Global Agenda | Leadership

Ethical systems design: what smart leaders are using to improve their organizations (and the world)

03 Jan 2017

Azish Filabi
CEO, Ethical Systems

Jonathan Haidt
Professor of Ethical Leadership, Stern School of
Business, New York University

In 2016, many developed nations faced the same two demons that have tormented them since the 2008 financial crisis: slow and disappointing growth, combined with rising income inequality. Some of these nations are also experiencing populist discontent or rebellion. While the causes of populist movements are varied and cannot be understood by economics alone, it's clear that faster and more equal growth would have reduced some of the anger.

Politicians and central bankers struggle against these two demons, but a powerful and under-utilized tool to fight them may already be in the hands of business leaders: ethical systems design.

If the business community in any country can find ways to make substantial and systemic improvements in the ethical behaviour of corporations, there are good reasons to expect that growth would increase, and that income inequality would decrease.

If this is indeed the case – and we'll outline why we think that's so – the next question this throws up is: can we make leadership more ethical? Yes we can, and we'll explain how.

What is ethical systems design?

All businesses are complex organizational systems that are nested within larger systems, such as national cultures and legal and regulatory systems, and composed of individuals who bring their own values and perspectives to work.

This interplay of personal, organizational and regulatory systems creates a dynamic environment that must be actively managed by leaders to promote the company's long-term success. Ethical failure at any level can bring catastrophe, but achieving good ethics at all levels yields enormous benefits in trust, efficiency and happiness. Bringing an ethical systems lens means simultaneously considering three levels of analysis:

1. Personal

How can you encourage ethical conduct among your employees? Nudging is one proven tactic, which considers the behavioural tendencies of employees and how the environment and their interactions can sway decision-making towards more ethical outcomes.

2. Organizational

At the company level, what are the values that emerge as individuals and groups interact? Leaders can maintain a focus on ethics to instill a culture centred on doing the right thing as a way of doing business. Hiring for ethics, in addition to skills, is one immediate way to make such an improvement.

3. Regulatory/Governmental

If you can get the regulatory system at the highest level to reward the development of ethical cultures at the organizational level – and if those cultures encourage ethical behaviour by individuals at the lower level – then you have full alignment.

Alignment of the three levels is one of the most important features of an ethical system.

Why would ethical systems design improve growth?

Designing companies to be more ethical pays off in three important ways:

1. A good reputation is more valuable

Research shows that companies with a good reputation have lower costs of doing business, they more easily attract investors, and they can charge higher prices than those that are less reputable.

2. Illegal conduct can be extremely costly

Scandals and misconduct cause a direct financial hit to companies' stock prices. One study found that on average firms lose 41% of their market value when news of

misconduct is publicly reported. This is in addition to direct financial penalties and legal costs incurred in connection with illegal conduct.

3. Good and ethical governance is financially rewarding

[Ethical leadership correlates with better employee performance](#). Such leaders model ethical behaviour and standards that attract high-value employees who know that they will be heard and taken care of, resulting in team members who are more satisfied with their job, more committed, and less likely to say they plan to leave the organization.

There's also growing evidence that [running a more ethical company pays off financially](#), including indices that demonstrate that over time ethical companies beat the MSCI and S&P 500 index (see a talk by [Jonathan Haidt at the 2016 Aspen Ideas Festival](#) as well as [Ethisphere's World's Most Ethical Companies](#) list, and [the Good Company Index](#)).

Why would ethical systems design improve income equality?

There are two general ways you can think about the responsibility of executives. Some think that they have a fiduciary duty to maximize shareholder returns. According to this view, it is the duty of executives to keep wages low and shareholder returns high – a recipe for rising inequality and brewing resentment against corporations and capitalism.

But most business leaders take a stakeholder view, to some extent. They know that they must manage many kinds of relationships, for the long run, and they are more motivated to invest in their employees rather than squeeze them to the bone.

In fact, research by Zeynep Ton in [the Good Jobs Strategy](#) shows that investing in employees can actually lead to reduced overall business costs and higher profits – a result that may be counterintuitive to those who take the "shareholder primacy" view.

Ton's case studies of iconic companies such as Costco and Trader Joe's show how decisions to invest in staff – through higher wages, but also by using management strategies that help create meaning and dignity in work – simultaneously created benefits for many stakeholders, including investors and customers.

When large numbers of businesses take a stakeholder view and stop focusing solely on short-term gains, businesses can act in ways that generate more value, and less inequality, on average. The result is a business-led solution without the need for government intervention or new regulations.

How can companies incorporate ethical systems design into their businesses?

Leadership is an essential ingredient in designing ethical systems, and anyone can learn how to become an ethical leader. As Ethical Systems Collaborator David Mayer outlined in *Fast Company,* leaders need to be not only good people but also moral managers. They need to bring their personal values to work and also demonstrate that fairness, integrity and mutual trust are of prime importance in their management style.

To facilitate ethical leadership, executives should also strive to make their company a learning organization. Such organizations view failure as an opportunity for education, and they develop cultures that support employees who speak up about ethical and operational challenges. Too often we see executives dismiss ethical failures as the fault of a few bad apples, rather than treating them as opportunities to look for a bad barrel – that is, a close examination of the systemic causes and consequences that contributed to those behaviours.

One way to address this gap is to annually measure a company's ethical culture. Culture measurement is essential for leaders wishing to gain control over complex organizations; one must search for ethical problems lurking in the shadows. Measuring culture also helps those at the helm of an organization clarify the objectives and effectiveness of the company's ethics & compliance programmes, reduce misbehaviour, and improve employee retention.

Ethical systems design brings benefits to companies, employees and shareholders. In the process, ethical companies may just help their countries fight the twin demons of slow growth and rising inequality.

Find out more about ethical systems design here: *http://ethicalsystems.org/*

Written by

Azish Filabi, CEO, Ethical Systems

Jonathan Haidt, Professor of Ethical Leadership, Stern School of Business, New York University