The Challenge of Ethical Leadership

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THE CHALLENGE OF ETHICAL LEADERSHIP

The challenge of ethical leadership has become a ubiquitous issue for executives and academics in a variety of fields. Within the recent past, we have read or seen disappointing reports of Olympic judging caught up in controversy. Award-winning journalists have been fired for fabricating sources and stories. Political leaders have been brought before the bar of justice or tried by the court of public opinion. Church leaders have been discovered covering up crimes committed by their subordinates. And of course, corporate America and Wall Street are feeling the sting of accusations that go to the heart of investor trust.

This article explores what some key business and academic leaders are saying and doing to address public concerns about various strategies and approaches for developing ethical leadership skills. Ethics, values, leadership, and trust are timely issues of immense importance to executives attempting to recover from a substantial downturn in the national and global economies. After a brief review of the context, I will introduce several leaders from the ranks of senior executives and academic and human resource development specialists who will describe largely in their own words their perspectives on and approaches to mediating the epidemic of unethical behavior in corporations. Individually, these leaders’ comments are insightful and pragmatic. Collectively, these observations form the basics of a systemic approach to the challenges of ethical leadership and suggest some responses that offer potential for raising the level of ethical behavior in organizations.

In the aftermath of numerous scandals involving major corporations across the country, Pepperdine University’s Graziadio School of Business and Management convened an Executive Learning Forum with more than 80 local and national business leaders, experts, and graduate students attending and discussing various strategies and approaches for developing ethical leadership skills.

Linda Livingston, dean of the Graziadio School, asserted in her opening remarks, “Ethics, values, leadership and trust are issues of immense importance to executives attempting to recover from a substantial downturn in the national and global economies. I am pleased and encouraged that we have such a collection of local and national business leaders, who by their participation today are clearly demonstrating their commitment to ethical practices in the conduct of their businesses.”

Everyone is Talking About Ethics

If there is any question that ethics is of widespread concern, a Yahoo search for “business ethics” generated 2,130,000 hits, including at least 16 institutes or centers devoted to discussing this issue. One web-based resource offers 150 comprehensive, interactive course modules covering 1,000 topics. Another describes web-based business ethics training and communications solutions for employees and offers courses covering over 180 ethics and compliance topics. The Ethics
Officers Association is a rapidly growing organization that provides a reference of practices to assist individuals who have been given specific corporate responsibility for coordinating internal ethics programs.

In late 2003, securities regulators announced the final terms of a $1.4 billion Wall Street research settlement, thus ending almost 2 years of investigations into charges that analysts had issued biased research to gain investment banking business.

More and more business schools are moving to add an ethics component to their curriculums. The Chicago Tribune recently highlighted some of the things business schools are doing to help improve the odds that their graduates do not get tangled in scandals such as those at Enron Corp. and WorldCom Inc. An estimated 90 percent of business schools now provide some form of training in business ethics.

Just before the end of 2003, The Boeing Company dismissed two senior executives for “breach of ethics,” four months after the Pentagon punished the company for stealing trade secrets from rival Lockheed Martin Corp. to help win rocket contracts. In a classic case of belatedly locking the barn door, Boeing concurrently announced the appointment of a new unit to monitor ethics.

Is Ethical Behavior Profitable?
Studies in the U.S. and the U.K. have shown that a strong sense of ethics can be profitable. Mounting evidence suggests that a company’s profitability is bolstered by its reputation as an honest, ethical business partner. Firms that routinely practice high business ethics and principles also attract the highest quality recruits and retain employees longer than other firms, according to a study by the Ethics Research Center (ERC) in Washington.

“The financial performance of companies stating a commitment to ethics is better than that of companies that didn’t, based on the annual rankings of large companies published by Business Week,” reports Curtis Verschoor, author of the study “Corporate Performance is Closely Linked to Strong Ethical Commitment.” The report reveals that the excess value a company provides its shareholders over the total amount of their investments increases significantly when an ethics code is clearly stated by a company. The report found that in the 87 companies where an ethics code was clearly stated, the average market value added (MVA) was 2.5 times larger than the average of companies not mentioning a code of ethics or conduct. For the 47 companies expressing an extensive commitment to an ethics code, the MVA was three times that of the other companies not expressing an ethics code.

