

REGULATION

Managing for Organizational Integrity

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Many managers think of ethics as a question of personal scruples, a confidential matter between individuals and their consciences. These executives are quick to describe any wrongdoing as an isolated incident, the work of a rogue employee. The thought that the company could bear any responsibility for an individual's misdeeds never enters their minds. Ethics, after all, has nothing to do with management.

In fact, ethics has *everything* to do with management. Rarely do the character flaws of a lone actor fully explain corporate misconduct. More typically, unethical business practice involves the tacit, if not explicit, cooperation of others and reflects the values, attitudes, beliefs, language, and behavioral patterns that define an organization's operating culture. Ethics, then, is as much an organizational as a personal issue. Managers who fail to provide proper leadership and to institute systems that facilitate ethical conduct share responsibility with those who conceive, execute, and knowingly benefit from corporate misdeeds.

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. In addition, they deprive their organizations of the benefits available under new federal guidelines for sentencing organizations convicted of wrongdoing. These sentencing guidelines recognize for the first time the organizational and managerial roots of unlawful conduct and base fines partly on the extent to which companies have taken steps to prevent that misconduct.

Prompted by the prospect of leniency, many companies are rushing to implement compliance-based ethics programs. Designed by corporate counsel, the goal of these programs is to prevent, detect, and punish legal violations. But organizational ethics means more than avoiding illegal practice; and providing employees with a rule book will do little to address the problems underlying unlawful conduct. To foster a climate that encourages exemplary behavior, corporations need a comprehensive approach that goes beyond the often punitive legal compliance stance.

An integrity-based approach to ethics management combines a concern for the law with an emphasis on managerial responsibility for ethical behavior. Though integrity strategies may vary in design and scope, all strive to define companies' guiding values, aspirations, and patterns of thought and conduct. When integrated into the day-to-day operations of an organization, such strategies can help prevent damaging ethical lapses while tapping into powerful human impulses for moral thought and action. Then an ethical framework becomes no longer a burdensome constraint within which companies must operate, but the governing ethos of an organization.

How Organizations Shape Individuals' Behavior

The once familiar picture of ethics as individualistic, unchanging, and impervious to organizational influences has not stood up to scrutiny in recent years. Sears Auto Centers' and Beech-Nut Nutrition Corporation's experiences illustrate the role organizations play in shaping individuals' behavior—and how even sound moral fiber can fray when stretched too thin.

In 1992, Sears, Roebuck & Company was inundated with complaints about its automotive service business. Consumers and attorneys general in more than 40 states had accused the company of misleading customers and selling them unnecessary parts and services, from brake jobs to front-end alignments. It would be a mistake, however, to see this situation exclusively in terms of any one individual's moral failings. Nor did management set out to defraud Sears customers. Instead, a number of organizational factors contributed to the problematic sales practices.

In the face of declining revenues, shrinking market share, and an increasingly competitive market for undercar services, Sears management attempted to spur the performance of its auto centers by introducing new goals and incentives for employees. The company increased minimum work quotas and introduced productivity incentives for mechanics. The automotive service advisers were given product-specific sales quotas—sell so many springs, shock absorbers, alignments, or brake jobs per shift—and paid a commission based on sales. According to advisers, failure to meet quotas could lead to a transfer or a reduction in work hours. Some employees spoke of the “pressure, pressure, pressure” to bring in sales.

Under this new set of organizational pressures and incentives, with few options for meeting their sales goals legitimately, some employees' judgment understandably suffered. Management's failure to clarify the line between unnecessary service and legitimate preventive maintenance, coupled with consumer ignorance, left employees to chart their own courses through a vast gray area, subject to a wide range of interpretations. Without active management support for ethical practice and mechanisms to detect and check questionable sales methods and poor work, it is not surprising that some employees may have reacted to contextual forces by resorting to exaggeration, carelessness, or even misrepresentation.

At Sears Auto Centers, management's failure to clarify the line between unnecessary service and legitimate preventive maintenance cost the company an estimated \$60 million.

