shareholders in the U.S. and may benefit the suppliers, distributors, creditors, managers, and other workers in both countries through improved competitiveness. The spillage of crude oil in Prince William Sound obviously harms the local population as well as the regional environment, but the elimination of the emergency response team—which had not been needed nor used for more than 18 years—doubtless reduced product costs for customers and increased dividend payments for owners.

'Harms to others in ways outside their own control' is a new though generally accepted definition in managerial ethics. See for example Velasquez (1992). It has supplanted the earlier definition that moral problems were decisions and actions that contravened the legal or moral standards of the community for exactly the reason mentioned previously: the need for greater clarity of thought. 'Harms to some and benefits to others' is a new and partially accepted extension of that definition. See for example Hosmer (1992). It has been adopted to increase realism and to recognize competition: some managerial actions have to be taken, despite the harms to some, in order to maintain or enlarge the benefits to others.

THE PRINCIPLES OF ETHICAL ANALYSIS

The principles of ethical analysis are the means by which a person can objectively determine whether the decisions or actions that either have led or will lead to an expected mixture of benefits and harms are 'right' or 'wrong,' 'just' or 'unjust,' 'fair' or 'unfair.' Ethical principles are not subjective measures that vary with cultural, social, and economic conditions; they are objective statements that transcend countries, religions, and times. They are the basic rules or first principles that have been proposed to ensure a 'good' society. A 'good' society is one in which people willingly cooperate for the benefit of all. See Rawls (1971) or Nozick (1974). I would hope that readers remember this definition; it is central to the latter argument.

'Normative ethics' is the study of these basic rules or first principles; the objective of that study until recently was to select the one principle that all could agree to be logically the most compelling. This is a goal that has never been satisfactorily achieved. Normative ethicists are still debating the relative merits of the various principles after 2,400 years, following the earliest considerations by Protagoras and Socrates.

'Applied ethics' is the use of these basic rules or first principles to gain insight and understanding. It must be admitted that this new approach—termed 'ecumenical' by Dunfey (1991 : 33) and a 'practitioner model (that) is philosophically suspect' by Lippke (1991 : 367)—is not as thoroughly accepted as are the modern definitions of moral problems described earlier. The new applied approach on ethical principles is currently more popular in instruction than in research, but the advantages are rapidly becoming more obvious. Even normative philosophers such as Hoffman (1984 : 263) have admitted that 'no one theory provides a complete answer to the question, what should I do?'

Multiple theories used to gain insight and understanding do provide an answer to that question, though at the expense of some rigor in the underlying concepts. It is no longer necessary, for example, to recognize all of the distinctions such as those between act utilitarianism and rule utilitarianism. Normative philosophers such as Lippke and Hoffman who have spent their working lives studying those distinctions *and* advancing the clarity of the principles are obviously hesitant to abandon the rigor though they acknowledge the usefulness of the applied approach.

Here is a summary of 10 of the most cited principles expressed in applied ethics terms; for further explanation see any current text in business ethics such as DeGeorge (1989), Velasquez (1992), or Hosmer (1992). They are described in some detail in order to avoid any of the conceptual misunderstandings that have prevented joint work in the past.

Self-interests (ethical egoism)

The argument here is that if we would all look after our own self-interests, without forcefully interfering with the rights of others, then society as a whole will be better off for the members of society will be as free and productive as possible. Over the short term this seems to be a simple recipe for selfishness; over the long term, however, it creates a much more meaningful guide for action for our long-term interests are usually very different from our short-term desires. The principle, then, can be expressed as 'never take any action that is not in the *long-term* self-interests of yourself and/or of the organization to which you belong.'

Personal virtues (Aristotle)

The argument in this instance is that the lack of forceful interference is not enough. As we each pursue our own self interests, even those that are good only over the long term, we have to adopt a set of standards for our 'fair' and courteous treatment of one another. We have to be honest, open and truthful, for example, to eliminate distrust, and we should live temperately so as not to incite envy. In short, we should be proud of our actions and of our lives. The principle, then, can be expressed as 'never take any action which is not honest, open and truthful, and which you would not be proud to see reported widely in national newspapers and on network news programs.'

Religious injunctions (St. Augustine and St. Thomas Aquinas)

Honesty, truthfulness and temperance are not enough; we also have to have some degree of compassion and kindness towards others to form a truly 'good' society. That compassion and kindness is best expressed in the Golden Rule, which is not limited to the Judeo Christian tradition but is part of almost all of the world's religions. Reciprocity—do unto others as you would have them do unto you—and compassion together build a sense of community. The principle, then, can be expressed as 'never take any action that is not kind and compassionate, and that does not build a sense of community, a sense of all of us working together for a commonly accepted goal.'

Government requirements (Hobbes and Locke)

Compassion and kindness would be ideal if everyone would be compassionate and kind, but everyone won't be. People compete for property and for position, and some people will always take advantage of others. In order to restrain that competition and maintain peace within our society, we all have to obey some basic rules from a central authority that has the power to enforce those rules. In a democratic nation we think of that authority as the government, and of those rules as the law. The principle, then, can be expressed as 'never take any action that violates the law, for the law represents the minimal moral standards of our society.'

Utilitarian benefits (Bentham and Mill)

Common obedience to basic rules would work if the people associated with the central authority did not have self-interests of their own. They do. Consequently we need a means of evaluating the laws of the government, and that same means can be used to evaluate the justice of our own actions. A law or an act is 'right' if it leads to greater net social benefits than social harms. This is the principle that is often summarized as the *greatest good for the greatest number*. A more accurate way of expressing the principles is, 'never take any action that does not result in greater good than harm for the society of which you are a part.'