More recently, the U.K. Institute of Business Ethics (IBE) found similar results from a sample of 350 firms categorized as “ethical” companies. Between 1997 and 2001, the study concluded, “There is strong indicative evidence that large U.K. companies with codes of business ethics/conduct produced an above-average performance when measured against a similar group without codes.”

Many Reasons to be Ethical
The keynote speaker at the Executive Learning Forum, Daniel Burnham, Raytheon Company’s chairman and CEO, put the recent emphasis on ethics in dramatic context. “Business integrity is not an oxymoron; it’s what smart companies insist upon to sustain their cultures—and to guide the individuals they select for leadership positions. I welcome the opportunity to talk about ethics—and so does our leadership team at Raytheon.”

Burnham asserted that it’s important to speak out right now, because violation of ethics is a key issue facing the United States. Burnham pointed out that corporate scandals have been a big contributor to the current climate of investor anger and mistrust. He elaborated, “Corporate revelations are shocking and disturbing. They go to the heart of investor confidence, even though the vast majority of companies behave responsibly. The source of investor frustration runs deep. Since 9/11, unethical behavior is perceived as unpatriotic. This is totally understandable.
When people feel that our country is under attack from terrorists, when fire fighters and police officers are asked to lay their lives on the line, when we send our young men and women in harm’s way abroad, we need to ask ourselves, ‘What are we asking them to fight for? What kind of way of life are we fighting to protect?’ Cast in this light, shady, greedy, unethical behavior seems even more shabby and intolerable.”

“Then there is the whole issue of market history,” Burnham continued. “In the ‘90s, a historic bull market pulled in millions of new investors. From ‘89 to ‘98 – according to the New York Stock Exchange (NYSE), using Federal Reserve Board data – share ownership increased by some 32 million people. From 1995 to 1998 alone, share ownership rose by 15 million people. These investors had never experienced a bear market. Many had developed expectations that the market would rise indefinitely, that annual returns of 20 percent, even 30 percent, were reasonable and sustainable. Now that we’re in a bear market, investors are disappointed; they’re looking for someone to blame.”

Mila Baker, director of worldwide organizational effectiveness at Pfizer Inc., commented on change at Pfizer, adding that “public concern has been heightened because of the behavior in U.S. corporations characterized by blatant abuse. This concern for ‘ethical consciousness’ exists at a time when the concept of leadership legitimacy is being questioned. The increased awareness of ethical issues and ethical dilemmas is a positive outgrowth of abuses in many arenas.”

Baker agreed that there is a legitimate concern over who is responsible for the moral development of the corporation and that public interest around the world is also high. Baker concluded that “CEOs face increased pressures, as corporate social responsibility demands increase without any decline in the emphasis on productivity and profitability. A demand for accountability, justice, and fairness is mounting. While there are clashing communities/cultures related to standards of ethical actions, it is clear, courageous leadership that is required. And there is a challenging role for all of us.”

Blair Sheppard, CEO of Duke Corporate Education – a world leader in customized executive education – echoed the notion that business and ethics are fundamentally tied together. “Today’s corporate leaders face a number of challenges to overcome fundamental erosion in confidence and to demonstrate their commitment to responsible leadership.”

The Search for Balance

As several of the Executive Forum participants suggested, high ethical conduct is no excuse for shoddy products or profits. Conversely, high profitability does not excuse shady conduct. Nancy McGaw, deputy director for a key policy program at the Aspen Institute – the Business and Society Program (Aspen BSP) — described Aspen BSP’s purpose. “At our inception just five years ago, we set ourselves one of those ‘Big Hairy Audacious Goals’ that Jim Collins and Jerry Porras talk about. We wanted to influence business practice in such a way that business executives would be better equipped and more inclined to consider the social and environmental impacts of their business decisions. We wanted these executives to be attentive to such impacts as well as to the economic performance of their enterprises. In other words, our objective was to assure the supply of what we called ‘balanced business leaders.’”