Shortly after the allegations against Sears became public, CEO Edward Brennan acknowledged management's responsibility for putting in place compensation and goal-setting systems that "created an environment in which mistakes did occur." Although the company denied any intent to deceive consumers, senior executives eliminated commissions for service advisers and discontinued sales quotas for specific parts. They also instituted a system of unannounced shopping audits and made plans to expand the internal monitoring of service. In settling the pending lawsuits, Sears offered coupons to customers who had bought certain auto services between 1990 and 1992. The total cost of the settlement, including potential customer refunds, was an estimated \$60 million.

Contextual forces can also influence the behavior of top management, as a former CEO of Beech-Nut Nutrition Corporation discovered. In the early 1980s, only two years after joining the company, the CEO found evidence suggesting that the apple juice concentrate, supplied by the company's vendors for use in Beech-Nut's "100% pure" apple juice, contained nothing more than sugar water and chemicals. The CEO could have destroyed the bogus inventory and withdrawn the juice from grocers' shelves, but he was under extraordinary pressure to turn the ailing company around. Eliminating the inventory would have killed any hope of turning even the meager \$700,000 profit promised to Beech-Nut's then parent, Nestlé.

A number of people in the corporation, it turned out, had doubted the purity of the juice for several years before the CEO arrived. But the 25% price advantage offered by the supplier of the bogus concentrate allowed the operations head to meet cost-control goals. Furthermore, the company lacked an effective quality control system, and a conclusive lab test for juice purity did not yet exist. When a member of the

research department voiced concerns about the juice to operating management, he was accused of not being a team player and of acting like “Chicken Little.” His judgment, his supervisor wrote in an annual performance review, was “colored by naïveté and impractical ideals.” No one else seemed to have considered the company’s obligations to its customers or to have thought about the potential harm of disclosure. No one considered the fact that the sale of adulterated or misbranded juice is a legal offense, putting the company and its top management at risk of criminal liability.

An FDA investigation taught Beech-Nut the hard way. In 1987, the company pleaded guilty to selling adulterated and misbranded juice. Two years and two criminal trials later, the CEO pleaded guilty to ten counts of mislabeling. The total cost to the company—including fines, legal expenses, and lost sales—was an estimated \$25 million.

Such errors of judgment rarely reflect an organizational culture and management philosophy that sets out to harm or deceive. More often, they reveal a culture that is insensitive or indifferent to ethical considerations or one that lacks effective organizational systems. By the same token, exemplary conduct usually reflects an organizational culture and philosophy that is infused with a sense of responsibility.

For example, Johnson & Johnson’s handling of the Tylenol crisis is sometimes attributed to the singular personality of then-CEO James Burke. However, the decision to do a nationwide recall of Tylenol capsules in order to avoid further loss of life from product tampering was in reality not one decision but thousands of decisions made by individuals at all levels of the organization. The “Tylenol decision,” then, is best understood not as an isolated incident, the achievement of a lone individual, but as the reflection of an organization’s culture. Without a shared set of values and guiding principles deeply ingrained throughout the organization, it is doubtful that Johnson & Johnson’s response would have been as rapid, cohesive, and ethically sound.

Acknowledging the importance of organizational context in ethics does not imply forgiving individual wrongdoers.

Many people resist acknowledging the influence of organizational factors on individual behavior—especially on misconduct—for fear of diluting people’s sense of personal moral responsibility. But this fear is based on a false dichotomy between holding individual transgressors accountable and holding “the

system” accountable. Acknowledging the importance of organizational context need not imply exculpating individual wrongdoers. To understand all is not to forgive all.

The Limits of a Legal Compliance Program

The consequences of an ethical lapse can be serious and far-reaching. Organizations can quickly become entangled in an all-consuming web of legal proceedings. The risk of litigation and liability has increased in the past decade as lawmakers have legislated new civil and criminal offenses, stepped up penalties, and improved support for law enforcement. Equally—if not more—important is the damage an ethical lapse can do to an organization’s reputation and relationships. Both Sears and Beech-Nut, for instance, struggled to regain consumer trust and market share long after legal proceedings had ended.