Universal rules (Kant)

Net social benefit is elegant in theory, but the theory does not say anything about how we should measure either the benefits or the harms—what is your life or health or well-being worth?—nor how we should distribute those benefits and allocate those harms. What we need is a rule to eliminate the self-interest of the person who decides, and that rule has to be applicable to everyone. This principle, then, can be expressed as 'never take any action that you would not be willing to see others, faced with the same or a closely similar situation, also be free or even encouraged to take.'

Individual rights (Jefferson and King)

Eliminating self-interest on the part of the decision maker isn't really possible, given what people actually are like. They are self-interested.

Consequently we need a list of agreed-upon rights for everyone that will be upheld by everyone. These rights would certainly include guarantees against arbitrary actions of the government and would ensure freedom of speech, of assembly, of religion, etc. and would provide security against seizure of property, interference with privacy, or deprivation of liberty without due process. The principle, then, can be expressed as 'never take any action that abridges the agreed-upon and accepted rights of others.'

Economic efficiency (Smith, Friedman and Blinder)

Basic rights are meaningless without the essentials of food, clothing and shelter. Therefore we should maximize the output of the needed goods and services at minimal usage of resources by setting marginal revenues equal to marginal costs. At this point the economic system will be operating as efficiently as possible, and we can reach a condition known as Pareto Optimality in which it is impossible to make any one person better off without harming someone else. The principle, then, is 'always act to maximize profits subject to legal and market constraints, for maximum profits are evidence of the most efficient production.'

Distributive justice (Rawls)

The problem with the economic efficiency argument is that the market distributes the output of needed goods and services unjustly, for it excludes those who are poor, uneducated, or unemployed. We need a rule to ensure that those people are not left out. If we did not know who among us would be rich and who poor, who educated and who uneducated, then any rule that we made for the distribution of the output goods and services could be considered just. It can be argued that under those conditions—known as the Social Contract—the only agreement we could make would be that the poor and uneducated and unemployed should not be made worse off. The principle, then, is 'never take any action in which the least among us are harmed in some way.'

Contributive liberty (Nozick)

Perhaps liberty—the freedom to follow one's own self-interests within the constraints of the law and the market—is more important than justice—the right to be included in the overall distribution of goods and services. If so, then the only agreement that would be made under the conditions of the Social Contract—in which people do not know who would be rich and who poor, who active and who slothful—would be that no law should interfere with the right of self development, for self development will eventually contribute to the welfare of society. The principle, then, is 'never take any action that will interfere with the right of all of us for our self-development and self-fulfillment to the limit of our abilities.'

Let me stress, once again, that these ethical principles of analysis are objective, not subjective. Let me state, as clearly as I can, that they do not vary by culture, by country, or by time. The rule of Rawls, for example, that we not harm the least among us, those with the least education, the least income and wealth, the least ability to influence the events which affect them, means exactly the same thing in Uzbekistan, India, Japan, and New York City. We can certainly disagree on exactly who qualifies as the 'least among us' on a global scale. We can certainly ask whether peasant farmers in Uzbekistan are better or worse off than homeless residents of New York City. But the rule does not require either selectivity or precision. It is in fact very straightforward: we should not harm either of those groups for our own benefit. We do not have to help them; we should merely avoid harming them in order to help ourselves. A simple and, to my mind, decent ethical principle of analysis that is objctive, consistent, and timeless.

JUSTIFICATION OF THE OBJECTIVITY OF ETHICAL PRINCIPLES

Many people confuse morals, values and ethics and this has led to a belief—widely accepted among both the theorists and practitioners of management—that the ethical principles of analysis are not and cannot be objective, consistent, and timeless. Let me digress for a moment here, to explain the ethicist's view of the important distinctions between morals, values, and ethics, and the consequent reasons for the reliance that can be placed upon the objectivity; consistency; and timelessness of ethical principles.

Most people, when they encounter a moral problem in which some individuals or groups are going to be hurt or harmed in some way while others are to be benefited, turn first to their moral standards of behavior. Moral standards do vary by culture, by country, and by time. They are subjective gauges of conduct. They are the way we human beings intuitively feel about the rightness or goodness of various actions.

Moral standards have been more formally defined as 'the means by which we judge our actions, and those of our neighbors' (Hosmer 1987 : 96). Moral standards are 'the expectations of society relative to the conduct of an individual that affects the interests of other people' (Beauchamp and Bowie, 1979 : 3). These 'means by which we judge our actions' and those 'expectations of society' will obviously vary with the background of the individual and the culture of the society. Moral standards, most ethicists readily admit, are not objective, consistent, nor timeless. They are personal, and vary with the individual.

Value judgments are the second means most people use to decide what is 'right' and 'just' and 'fair' when confronting a moral problem in which some individuals or groups are to be hurt or harmed in some way while others are to be benefited. For simple moral temptations, particularly those involving such basic issues as insider trading or bribe paying where the harms are obvious and widespread and the benefits are limited and focused, there is no need for most of us to go beyond our personal moral standards. But, for the more complex managerial dilemmas, where the outcomes are mixed as in the coal-fired generation of electricity which results in low costs for the consumer and acid emissions for the environment, or where the duties are unclear as in corporate downsizing where the harms for a small group are offset by benefits for a much larger number of individuals, most people move from their moral standards of behavior to their value judgments of purpose.

Value judgments of purpose also vary by culture, by country, and by time. They are subjective evaluations of what we think is important. They are the way we human beings intuitively feel about the rightness and goodness of various goals.