McGaw explained that four years ago, Aspen BSP initiated what has become an ongoing series of small conferences to learn from experts in leadership development programs around the world—in academia, in corporations and in professional service firms. Aspen BSP brought together experts who shared their commitment to developing leaders who are expert at this “daring balancing act” of understanding the complex interdependence between business success and social and environmental progress.
McGaw explained, “Our meetings focused on what it means to be a balanced leader—not just a CEO, mind you, but a leader at any level of the business enterprise. And we’ve considered what the impacts are of balanced leadership within corporations and for executive education. Our findings indicate that there are key essential skills and qualities that balanced leaders possess. Educators told us that balanced leaders are ethical, need to be able to span boundaries and listen to diverse constituencies and be willing to be altered by these interactions. Such leaders are enriched by complexity and diversity, not overwhelmed by it, and their decisions acknowledge and honor the often conflicting values and expectations of diverse constituencies.”

McGaw reported that remarkable consensus about what kinds of leaders the conferees said were needed characterized their discussions at the meetings, but that there was also general agreement that in practice, such leaders are in short supply. McGaw summed up by stating, “Participants at our convenings continue to observe behaviors and attitudes that reflect the absence of these qualities. Instead, they see managers who:

- Are blindsided by public outrage at the corporation’s handling of an environmental or social crisis.
- Emphasize the primacy of shareholder interests and marginalize the interests of other stakeholders.
- Think economic models will ultimately provide every answer.
- Ignore critical constituencies – even within their own companies – when making decisions.
- Consistently place work commitments above other commitments in their lives and expect their colleagues to do the same.”

The Road to Ethical, Balanced Leadership

With unanimous agreement about the need to develop leaders who are balanced between strong ethical sensitivity and the ability to produce results, the Forum participants rose to the challenge of identifying ways in which a spectrum of leaders in business education and practice could be a part of the solution. Because of the different perspectives of the various speakers, the totality of their suggestions offers an overarching systems approach to improving ethical practice in organizations. These suggestions are grouped under the headings of various attitudes and behaviors that are appropriate for CEOs and corporate directors, organizational tools and initiatives, and challenges for business education.

The CEO perspective. As Raytheon’s CEO, Dan Burnham was outspoken and personal in articulating what he viewed as the responsibility of senior executives. “Implementing and sustaining ethics programs is important, but we need to do more. Leaders and leaders-to-be need to focus on the desired end state:

- On the vision for their company.
- On the values and the culture of their company.”

Burnham continued by asserting, “The CEO must be the chief ethics officer of the firm. He or she cannot delegate integrity. We cannot be distracted by resistance in the organization from those who think that the company is already ethical, or that we’re trying to be social engineers. The CEO must make everyone understand that the organization’s future is dependent on its reputation. The organization must to be personal, human, and individual. Every employee must feel empowered and responsible for the reputation of the company, and the leader must demonstrate an interest in uncovering problems and finding solutions.”

Burnham suggested that CEOs should develop an “early warning system” that identifies problems and even potential problems. He further urged, “If unethical behavior is uncovered, it’s important to act swiftly and decisively. My goal is to act on facts, not emotion. Objective tools to achieve and measure results help take the subjectivity out of the equation. The right kind of climate can be developed by asking tough questions and
surrounding yourself with those who will tell it like it is.”

**Setting the tone and benchmarking.** Top management sets an important tone by encouraging open and honest communication so that employees feel empowered to raise issues. Burnham reported that Raytheon and many other leading firms encourage their managers to benchmark the firms they admire—to look beyond the walls and structures of their companies and industries.

He stated, “We [at Raytheon] strive for constancy and try to document how the company handled similar problems in the past. I think we must create an environment of inclusion; that’s good ethics and good business as well. I talk about ethics and integrity routinely and make sure others see these [aspects of business.] You can find at least a couple of speeches on our [Raytheon’s] Web site that deal with ethics and integrity.”

In addition to Burnham’s suggestions of things that a CEO can do to improve the ethical climate of a firm and its reputation, he also responded to the question, “What happens when an organization is being investigated by the SEC—or is accused of wrongdoing by former employees or by the contentious litigation of a class action lawsuit?”