As more managers have become alerted to the importance of organizational ethics, many have asked their lawyers to develop corporate ethics programs to detect and prevent violations of the law. The 1991 Federal Sentencing Guidelines offer a compelling rationale. Sanctions such as fines and probation for organizations convicted of wrongdoing can vary dramatically depending both on the degree of management cooperation in reporting and investigating corporate misdeeds and on whether or not the company has implemented a legal compliance program. (See the insert “Corporate Fines Under the Federal Sentencing Guidelines.”)

Corporate Fines Under the Federal Sentencing Guidelines

What size fine is a corporation likely to pay if convicted of a crime? It depends on a number of factors, some of which are beyond a CEO’s control, such as the existence of a prior record of similar misconduct. But it also depends on more controllable factors. The most important of these are reporting and accepting responsibility for the crime, cooperating with authorities, and having an effective program in place to prevent and detect unlawful behavior.

The following example, based on a case studied by the United States Sentencing Commission, shows how the 1991 Federal

Such programs tend to emphasize the prevention of unlawful conduct, primarily by increasing surveillance and control and by imposing penalties for wrongdoers. While plans vary, the basic framework is outlined in the sentencing guidelines. Managers must establish compliance standards and procedures; designate high-level personnel to oversee compliance; avoid delegating discretionary authority to those likely to act unlawfully; effectively communicate the company’s standards and procedures through training or publications; take reasonable steps to achieve compliance through audits, monitoring processes, and a system for employees to report criminal misconduct without fear of retribution; consistently enforce standards through appropriate disciplinary measures; respond

Sentencing Guidelines have affected overall fine levels and how managers' actions influence organizational fines.

Acme Corporation was charged and convicted of mail fraud. The company systematically charged customers who damaged rented automobiles more than the actual cost of repairs. Acme also billed some customers for the cost of repairs to vehicles for which they were not responsible. Prior to the criminal adjudication, Acme paid \$13.7 million in restitution to the customers who had been overcharged.

Deciding before the enactment of the sentencing guidelines, the judge in the criminal case imposed a fine of \$6.85 million, roughly half the pecuniary loss suffered by Acme's customers. Under the sentencing guidelines, however, the results could have been dramatically different. Acme could have been fined anywhere from 5% to 200% the loss suffered by customers, depending on whether or not it had an effective program to prevent and detect violations of law and on whether or not it reported the crime, cooperated with authorities, and accepted responsibility for the unlawful conduct. If a high ranking official at Acme were found to have been involved, the maximum fine could have been as large as \$54,800,000 or four times the loss to Acme customers. The following chart shows a possible range of fines for each situation:

What Fine Can Acme Expect?		
	Maximum	Minimum
Program, reporting, cooperation, responsibility	\$2,740,000	\$685,000
Program only	10,960,000	5,480,000
No program, no reporting no cooperation, no responsibility	27,400,000	13,700,000
No program, no reporting no cooperation, no responsibility, involvement of high-level personnel	54,800,000	27,400,000

Based on Case No.: 88-266, United States Sentencing Commission, Supplementary Report on Sentencing Guidelines for Organizations.

appropriately when offenses are detected; and, finally, take reasonable steps to prevent the occurrence of similar offenses in the future.

There is no question of the necessity of a sound, well-articulated strategy for legal compliance in an organization. After all, employees can be frustrated and frightened by the complexity of today's legal environment. And even managers who claim to use the law as a guide to ethical behavior often lack more than a rudimentary understanding of complex legal issues.

Managers would be mistaken, however, to regard legal compliance as an adequate means for addressing the full range of ethical issues that arise every day. "If it's legal, it's ethical," is a frequently heard slogan. But conduct that is lawful may be highly problematic from an ethical point of view. Consider the sale in some countries of hazardous products without appropriate warnings or the purchase of goods from suppliers who operate inhumane sweat-shops in developing countries. Companies engaged in international business often discover that conduct that infringes on recognized standards of human rights and decency is legally permissible in some jurisdictions.