Value judgments in more formal definitions are thought of as priorities by Hosmer (1994) and as preferences by Hofstede (1984). 'A shorthand definition of a value is a broad preference for one state of affairs over others' (1994 : 389). Rokeach in his truly basic work (1973) identifies instrumental values as desirable modes of conduct and terminal values as desirable end states of existence. The desirable end states of existence or value judgements clearly dominate the desirable modes of conduct or moral standards.

McCoy adopts this priority or preference among end states view of values when he states that it is necessary to take more than profit into account in business management, and that 'values beyond the short-term bottom line are a necessity, not an option, to be considered' (1985 : 6). He continues with the statement that making decisions and setting policies in a business firm involves choosing between competing purposes, and that choosing involves having a clear listing of priorities or values. The paramount task of senior executives, McCoy concludes, is the setting of priorities, or the management of values.

McCoy does not state, however, how those values to be managed should be selected for it seems clear to most of us that the values of the senior executives will doubtless differ from the values of the hourly employees, and it seems even more obvious to those who have had global experience that the differences between the values of those two groups will either narrow or widen once we reach India, Japan, or Europe. Value judgments are similar to moral standards in the view of most ethicists: they are variable. They are not objective, consistent, and timeless. Again, they are personal, and vary with the individual.

Moral standards and value judgements differ between people. There have been numerous studies in anthropology, sociology, and a new subfield now known as descriptive ethics confirming these differences between social groups, national states, and historical periods. It is not, in my opinion, necessary to cite those studies. We all have experience of these differences, and accept their existence.

The reasons for these moral and value differences between groups, countries and times are not as clearly known, nor as widely accepted. Kohlberg (1981) provided a definitive study of the moral development of individuals, through stages. It now seems apparent, however, that there are religious/cultural and economic/social

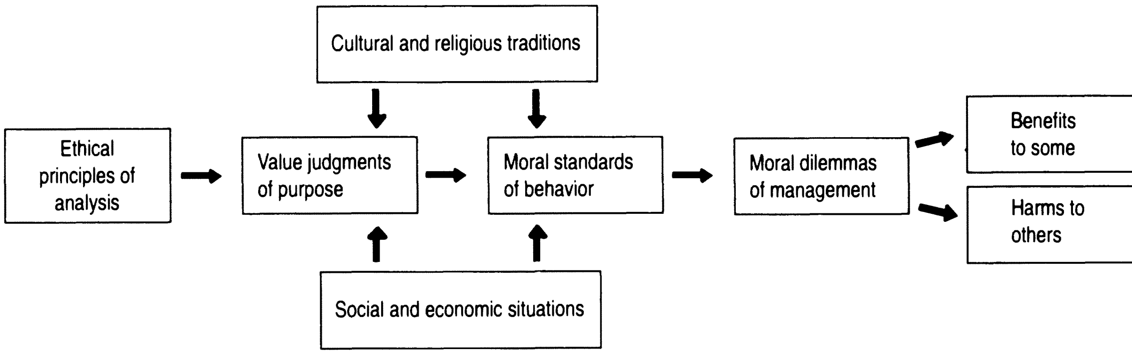

Figure 1. Relationships between morals, values and ethics

influences upon that development. See, for example, Likona (1976) or Gilligan (1982). These influences have not been as definitely studied, but it is certainly possible to cite Inkles and Smith's (1974) discussions of the changes in personal values and behavior patterns as a result of economic development; Matasugu's (1982) description of the influence of national culture on the development of moral standards; and Haney's (1983) study of the impact of economic and social variables upon the norms of acceptable behavior as examples of the needed work in this area.

Ethical principles, however, do not differ between people. They remain exactly the same across cultural groups, national states, and historical periods. They form the bedrock of moral philosophy. They are, to repeat the earlier definition that I peremptorily asked readers to remember, the first principles of what constitutes a 'good' society, and a 'good' society has been further defined as one in which people willingly cooperate for the benefit of all (Hobbes, 1986, Rawls 1971, or Nozick 1974).

Ethical principles are the fundamental rules by which an individual can, if he or she chooses and has the necessary knowledge of the principles, examine his or her moral standards and verify his or her value judgments. Ethical principles are, finally, the topic of Socrates most impassioned plea: 'The unexamined life is not worth living' (Plato, 1955 : 43). This was his final statement in his defense at the trial that led to his death in 399 BC. It has been taken by generations of scholars to mean that we should all examine our standards of behavior and our choice of goals using the fundamental logic of the ethical principles of analysis.

Ethics has been more formally defined as thinking about moral standards in a logical and structured manner (Frankena, 1973). It is the study of what is good or right for human beings (Hoffman and Moore, 1984). It is the search for the general character that makes right acts right (Ross, 1930). Ethics, finally, has been defined by DeGeorge in a sentence that almost exactly follows the conceptual framework expressed here as 'a systematic attempt through the use of reason to make sense of our individual and social moral experience in such a way as to determine the rules which ought to govern human conduct and the values worth pursuing in life' (1982 : 12).

In summary, we can legitimately justify the conception of ethical principles as objective, consistent, and timeless if we accept the proposed distinctions between morals, values, and ethics, and if we understand that only our moral standards and value judgements are subject to cultural, religious, social and economic influences. The ethical principles are not subject to those influences. This is the accepted view, as was cited in the discussion, of most normative ethicists.