Burnham spoke to the question by stating, “Adversity is the real test of leadership and integrity. Trying times test the commitment to a statement of values. If the CEO and his or her team can stay true to personal values and communicate as openly as possible in the context of legal restrictions, these firms that demonstrate their ethicality when they are being publicly challenged will come through this test with their reputations enhanced rather than destroyed. Ralph Larsen, former chairman and CEO of Johnson & Johnson, said that his company’s famous credo really boiled down to one core thought, ‘personal responsibility.’ This credo has become a part of the DNA of Johnson & Johnson, and adherence to it is a requirement for rising through the ranks at one of America’s most admired corporations.”

**Organizational Tools and Initiatives**

Any organization whose CEO has strong ethical values and commitment has a head start in creating an ethical organization, yet no CEO can review the day-to-day decisions and behavior of each employee. Successful firms must consequently translate the desire for ethicality into concrete institutional policies and practices. For example, Pfizer’s program for organizational effectiveness focuses on four key areas:

- Enhancing organization effectiveness in a global context.
- Developing leaders.
- Building productive, healthy and satisfying environments.
- Improving governance; strategy, structure, process and relationships.

Such proactive elements can together create a system in which ethical leadership can become a core competency and impetus for organizational effectiveness. A best practice study of succession management conducted by the American Productivity and Quality Center found that the exemplars utilized a matrix to assess leaders on both their results and their demonstrated values.

Dan Burnham pointed out the importance of making integrity a part of any assessment system by describing a similar system at Raytheon: “What do we look for in a leadership candidate with respect to integrity? What we’re really looking for when we recruit leaders are people who have developed an inner gyroscope of ethical principles. We look for people for whom ethical thinking is part of what they do—no different from ‘strategic thinking’ or ‘tactical thinking.’ It’s the ongoing process of reasoning about what is proper given a set of values and a mission in a very messy world filled with many complexities.”

Burnham reported what Raytheon’s Leadership Assessment Instrument says under “integrity”: 311
• Maintains unequivocal commitment to honesty, truth and ethics in every facet of behavior.
• Conforms with the letter and intent of company policies while working to effect any necessary policy changes.
• Actions are consistent with words; follows through on commitments; readily admits mistakes.
• Is trusted and inspires others to strive to be trusted.

“We believe this kind of person will get better results,” said Burnham. “We know that such people will help us build a successful future.”

Blair Shepherd of Duke Corporate Education also commented on aspects of developing good organizational tools and initiatives. He asserted, “Firms that know what kinds of developmental needs their people have and are committed to providing those developmental opportunities are obviously ahead of companies that simply assume that the ‘fit will survive’—without asking, ‘fit for what?’ Integrity is probably a more important developmental need than the ability to understand foreign exchange or transfer pricing.”

Pfizer’s Mila Baker spoke of ways that ethical leadership can become a core competency and lever for organizational effectiveness. “First, it is essential to establish ethical leadership as a strategic imperative. Next, care should be taken to develop a ‘Strategic Ethical Leadership Agenda’ with as much specificity as possible. This agenda should describe actions that demonstrate commitment and acceptable conduct as well as identify actions that do not measure up to the values of the firm. While it is impossible to make this a comprehensive list, it is important to define a set of ‘rules of engagement,’” which includes recognition of risk determination and consequences. We have attempted to create a “roadmap to ethical behavior” through the Pfizer Leader Behaviors and Values. We put a spotlight on ethics by incorporating this subject into our leadership and change management initiatives. We try to increase the ethical awareness, skills, and knowledge of all employees while encouraging dialogue and conversation with others around ethical dilemmas. We institutionalize stories on how colleagues deal successfully with issues of integrity. Fundamentally, we want to create an environment that is ethically competent and ethically sensitive. We strive to understand the challenges created by the complexity and scale of our organization and what the implications of these challenges mean for ethical leadership. Perhaps most importantly at Pfizer, every leader is expected to model what he or she is attempting to instill,” Baker concluded.

Corporate Governance

Since the top of the organization sets the tone for leadership throughout the firm, boards of directors should be asked to assume increased responsibility for developing an ethical corporate climate.