Legal clearance does not certify the absence of ethical problems in the United States either, as a 1991 case at Salomon Brothers illustrates. Four top-level executives failed to take appropriate action when learning of unlawful activities on the government trading desk. Company lawyers found no law obligating the executives to disclose the

What Fine Can Acme Expect? Based on Case No.: 88-266, United States Sentencing Commission, Supplementary Report on Sentencing Guidelines for Organizations.

improprieties. Nevertheless, the executives' delay in disclosing and failure to reveal their prior knowledge prompted a serious crisis of confidence among employees, creditors, shareholders, and customers. The executives were forced to resign, having lost the moral authority to lead. Their ethical lapse

compounded the trading desk's legal offenses, and the company ended up suffering losses—including legal costs, increased funding costs, and lost business—estimated at nearly \$1 billion.

A compliance approach to ethics also overemphasizes the threat of detection and punishment in order to channel behavior in lawful directions. The underlying model for this approach is deterrence theory, which envisions people as rational maximizers of self-interest, responsive to the personal costs and benefits of their choices, yet indifferent to the moral legitimacy of those choices. But a recent study reported in *Why People Obey the Law* by Tom R. Tyler shows that obedience to the law is strongly influenced by a belief in its legitimacy and its moral correctness. People generally feel that they have a strong obligation to obey the law. Education about the legal standards and a supportive environment may be all that's required to insure compliance.

Discipline is, of course, a necessary part of any ethical system. Justified penalties for the infringement of legitimate norms are fair and appropriate. Some people do need the threat of sanctions. However, an overemphasis on potential sanctions can be superfluous and even counterproductive. Employees may rebel against programs that stress penalties, particularly if they are designed and imposed without employee involvement or if the standards are vague or unrealistic. Management may talk of mutual trust when unveiling a compliance plan, but employees often receive the message as a warning from on high. Indeed, the more skeptical among them may view compliance programs as nothing more than liability insurance for senior management. This is not an unreasonable conclusion, considering that compliance programs rarely address the root causes of misconduct.

Management may talk of mutual trust when unveiling a compliance plan, but employees often see a warning from on high.

Even in the best cases, legal compliance is unlikely to unleash much moral imagination or commitment. The law does not generally seek to inspire human excellence or distinction. It is no guide for exemplary behavior—or even good practice. Those managers who define ethics as legal compliance are implicitly endorsing a code of moral mediocrity for their organizations. As Richard Breeden, former chairman of the Securities and Exchange Commission, noted, “It is not an adequate ethical standard to aspire to get through the day without being indicted.”

Integrity as a Governing Ethic

A strategy based on integrity holds organizations to a more robust standard. While compliance is rooted in avoiding legal sanctions, organizational integrity is based on the concept of self-governance in accordance with a set of guiding principles. From the perspective of integrity, the task of ethics management is to define and give life to an organization’s guiding values, to create an environment that supports ethically sound behavior, and to instill a sense of shared accountability among employees. The need to obey the law is viewed as a positive aspect of organizational life, rather than an unwelcome constraint imposed by external authorities.

An integrity strategy is characterized by a conception of ethics as a driving force of an enterprise. Ethical values shape the search for opportunities, the design of organizational systems, and the decision-making process used by individuals and groups. They provide a common frame of reference and serve as a unifying force across different functions, lines of business, and employee groups. Organizational ethics helps define what a company is and what it stands for.

Many integrity initiatives have structural features common to compliance-based initiatives: a code of conduct, training in relevant areas of law, mechanisms for reporting and investigating potential misconduct, and audits and controls to insure that laws and company standards are being met. In addition, if suitably designed, an integrity-based initiative can establish a foundation for seeking the legal benefits that are available under the sentencing guidelines should criminal wrongdoing occur. (See the insert “The Hallmarks of an Effective Integrity Strategy.”)