ETHICAL PRINCIPLES APPLIED TO STRATEGIC MANAGEMENT: THE METHOD

What does all this mean? What possible connection can the closing statements at a trial in 399 BC have with the managerial practices of the late 20th Century? Let us say that you accept, for now, the proposal that the ethical principles of analysis are objective, not subjective, and that they do provide collectively a way of deciding what is 'right' and 'just' and 'fair' in human actions and goals. How can they be used in management, and—particularly—how can they be used in strategic management which determines firstly the goals, policies, and character (Andrews, 1971) and secondly the competitive posture and position (Porter, 1980) of the firm?

These 10 ethical principles of analysis provide different perspectives, different ways of looking at either the content or the process of strategic management decisions and actions. The more usual perspectives are those of (1) neoclassical economics which uses accounting measures of return and/or stock price changes, (2) industry organization economics which uses sustainable competitive advantages and/or market share improvements, and (3) population ecology, which uses organizational survival, growth and/or development.

Currently changes in corporate or divisional strategies are examined using those measures from neoclassical economics, industry organizational economics, and population ecology. What effect will this proposed change have upon our return on investment and our stock price? Upon our competitive advantage and our market share? Upon our organizational potential for survival, growth, and development?

If we wish to add ethical considerations to strategic planning, then we must begin to look at those proposed changes using the perspectives and the measures of the applied ethical principles. What effect will this proposed change have upon our long-term, rather than merely our short-term, self interests? Is this proposed change open and honest and truthful; and something of which we could all be proud if it were to become widely known? Does it build a sense of community among all of our stakeholders, or does it tend to destroy—or even worse, to exploit—that sense of community?

It is assumed that any company adding these ethical considerations to the strategic planning process currently uses some approximation of the iterative planning system originally described in Chandler (1966) and then further detailed by Lorange and Vancil (1977) for multidivisional firms. A statement of planning objectives is first prepared by the central office, and then strategic plans (the method of competition), program plans (the allocation of resources), and budgetary plans (the estimation of revenues and expenses) to meet those objectives are prepared by the divisions and approved by the headquarters, in sequence. It is clear that ethical considerations can be part of the approval process at all three stages. The important issue, however, is not whether ethical principles *can be included* in the planning process; it is whether they *should be included*.

ETHICAL PRINCIPLES APPLIED TO STRATEGIC MANAGEMENT: THE REASON

Now we come to the critical issue. Granted that ethical principles are objective, and do provide different perspectives that can help in determining whether a given decision or action can be considered to be 'right' and 'just' and 'fair.' Granted that it is possible to include these ethical principles in the strategic management process so that given decisions or actions that impact the welfare of stakeholder groups can be considered to be 'right' and 'just' and 'fair.' The critical question is whether we are under any compunction to do so.

It may make us feel good to be moral. It may make us feel superior to be moral. It may even make us feel less susceptible to legal claims from unfairly discharged employees and/or badly misinformed customers to be moral. Why should we do so?

The argument of this article is that it may or may not be nice to be moral, it may or may not be better to be moral, it may or may not be prudent to be moral, but that *it is essential in any competitive sense to be moral*. Let me make this argument in a series of propositions:

> *Proposition 1 Companies operating in a competitive global economy are dependent upon a wide range of stakeholders.*

Stakeholders have been defined (Freeman 1984 : 46) as those groups that 'are affected by and can in turn affect the achievement of the organizational objectives' of the firm. There has been little debate about that concept. The ability of stakeholders to affect the achievement of objectives, both negatively and positively, is widely accepted though seldom explicitly mentioned in the literature.

Which individuals and groups should be included among the stakeholders? There is less agreement here, but hourly workers, administrative staff, functional and technical managers, senior executives and the other groups that fit within the hierarchical boundaries of the firm are almost always included. Material and component suppliers, and wholesale and retail distributors, outside of the hierarchical boundaries but within the industry limits, are generally included following the examples of the Japanese keiretsu. Customers often are included, following the precepts of the total quality approach. Creditors, investors, and the organizations that supply advanced technologies and trained personnel are equally necessary to the firm though less subject to their direction and control, and may or may not be included. Industry associations, interest groups, joint ventures, and strategic alliances are even further out on the periphery of the organization, but able to interact with domestic and foreign governmental agencies which obviously can affect the operations of the firm, and again may or may not be included.

The issue, however, is not whether or not these groups have been included at some point in the past in a definition of an extended organization. The issue is whether or not these groups at some point in the future can affect the achievement of the objectives of the firm. It seems reasonable to make the assumption that they can. Figure 2 provides a graphic depiction of the full range of stakeholder groups following that assumption.

Proposition 2 Companies are dependent upon their stakeholder groups not only for cooperative actions but also for innovative developments.

The need for cooperation among the stakeholder groups is obvious; indeed, this need is inherent in the definition of stakeholders previously cited as the individuals and groups who 'are affected by and can in turn affect the achievement of the organizational objectives'.

The question, however, is whether cooperation in the sense of 'you tell us what to do and we'll do it' is enough. Perhaps innovation is also required for meaningful technology advances, product and process developments, cost reductions, and quality improvements. Certainly many of the popular management books of the 1980s such as Peters and Waterman (1982) and Pinchot (1985) stressed the need for innovation and entrepreneurship. The problem was that the focus seemed to be on new products rather than on new strategies, and that the entrepreneur or—more properly—the intrapreneur often seemed to be a loose cannon, paying little attention to the directions or intentions of the management.

The recent work of Hamel and Prahalad (1989) seems much more relevant to strategic rather than product innovation, though it continues to focus within the hierarchy of the firm. They start by deriding organizations so 'hidebound, so orthodox ridden that the only way to innovate is to put a few bright people in a small dark room, pour in some money, and hope that something wonderful will happen' (1989 : 66). They then stress the need for improvisation, creativity, and innovation. 'While strategic intent is clear about ends, it is flexible as to means—it leaves room for improvisation. Achieving strategic intent requires enormous creativity with respect to means . . . The goal is not competitive imitation but competitive innovation' (1989 : 67).

