FUNDHOUSE

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Enron, KPMG…what can we learn about making ethical choices? (Part Three)

In Part One of this article, we looked at Dan Ariely's work on how we all have the potential to act unethically, no matter how ethical we may think we are. The two key forces that impact on our ability to act ethically are firstly the extent to which we can (or can't) look at ourselves in the mirror, and this depends on what Ariely refers to as our personal “fudge factor”; and secondly the social context in which we operate. This presents two challenges for business owners. Firstly, how do you get individuals to shrink their personal “fudge factor” in the workplace? We considered this question in Part Two. Now in this third and final part of the article, we consider the second challenge, namely, how do you create a social context at work where people see ethical behaviour as the "norm"?

Ron Carucci, in an article published in the Harvard Business Review, outlines five ways that organizations can actually provoke good people to make unethical choices.

1) It is psychologically unsafe to speak up.

This factor talks to the culture of the business. As Carucci puts it, “Creating a culture in which people freely speak up is vital to ensuring people don’t collude with, or incite, misconduct”. It is no coincidence that the first outcome of TCF is that Customers have the comfort that they are dealing with an organization where Treating Customers Fairly is central to the culture of the organization.

Often businesses will say that they operate on an “open door” policy, and encourage their staff and employees to speak up. But a very real pattern in ethical disasters is that whistle-blowers are in fact victimized and attacked. This has been the case in the Enron scandal and recently in the Eskom-related case of Trillian where the whistle blower was left out in the cold.

According to Elizabeth Morrison from the Stern School of Business at New York University, employee silence is a real problem. In a presentation entitled “Beyond Carrots and Sticks: Encouraging a Speak Up Culture“ she says: “You have to confront the two fundamental challenges preventing employees from speaking up. The first is the natural feeling of futility – feeling like speaking up isn’t worth the effort or that no one wants to hear it. The second is the natural fear that speaking up will lead to retribution or harsh reactions.” And in the article, “Employee Voice and Silence,” she warns that: “If voice is withheld within an organizational context, both performance and employee morale may suffer, so the consequences may be significant. In addition, there is evidence suggesting that voice is in fact stifled in many organizations and that employees are often very hesitant to engage in voice, particularly when the information could be viewed by the recipient as negative or threatening." (Morrison defines "voice" in the workplace as informal communication from an employee to someone higher up in the organizational hierarchy.)

Probably the key aspect of trying to facilitate "speaking up" against ethical misconduct is the reaction of the leadership and the behaviour of an owner or manager when an employee raises a concern. Whilst big organizations can facilitate anonymous whistle-blowing, this is far more challenging in small businesses. As the leader of your business, if you want to test how ethical your culture is, consider how open you are to hearing feedback or comments that either are not positive, or that you don't agree with. Does your "open" door policy translate into an "open mouth" policy?

2) There is excessive pressure to reach unrealistic performance targets

The most recent example of this factor at play is the Wells Fargo scandal, which played out in the US last year. In this instance employees who were arguably ethical people, felt the pressure to open new client accounts without the clients' permission. The rationale for this was that the key performance measure was new accounts, and meeting specific new account targets determined whether an employee would get a bonus or not.

Carucci points out "Once people sense the risk of failure, they go into "loss prevention" mode, fearing the loss of job, status, or at-risk incentives". He shares the story how in the US the Veterans Administration tried to reduce a 115-day waiting time at a hospital in Phoenix by setting the goal of a 14-day wait. This shift supposedly resulted in a 24-day waiting period but in fact employees were simply manipulating performance records to give the appearance of meeting these goals. In reality, some veterans had a waiting period of more than a year, and up to 40 veterans died as a result of the actual, rather than reported, waiting period.

In financial planning businesses, there is a significant ethical risk where performance targets are set with respect to revenue generated. If a financial planner is under pressure to generate a certain amount of revenue every month or quarter, whether in the form of fees or commission, there is a risk that the planner will make decisions that benefit the revenue of the business, rather than necessarily being in the best interests of the client.

3) Conflicting goals provoke a sense of unfairness

Maureen Ambrose, Mark Seabright and Marshall Schminke have conducted research on organizational injustice, and they have found that there is a direct correlation between an employee's sense of fairness and their conscious choice to sabotage the organization. Ron Carucci relates the story of a business that decided to invest in increased production capacity, but reduced marketing spend and effectively raised sales targets. Once again the result was an attempt to manipulate results.

In a financial planning business, there may be conflicting goals for financial planners who are required to provided uncompromised ongoing service to existing clients but expected to grow a book of new clients without any additional resources. Corners are likely to be cut somewhere, and ultimately the client could suffer.

4) Ethical behaviour is not part of routine conversation

Very often ethical behaviour in a business is only discussed in an annual risk and compliance review meeting. Carucci describes this as the annual "ethics flu shot" and the assumption is that all is good till the next annual review. But he argues that leaders have to "infuse everyday activities with ethical considerations and design policies and norms that keep ethics top of mind." Jonathan Haidt, Professor of Business Ethics at NYU suggests "It's important to talk about the positive examples of ethical behaviour, not just the bad ones. Focusing on the positive reasons you are in business, and reinforcing the good things people do strengthens ethical choices as 'the norm' of the organization."

On the Adviser Programmes that Fundhouse runs, we encourage businesses to consider the Simon Sinek-inspired question of "Why" they are in business. And ideally the answer to this question is not simply "to make money". Making money is simply a function of how well or badly a business is doing. But the "Why" of the business will clarify its purpose, and in financial planning, hopefully the answer to this question will focus on benefitting the financial life of a client. Keeping the "Wwhy" top of mind will inevitably mean that ethical treatment of clients will become part of routine conversation.

Another way to make ethical behaviour part of routine conversation is to have regular reviews of the extent to which the business and individuals are adhering to the 8 principles of the Financial Planner's Code of Conduct, as well as meeting the 6 outcomes of TCF. Having these two frameworks as part of regular individual and business reviews will also help ethics become part of routine conversation.

5) A positive example isn't being set

In the same way that the culture of an organization is driven from the top, so too are the ethics of an organization. For business owners or leaders, ideally it would be a non-negotiable that the leadership displays ethical behaviour.

Carucci argues that leaders must accept that they will be judged according to higher standards than others, and in this regard they "must be extra vigilant about not just their intentions, but how it is others might interpret their behaviour. He stresses that the challenge for leaders is to make careful choices in a range of situations, whether it be how they react to stressful situations, confront poor performance, how they deal with controversy or respond to bad news. "Leaders must put themselves in the shoes of those they lead to see what unintended messages they may be sending."

In a financial planning business, the "busyness" of a leader's life, could lead, for example, to unintended short-cuts of process to save time or delays in responses to clients. These unintended lapses could send messages to other staff and planners about the fair treatment of clients, or that such short-cuts are simply the way things are done.

Ongoing effort is the key

Just as for individuals ethical behaviour is an ongoing work in progress, so too for organisations. As Carucci puts it: "Organisations who don't want to find themselves on a front-page scandal must scrutinize their actions to far greater degrees than they may have realized. In an age of corporate mistrust, creating ethical workplaces takes more than compliance programmes. It requires ongoing intensified effort to make the highest ethical standards the norm, and ruthless intolerance of anything less."

Whilst I'm sure most financial planning businesses believe that the social context in which they operate is conducive to ethical behaviour, I don't think there would be any harm in doing a regular check of Carucci's five points outlined in this article to ensure that you are not at risk of provoking any unethical behaviour from people in your business.

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