The Hallmarks of an Effective Integrity Strategy

There is no one right integrity strategy. Factors such as management personality, company history, culture, lines of business, and industry regulations must be taken into

But an integrity strategy is broader, deeper, and more demanding than a legal compliance initiative. Broader in that it seeks to enable responsible conduct. Deeper in that it cuts to the ethos and operating systems of the organization and its members, their guiding values and patterns of

account when shaping an appropriate set of values and designing an implementation program. Still, several features are common to efforts that have achieved some success:

- *The guiding values and commitments make sense and are clearly communicated.* They reflect important organizational obligations and widely shared aspirations that appeal to the organization's members. Employees at all levels take them seriously, feel comfortable discussing them, and have a concrete understanding of their practical importance. This does not signal the absence of ambiguity and conflict but a willingness to seek solutions compatible with the framework of values.
- *Company leaders are personally committed, credible, and willing to take action on the values they espouse.* They are not mere mouthpieces. They are willing to scrutinize their own decisions. Consistency on the part of leadership is key. Waffling on values will lead to employee cynicism and a rejection of the program. At the same time, managers must assume responsibility for making tough calls when ethical obligations conflict.
- *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.*

thought and action. And more demanding in that it requires an active effort to define the responsibilities and aspirations that constitute an organization's ethical compass. Above all, organizational ethics is seen as the work of management. Corporate counsel may play a role in the design and implementation of integrity strategies, but managers at all levels and across all functions are involved in the process. (See the chart, "Strategies for Ethics Management.")

Information systems, for example, are designed to provide timely and accurate information. Reporting relationships are structured to build in checks and balances to promote objective judgment. Performance appraisal is sensitive to means as well as ends.

- *Managers throughout the company have the decision-making skills, knowledge, and competencies needed to make ethically sound decisions on a day-to-day basis.* Ethical thinking and awareness must be part of every managers' mental equipment. Ethics education is usually part of the process.

Success in creating a climate for responsible and ethically sound behavior requires continuing effort and a considerable investment of time and resources. A glossy code of conduct, a high-ranking ethics officer, a training program, an annual ethics audit—these trappings of an ethics program do not necessarily add up to a responsible, law-abiding organization whose espoused values match its actions. A formal ethics program can serve as a catalyst and a support system, but organizational integrity depends on the integration of the company's values into its driving systems.

Strategies for Ethics Management

Characteristics of Compliance Strategy

Ethos	conformity with externally imposed standards
Objective	prevent criminal misconduct
Leadership	lawyer driven
Methods	education, reduced discretion, auditing and controls, penalties
Behavioral Assumptions	autonomous beings guided by material self-interest

Characteristics of Integrity Strategy

Ethos	self-governance according to chosen standards
Objective	enable responsible conduct
Leadership	management driven with aid of lawyers, HR, others
Methods	education, leadership, accountability, organizational systems and decision processes, auditing and controls, penalties
Behavioral Assumptions	social beings guided by material self-interest, values, ideals, peers

Implementation of Compliance Strategy

Standards	criminal and regulatory law
Staffing	lawyers
Activities	develop compliance standards train and communicate handle reports of misconduct conduct investigations oversee compliance audits enforce standards
Education	compliance standards and system

Implementation of Integrity Strategy

Standards	company values and aspirations social obligations, including law
Staffing	executives and managers with lawyers, others
Activities	lead development of company values and standards train and communicate integrate into company systems provide guidance and consultation assess values performance identify and resolve problems oversee compliance activities
Education	decision making and values compliance standards and system

Strategies for Ethics Management

During the past decade, a number of companies have undertaken integrity initiatives. They vary according to the ethical values focused on and the implementation approaches used. Some companies focus on the core values of integrity that reflect basic social obligations, such as respect for the rights of others, honesty, fair dealing, and obedience to the law. Other companies emphasize aspirations—values that are ethically desirable but not necessarily morally obligatory—such as good service to customers, a commitment to diversity, and involvement in the community.

When it comes to implementation, some companies begin with behavior. Following Aristotle's view that one becomes courageous by acting as a courageous person, such companies develop codes of conduct specifying appropriate behavior, along with a system of incentives, audits, and controls. Other companies focus less on specific actions and more on developing attitudes, decision-making processes, and ways of thinking that reflect their values. The assumption is that personal commitment and appropriate decision processes will lead to right action.

Martin Marietta, NovaCare, and Wetherill Associates have implemented and lived with quite different integrity strategies. In each case, management has found that the initiative has made important and often unexpected contributions to competitiveness, work environment, and key relationships on which the company depends.