Does 'competitive innovation' come only from lower level employees, as seems to be implied in Hamel and Prahalad? Or, can this key to competitive success come from any and all of the stakeholders, including employees, suppliers, distributors, customers, creditors, owners, technology centers, educational institutions, industry associations, and all of the other groups shown in Figure 2. Innovations reducing the cost of health care or increasing the supply of trained workers would certainly improve the competitive position of companies in a global economy, for example, so it would seem clear that creativity and improvisation can and should come from any and all of the stakeholders. At all events, it seems reasonable once again to make that assumption.

Proposition 3 It is difficult to motivate behavior that is both cooperative and innovative by all of the stakeholders of the firm.

If we accept the first assumption that companies operating in a competitive global environment are dependent upon their stakeholders, both those within the firm and those outside the formal authority structure, and if we accept the

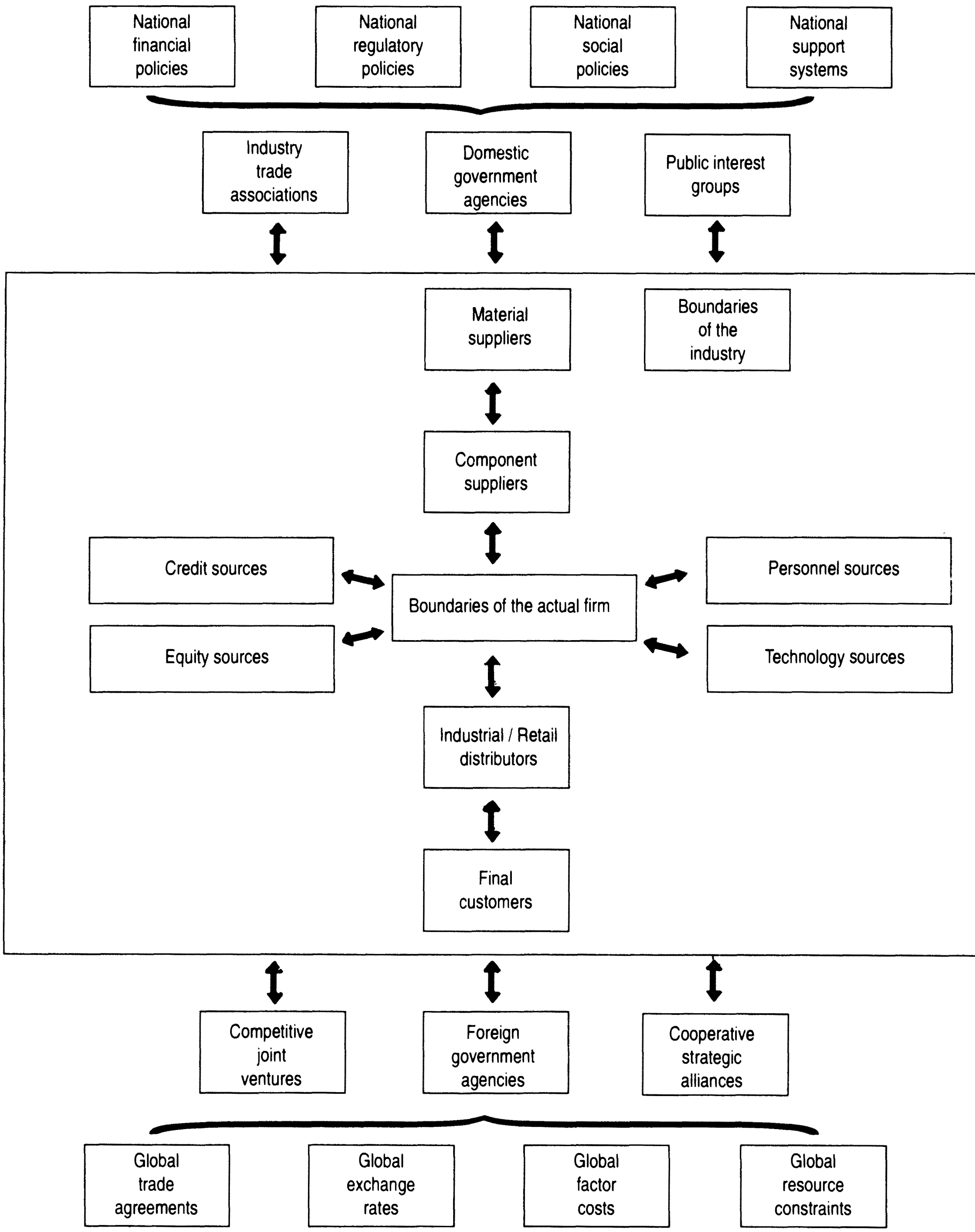

Figure 2. An extended view of business organizations

second assumption that this dependency extends beyond simple cooperative acts to the much more complex innovative developments, then we are faced with the need to motivate creativity and improvisation.

Motivation has been the topic of extensive work in the behavioral sciences. See, for example, Steers and Porter (1987). Most of this work however has focused on cooperation, not innovation, by persons within the formal, not the extended, organization. The usual recommendation starts with a proposal that goals be set, either by joint agreement or by administrative fiat. Actual results are then measured against these planned outcomes, the divergences are analyzed, and positive or negative performance evaluations are computed. Incentives are then paid to reward the positive performance evaluations.