Martin Marietta: Emphasizing Core Values

Martin Marietta Corporation, the U.S. aerospace and defense contractor, opted for an integrity-based ethics program in 1985. At the time, the defense industry was under attack for fraud and mismanagement, and Martin Marietta was under investigation for improper travel billings. Managers knew they needed a better form of self-governance but were skeptical that an ethics program could influence behavior. “Back then people asked, ‘Do you really need an ethics program to be ethical?’” recalls current President Thomas Young. “Ethics was something personal. Either you had it, or you didn’t.”

The corporate general counsel played a pivotal role in promoting the program, and legal compliance was a critical objective. But it was conceived of and implemented from the start as a company-wide management initiative aimed at creating and maintaining a “do-it-right” climate. In its original conception, the program emphasized core values, such as honesty and fair play. Over time, it expanded to encompass quality and environmental responsibility as well.

Today the initiative consists of a code of conduct, an ethics training program, and procedures for reporting and investigating ethical concerns within the company. It also includes a system for disclosing violations of federal procurement law to the government. A corporate ethics office manages the program, and ethics representatives are stationed at major facilities. An ethics steering committee, made up of Martin Marietta’s president, senior executives, and two rotating members selected from field operations, oversees the ethics office. The audit and ethics committee of the board of directors oversees the steering committee.

The ethics office is responsible for responding to questions and concerns from the company’s employees. Its network of representatives serves as a sounding board, a source of guidance, and a channel for raising a range of issues, from allegations of wrongdoing to complaints about poor management, unfair supervision, and company policies and practices. Martin Marietta’s ethics network, which accepts anonymous complaints, logged over 9,000 calls in 1991, when the company had about 60,000 employees. In 1992, it investigated 684 cases. The ethics office also works closely with the human resources, legal, audit, communications, and security functions to respond to employee concerns.

Shortly after establishing the program, the company began its first round of ethics training for the entire workforce, starting with the CEO and senior executives. Now in its third round, training for senior executives focuses on decision making, the challenges of balancing multiple responsibilities, and compliance with laws and regulations critical to the company. The incentive compensation plan for executives makes responsibility for promoting ethical conduct an explicit requirement for reward eligibility and requires that business and personal goals be achieved in accordance with the company's policy on ethics. Ethical conduct and support for the ethics program are also criteria in regular performance reviews.

Martin Marietta's ethics training program teaches senior executives how to balance responsibilities.

Today top-level managers say the ethics program has helped the company avoid serious problems and become more responsive to its more than 90,000 employees. The ethics network, which tracks the number and types of cases and complaints, has served as an early warning system for poor management, quality and safety defects, racial and gender discrimination, environmental concerns, inaccurate and false records, and personnel grievances regarding salaries, promotions, and layoffs. By providing an alternative channel for raising such concerns, Martin Marietta is able to take corrective action more quickly and with a lot less pain. In many cases, potentially embarrassing problems have been identified and dealt with before becoming a management crisis, a lawsuit, or a criminal investigation. Among employees who brought complaints in 1993, 75% were satisfied with the results.

Company executives are also convinced that the program has helped reduce the incidence of misconduct. When allegations of misconduct do surface, the company says it deals with them more openly. On several occasions, for instance, Martin Marietta has voluntarily disclosed and made restitution to the government for misconduct involving potential violations of federal procurement laws. In addition, when an employee alleged that the company had retaliated against him for voicing safety concerns about his plant on CBS news, top management commissioned an investigation by an outside law firm. Although failing to support the allegations, the investigation found that employees at the plant feared retaliation when raising health, safety, or environmental complaints. The company redoubled its efforts to identify and discipline those employees taking retaliatory action and stressed the desirability of an open work environment in its ethics training and company communications.

Although the ethics program helps Martin Marietta avoid certain types of litigation, it has occasionally led to other kinds of legal action. In a few cases, employees dismissed for violating the code of ethics sued Martin Marietta, arguing that the company had violated its own code by imposing unfair and excessive discipline.