The incentives can be financial (commissions or bonuses), positional (promotions or 'perks' in lieu of promotions), or perceptual (widespread recognition and approval by members of the organization). The effectiveness of these incentives is said to vary depending upon the nature of the task, the needs of the individual, and the cohesion of the group. The process obviously focuses on cooperative acts for which measurable goals can be set, and is primarily designed for individuals and groups within the formal hierarchy who can legitimately be given commissions, bonuses, promotions, or 'perks.'

Incentives to motivate creativity and improvisation by individuals and groups outside the formal hierarchy of the firm seems seldom to have been considered in behavioral theory. Here we have to move to the more general approach of agency theory which can be applied to any principal–agent relationship, including those outside the hierarchical boundaries (Harris and Raviv 1978, quoted in Eisenhardt, 1989). Agency theory is not limited to the special case of the owner/manager relationship. It can be and has been used to design governance mechanisms that will limit any agent's self-serving behavior given goal conflicts and varying levels of risk aversion, task programmability, and outcome uncertainty, exactly the issues we wish to address.

Principal–agent contracts can be based upon either behaviors or outcomes. *Behaviors* in the nonprogrammable tasks—i.e., those that involve a substantial degree of improvisation and creativity—cannot be accurately measured, and therefore investments in information systems or management structures to detect self serving acts and lack of effort (the joint moral hazards) cannot be justified (Demski and Feltham, 1978, again quoted in Eisenhardt, 1989).

Outcomes in some of these nonprogrammable tasks can be measured, but then the risk is transferred to the agent. The risk is transferred because the outcome is only partially a function of the behavior; technological feasibilities, competitive actions, government policies, economic and social changes all 'cause uncontrollable variations in outcomes' (Eisenhardt, 1989 : 61). Outcomes in other nonprogrammable tasks — i.e., those that 'take a long time to complete, involve joint or team effort, or produce soft outcomes' (1989 : 62) cannot easily be measured.

What can be done when it becomes overly expensive to transfer risk to the agent in the event of measurable but uncertain outcomes, or when it becomes overly difficult to measure those outcomes? The only solution is to overcome the moral hazards by building trust, commitment, and effort among the agents who are, of course, the stakeholders of the firm.

Proposition 4 It is possible to build trust, commitment and effort on the part of all of the stakeholders by including the ethical principles in the strategic decision processes of the firm.

Trust is 'confidence in the honesty, integrity, reliability, justice of another person or thing' (Webster, 1953 : 1565). Trust in managerial terms is confidence that the self-interests of the principal will not necessarily take total precedence over the self-interests of the agent. Trust, again in managerial terms, is reliance upon the belief that when agents or stakeholders of the firm are to be hurt or harmed in some way outside of their own control, while others, often including the owners and managers, are to be benefited, the decision will be made by applying the ethical principles of analysis in addition to the more common microeconomic, industry organization, and population ecology standards. The ethical principles of analysis, of course, do address what is 'right,' what is 'just,' and what is 'fair' in the critical relationships between the firm and its various stakeholder groups, and were designed to eliminate short-term self-interest as a decision criteria by the representatives of the firm.

The basic argument of this article is that decisions and actions by the managers of extended firms that (1) recognize the moral problems that occur when one or more of the stakeholders groups will be hurt or harmed in some way outside of their own control that; (2) resolve those moral problems by applying the ethical principles of analysis in addition to the more common strategic concepts of industry position, competitive advantage, and organizational development; and that (3) have the moral courage to insist upon the recognition and resolution of those problems, will result in trust amongst all of the stakeholder groups. Trust generates commitment. Commitment builds effort. Effort that is cooperative, innovative and strategically directed results in success whether measured by stock price, market share, or organizational development.

In brief, an ethical approach to strategic management does not penalize the extended firm in a competitive global economy. It benefits that company by ensuring a cooperative, innovative, and directed effort on the part of all of the stakeholders of the firm.

JUSTIFICATION OF THE ETHICS-TRUST-COMMITMENT-EFFORT SEQUENCE

Why should this be so? Why should we accept the proposal that the application of ethical principles to strategic decisions builds stakeholder trust, that stakeholder trust generates organizational commitment, and that organizational commitment results in the cooperative and innovative effort that is so essential for success given the intensely competitive nature of the global economy?

Certainly there is very limited empirical support for this proposal. This lack of existent studies, however, should not surprise us. The divergent conceptual frameworks and the inherent conceptual misunderstandings of corporate strategy and managerial ethics—both described earlier, in the introduction to this article—have precluded the joint work that might have been so useful. And managerial ethics, despite its applied nature, has remained normative, not descriptive, in most of its research and cannot provide the needed support by itself.

We all know of anecdotal examples that seem to support the proposal that trust builds commitment, particularly when the affected stakeholders are customers and/or employees. Johnson and Johnson removed Tylenol from store shelves nationwide at a cost of $80,000,000 when it was feared that the product poisoning might have spread beyond the original boundaries of Chicago, and the company has benefited extensively from consumer goodwill. Herman Miller offered all employees a silver parachute when it was feared that the company might be the subject of a hostile take-over attempt, and worker morale has remained exceedingly high. But, anecdotal evidence is not very compelling. Given the lack of large scale studies and the unsatisfactory nature of most case examples, let us adopt a more conceptual approach. Let us return to agency theory, and the accepted economic rationale of the principal–agent relationship.

The economic rationale of the principle–agent

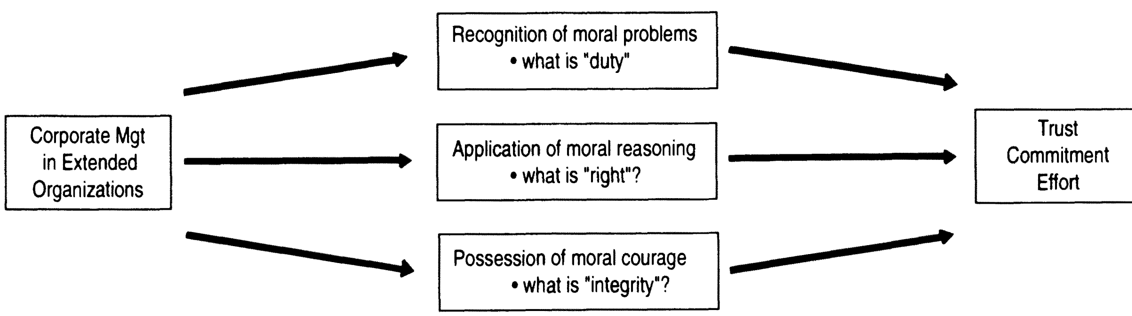

Figure 3. Building trust, commitment, and effort

relationship looks at each exchange as a new event, unemcumbered by feelings of gratitude, indifference, disloyalty, or revenge. Any notion of intended reciprocity for past benefits and/or harms on the part of the agent is sternly excluded. Indeed, moral hazards—the lack of enthusiastic adherence to contractural agreements—are felt to be a problem only for the agent, never for the principal, and consequently acts on the part of the principal that might induce feelings of ingratitude, indifference, or 'getting even' on the part of the agent are thought not to occur.

What happens if we relax this requirement? What happens if we accept the belief that contractural agreements between companies and stakeholders have both explicit and implicit terms, and that companies may only occasionally violate the explicit obligations but frequently compromise the implicit understandings? An energetic marketing manager who has maintained sales for a mature product line is legally subject to employment 'at will,' but I think it is safe to assume that was not the impression given by the corporate recruiter 5 years previously. An innovative component supplier who has developed a successful product feature for their customer has no guarantee of future orders, but I doubt that was clearly explained at the award ceremony honoring the supplier.

What happens if the marketing manager sees her friends and associates within the firm unjustly battered by corporate restructurings? What happens if the component supplier sees other suppliers unfairly given its drawings for the new product feature and asked to bid competitively? Agency theory assumes that both will continue to work for the advantage of the principal, without any slackening of their energy and/or innovation, because it is in their short-term self-interest to do so *as long as their behavior can be measured or their output can be evaluated*. The problem is seen to be in the measurement and evaluation procedures, and the need to make these more precise for unprogramed tasks and extended time frames. The problem is not thought to be in the microeconomic behavioral assumptions of short-term advantage and self-interest maximization, which may be misleading given the lack of trust, commitment, and effort that often come from acts that are felt by agents to be 'unjust' or 'unfair.'

Numerous economists and sociologists have questioned the microeconomic behavioral assumptions of short-term advantage and self-interest maximization for either descriptive or predictive use. See, for example, the lengthy source listing in Sen (1991 : 16f) that follows his classic statement, 'To try to use the demands of rationality in going to battle on behalf of the standard behavioral assumption of economic theory (to wit, actual self-interest maximization) is like leading a cavalry charge on a lame donkey'.

None of us want to lead such a cavalry charge. What other behavioral assumptions are possible, then, following an overall belief in economic rationality; that could be seen as including knowledge by the agent about *prior benefits and harms* of the principal in the principal–agent contract that might influence the degree of cooperation and the amount of innovation by the agent? There would seem to be three alternatives:

1. Multiple utilities. Etzioni (1988) is well known for his amusing attacks upon the assumption of short-term rationality and self-interested behavior. 'People typically do not render rational decisions. They brush their teeth but do not fasten their seat belts' (1988 : xi). Etzioni instead suggests that decisions are based upon an I/We dichotomy, with equal concerns for the person and for the group. He terms the group half of this dichotomy a deontological commitment, or moral sense of duty to others, and he recommends the use of dual utilities to encompass both the personal and the moral sources of motivation.

Etzioni has directly applied this concept of dual personal and moral interests to the issue with which we are concerned here, that of the principal–agent relationship, and finds that concern for the good of the group and trust in the reliability of the principle are both essential. 'Moral commitments reduce what economists have come to call *moral hazards*. Specifically, the stronger the moral underwriting of implicit contracts, the lower the administrative costs resulting in less of a need to buy hedge protection' (1986 : 175). It has to be admittted, however, that the I/We paradigm proposed by Prof. Etzioni has not gained wide support. Dual utilities are computationally complex, and the continual question arises: why stop at two? Why not add affection, anger, conformity, homogeneity, or others? Etzioni provides some support for the importance of trust in principal–agent relationships with his concept of multiple utilities, but perhaps we can go further.

2. *Interdependent utilities.* Sen (1991) addresses the same personal vs. group concerns, and also writes with an amusing, elegant style, but he has less bite and more compassion for the problem of developing an economic theory that is both parsimonious and complete. He is a very distinguished economist, which makes his beliefs more acceptable to that large part of the academic spectrum, and he bases his arguments on rights rather than duties which certainly appeals to many if not most of the ethicists.

It is difficult to summarize this argument on rights, but let me make the attempt. Sen starts by rejecting utility as a motivational means. 'It is . . . arguable that since the claim of utility to be the only source of value rests allegedly on identifying utility with well-being, it can be criticized both on the ground that well-being is not the only thing that is valuable, and on the ground that utility does not adequately represent well-being' (1991 : 46).