Still, the company believes that its attention to ethics has been worth it. The ethics program has led to better relationships with the government, as well as to new business opportunities. Along with prices and technology, Martin Marietta's record of integrity, quality, and reliability of estimates plays a role in the awarding of defense contracts, which account for some 75% of the company's revenues. Executives believe that the reputation they've earned through their ethics program has helped them build trust with government auditors, as well. By opening up communications, the company has reduced the time spent on redundant audits.

The program has also helped change employees' perceptions and priorities. Some managers compare their new ways of thinking about ethics to the way they understand quality. They consider more carefully how situations will be perceived by others, the possible long-term consequences of short-term thinking, and the need for continuous improvement. CEO Norman Augustine notes, "Ten years ago, people would have said that there were no ethical issues in business. Today employees think their number-one objective is to be thought of as decent people doing quality work."

NovaCare: Building Shared Aspirations

NovaCare Inc., one of the largest providers of rehabilitation services to nursing homes and hospitals in the United States, has oriented its ethics effort toward building a common core of shared aspirations. But in 1988, when the company was called InSpeech, the only sentiment shared was mutual mistrust.

Senior executives built the company from a series of aggressive acquisitions over a brief period of time to take advantage of the expanding market for therapeutic services. However, in 1988, the viability of the company was in question. Turnover among its frontline employees—the clinicians and therapists who care for patients in nursing homes and hospitals—escalated to 57% per year. The company's inability to retain therapists caused customers to defect and the stock price to languish in an extended slump.

After months of soul-searching, InSpeech executives realized that the turnover rate was a symptom of a more basic problem: the lack of a common set of values and aspirations. There was, as one executive put it, a "huge disconnect" between the values of the therapists and clinicians and those of the managers who ran the company. The therapists and clinicians evaluated the company's success in terms of its delivery of

high-quality health care. InSpeech management, led by executives with financial services and venture capital backgrounds, measured the company's worth exclusively in terms of financial success. Management's single-minded emphasis on increasing hours of reimbursable care turned clinicians off. They took management's performance orientation for indifference to patient care and left the company in droves.

At NovaCare, clinicians took management's performance orientation for indifference to patient care and left the company in droves.

CEO John Foster recognized the need for a common frame of reference and a common language to unify the diverse groups. So he brought in consultants to conduct interviews and focus groups with the company's health care professionals, managers, and customers. Based on the results, an employee task force drafted a proposed vision statement for the company, and another 250 employees suggested revisions. Then Foster and several senior managers developed a succinct statement of the company's guiding purpose and fundamental beliefs that could be used as a framework for making decisions and setting goals, policies, and practices.

Unlike a code of conduct, which articulates specific behavioral standards, the statement of vision, purposes, and beliefs lays out in very simple terms the company's central purpose and core values. The purpose—meeting the rehabilitation needs of patients through clinical leadership—is supported by four key beliefs: respect for the individual, service to the customer, pursuit of excellence, and commitment to personal integrity. Each value is discussed with examples of how it is manifested in the day-to-day activities and policies of the company, such as how to measure the quality of care.

To support the newly defined values, the company changed its name to NovaCare and introduced a number of structural and operational changes. Field managers and clinicians were given greater decision-making authority; clinicians were provided with additional resources to assist in the delivery of effective therapy; and a new management structure integrated the various therapies offered by the company. The hiring of new corporate personnel with health care backgrounds reinforced the company's new clinical focus.

At NovaCare, executives defined organizational values and introduced structural changes to support those values.

The introduction of the vision, purpose, and beliefs met with varied reactions from employees, ranging from cool skepticism to open enthusiasm. One employee remembered thinking the talk about values “much ado about nothing.” Another recalled, “It was really wonderful. It gave us a goal that everyone aspired to, no matter what their place in the company.” At first, some were baffled about how the vision, purpose, and beliefs were to be used. But, over time, managers became more adept at explaining and using them as a guide. When a customer tried to hire away a valued employee, for example, managers considered raiding the customer’s company for employees. After reviewing the beliefs, the managers abandoned the idea.