Well-being is not the only thing that is valuable because people value the promotion of both causes (rights, liberties, and opportunities) and groups (families, communities, and classes). Utility does not adequately represent well-being because of the interpersonal comparisons that are possible. You may have more than I do, or your group may have more than my group, in either advantage or freedom, and that affects my conception of my goal, and my means of achieving that goal. I may, however, recognize that my achieving my complex goal is interdependent with you achieving your complex goal and therefore cooperation is essential. 'Behavior is ultimately a social matter as well, and thinking in terms of what "we" should do, or what should be "our" strategy, may reflect a sense of identity involving recognition of other people's goals, and the mutual interdependencies involved' (1991 : 85).

If we accept Sen's argument that behavior is socially motivated by a comparison of personal utilities and a recognition of mutual interdependencies, then we have a new and more compelling reason to accept the proposal that the actions of the principal affect the behavior of the agent, and that trust in the mutual beneficiency of the principal is essential for the cooperation and innovation by the agent. However, we may be able to find an even simpler economic rationale.

3. *Extended utilities.* The standard economic rationale for the motivation of the agent in principal–agent transactions is short-term advantage or personal utility. Both Etzioni and Sen object to the monolithic nature of this concept, but let us accept it for now with the proviso that we extend the time frame through a series of infinite exchanges. That would seem to be a reasonable proviso. Energetic employees expect to be employed not 'at will' but over time with some sense of gratitude by the company for the past market share achievements that were so beneficial. Innovative suppliers expect to receive additional orders not 'at cost,' but over time with some sense of appreciation for the past product feature developments that were so helpful. These expectations of future benefits can obviously be discounted back by the agent to be added to his or her sense of current advantage or utility.

What happens if the actions of the principal, in distributing the benefits and allocating the harms of company operations, destroys those expectations? The motivations of the agent towards cooperation and innovation will clearly be decreased. Stakeholders expect 'right,' 'just' and 'fair' treatment, and those expectations can be destroyed by actions that are arbitrary or capricious, and that do not follow the known principles of ethical analysis that tend to give the same consideration to the self-interests of the agent as to the self-interests of the principal. Actions of the principal that give total weight to their own short-term self-interests, and neglect those of the agent, would seem to destroy the trust, commitment, and effort of the agent through reducing the long-term utility of his or her future cooperation and innovation.

In short, we can rationally justify the ethics-trust-commitment-effort sequence if we first assume that principals in any principal/agent exchange occasionally act in ways that can be seen by the agents to be 'unjust' or 'unfair' and if we are willing to conceive of either multiple utilities, interdependent utilities, or extended utilities. The latter, in my view, is computationally most simple and logically follows most directly from the accepted economic rationale of agency theory.

CONCLUSION

The basic argument of this article—which is that the trust, commitment and effort on the part of all of the stake-holders of a firm are as essential to the success of that firm as are the competitive advantages and strategic positions of its planning process—can be summarized in a series of five statements:

1. The strategic decisions of any large scale economic enterprise in a competitive global environment result in both benefits and harms. The harms, which include the discharge of employees, the termination of suppliers, the deterioration of environments, etc. cannot be avoided though until recently they have been ignored.
2. It is the responsibility of the senior executives of the firm to distribute those benefits and allocate those harms among the stakeholders of the company. This can be done arbitrarily or thoughtfully. If it is done thoughtfully, then the ethical principles offer the only form of analysis that is relevant.
3. The ethical principles offer the only form of analysis that is relevant for the distribution of benefits and the allocation of harms because they provide the only means of recognizing the interests and rights of each of the stakeholders and comparing those interests and rights through the use of Known principles.
4. Stakeholders who believe that the benefits have been distributed and the names allocated through a process that recognizes their interests and rights, and that compares those interests and rights with those of other stakeholders through the use of known principles, will develop trust in the direction of the firm.
5. Stakeholders who develop trust in the direction of the firm will show commitment to its future. Commitment to the future of a firm will ensure efforts that are both cooperative and innovative. Cooperative, innovative, and directed efforts on the part of all of the stakeholder groups will lead to competitive and economic success, however measured, for that firm over time.

This is a considerable departure from the existing paradigm of the field, which is that the selection of a strategic posture within an industry (Porter, 1980) and the leveraging of strategic resources across industries (Prahalad and Hamel, 1990) lead towards competitive and economic success. The argument here is that the selection of the posture and the leveraging of the resources are not enough in a competitive global economy. Trust, commitment, and effort must be added to ensure cooperative and innovative acts on the part of all of the stakeholders. The argument here is that strategic planning must be both analytical and ethical, which brings us back to the original views of Barnard, Simon, and Andrews.

ADDENDUM

A traditional objection by normative philosophers to the use of simplified ethical principles in the analysis of pragmatic moral problems is that these principles, while ostensibly leading towards the betterment of society over the short-term, in reality lead towards the betterment of the decision maker over the long-term. No one, to my knowledge, has ever used the term 'heuristic' in describing this view of the simplified ethical principles, but that meaning is implied. 'You are unable,' the traditionalist philosopher would state, 'to think through the full consequences of your actions because you are unable to anticipate the full range of possible actions by others, and therefore you are attempting to ensure their future cooperation in your endeavors by recognizing their self-interests now.' This, in the view of the traditional ethicist, negates those principles for it substitutes personal betterment for the common good. Perhaps, for the nontraditional strategist, this verifies those principles for it makes them heuristics, and very useful heuristics, for strategic planning in an increasingly competitive global economy.

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