NovaCare managers acknowledge and company surveys indicate that there is plenty of room for improvement. While the values are used as a firm reference point for decision making and evaluation in some areas of the company, they are still viewed with reservation in others. Some managers do not “walk the talk,” employees complain. And recently acquired companies have yet to be fully integrated into the program. Nevertheless, many NovaCare employees say the values initiative played a critical role in the company’s 1990 turnaround.

The values reorientation also helped the company deal with its most serious problem: turnover among health care providers. In 1990, the turnover rate stood at 32%, still above target but a significant improvement over the 1988 rate of 57%. By 1993, turnover had dropped to 27%. Moreover, recruiting new clinicians became easier. Barely able to hire 25 new clinicians each month in 1988, the company added 776 in 1990 and 2,546 in 1993. Indeed, one employee who left during the 1988 turmoil said that her decision to return in 1990 hinged on the company’s adoption of the vision, purpose, and beliefs.

Wetherill Associates: Defining Right Action

Wetherill Associates, Inc.—a small, privately held supplier of electrical parts to the automotive market—has neither a conventional code of conduct nor a statement of values. Instead, WAI has a *Quality Assurance Manual*—a combination of philosophy text, conduct guide, technical manual, and company profile—that describes the company’s commitment to honesty and its guiding principle of right action.

WAI doesn't have a corporate ethics officer who reports to top management, because at WAI, the company's corporate ethics officer is top management. Marie Bothe, WAI's chief executive officer, sees her main function as keeping the 350-employee company on the path of right action and looking for opportunities to help the community. She delegates the "technical" aspects of the business—marketing, finance, personnel, operations—to other members of the organization.

Right action, the basis for all of WAI's decisions, is a well-developed approach that challenges most conventional management thinking. The company explicitly rejects the usual conceptual boundaries that separate morality and self-interest. Instead, they define right behavior as logically, expediently, and morally right. Managers teach employees to look at the needs of the customers, suppliers, and the community—in addition to those of the company and its employees—when making decisions.

WAI also has a unique approach to competition. One employee explains, "We are not 'in competition' with anybody. We just do what we have to do to serve the customer." Indeed, when occasionally unable to fill orders, WAI salespeople refer customers to competitors. Artificial incentives, such as sales contests, are never used to spur individual performance. Nor are sales results used in determining compensation. Instead, the focus is on teamwork and customer service. Managers tell all new recruits that absolute honesty, mutual courtesy, and respect are standard operating procedure.

Newcomers generally react positively to company philosophy, but not all are prepared for such a radical departure from the practices they have known elsewhere. Recalling her initial interview, one recruit described her response to being told that lying was not allowed, "What do you mean? No lying? I'm a buyer. I lie for a living!" Today she is persuaded that the policy makes sound business sense. WAI is known for informing suppliers of overshipments as well as undershipments and for scrupulous honesty in the sale of parts, even when deception cannot be readily detected.

Since its entry into the distribution business 13 years ago, WAI has seen its revenues climb steadily from just under \$1 million to nearly \$98 million in 1993, and this in an industry with little growth. Once seen as an upstart beset by naysayers and industry skeptics, WAI is now credited with entering and professionalizing an industry in which kickbacks, bribes, and "gratuities" were commonplace. Employees—equal numbers of men and women ranging in age from 17 to 92—praise the work environment as both productive and supportive.

WAI's approach could be difficult to introduce in a larger, more traditional organization. WAI is a small company founded by 34 people who shared a belief in right action; its ethical values were naturally built into the organization from the start. Those values are so deeply ingrained in the company's culture and operating systems that they have been largely self-sustaining. Still, the company has developed its own training program and takes special care to hire people willing to support right action. Ethics and job skills are considered equally important in determining an individual's competence and suitability for employment. For WAI, the challenge will be to sustain its vision as the company grows and taps into markets overseas.

Creating an organization that encourages exemplary conduct may be the best way to prevent damaging misconduct.

At WAI, as at Martin Marietta and NovaCare, a management-led commitment to ethical values has contributed to competitiveness, positive work-force morale, as well as solid sustainable relationships with the company's key constituencies. In the end, creating a climate that encourages exemplary conduct may be the best way to discourage damaging misconduct. Only in such an environment do rogues really act alone.

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This article is about REGULATION

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