In early 2003, Burnham spoke in New England to the National Association of Corporate Directors and urged members of this important group to meet their challenge of representing societal and shareholder interest in high standards of content. At the Pepperdine Executive Learning Forum, Burnham added: “Being a corporate director provides a way of building confidence in a system that has fueled our national success. Leadership integrity carries over to corporate governance as well. Every company, no matter how strong and ethical, needs to take a second look at corporate governance, to take advantage of every opportunity for improvement. We’ve done a close review of our [Raytheon’s] corporate governance. We feel pretty good about the changes we’ve made:
• We have fewer board meetings, but with lots of interaction.
• We try to focus on large questions without ignoring details.
We do frequent reviews of the strategic landscape.

There are no former Raytheon CEOs on the board, and we’ve decided there shouldn’t be except under special circumstances.

A very substantial portion of our board is independent.

We’ve named a lead director.

Before the New York Stock Exchange proposed standards and before legislation [Sarbanes-Oxley], we started digging into the whole area of corporate governance with an eye toward best practices—what we could do better. Since NYSE/Sarbanes-Oxley, we’ve added to and taken an inventory of our practices, and we believe our governance practices are strong and thorough, but we’re going to try to keep getting better.

Moreover, the government has given us tools to reassure investors that we are meeting our fiduciary duties as board members to be active monitors of corporate performance.”

“Oversight, transparency, diligence—they’re all critical to confidence. There is no substitute,” Burnham continued. “Integrity must be felt and lived. But these don’t substitute for a well-run business—for strategies that stretch, for risks that are managed and become rewards, for disciplined and predictable execution. Good governance cannot fix a lousy business. Bad governance can ruin a great business,” Burnham said. “No institution in America is perfect,” he said. “But good institutions are led in the right direction by good people and the right values.”

The Challenge for Education

Since the Executive Learning Forum was hosted by an educational institution and attended both by professors and M.B.A. students, it seemed appropriate to consider what contributions could be made at the level of graduate business education. As Nancy McGaw reviewed the seminars and interviews conducted by Aspen BSP, she concluded:

“It is difficult to generalize, but I think there is one overriding theme from these conversations about leadership development—and it is this: If we want to develop more balanced leaders, we need to shift management education from a focus on mastery to an emphasis on discovery. For too long we have accorded primacy to solving problems with the use of economic and other technical tools.

“I recall a story told at one of our convenings by a woman from the Munich office of a major consulting firm. She had worked on teams in Eastern Europe on privatization initiatives. She recalled running the spread sheets, testing scenarios as she had been trained to do, but all the economic modeling in the world couldn’t get the team to the ‘right’ answer when they considered all the lives that would be impacted by the decisions suggested via this economic modeling process. Making those decisions required judgment of quite a different sort,” McGaw stated.

Many business activities require judgment of a different sort. How does one structure a project’s financing, for example, in a disadvantaged area that needs the jobs and tax revenues that will be generated even though the project is going to disrupt communities and ecosystems? How does one decide how much tax avoidance is enough? The list of such questions is long.

McGaw reported attending a presentation by a business school who was explaining how the school built its M.B.A. curriculum around a core query: “What Does Every MBA Need to Know?”

“While one would certainly not dispute the need to equip M.B.A.s with the technical skills that are required to get their jobs done, we wondered if we shouldn’t also be thinking
about building curriculum around ‘What Every M.B.A. Needs to Ask,’” she said.

**Four Questions for Consideration**

McGaw reported that Aspen BSP recently asked leadership development experts to name some of the questions that typically don’t get asked in M.B.A. curricula or in executive education programs. She offered to share four questions that every program design should consider:

- What is the purpose of our enterprise?
- Is it possible to articulate that purpose in a way that engages the passions of employees?
- How do we measure success?
- What is it that we do as a business when we are at our best that allows us to say that our life has meaning?

McGaw reported, “I was a corporate banker for 18 years. I can tell you that there would have been some startled – and probably some cranky – responses to such questions if they had been raised in open discussions in the bank in which I worked. Had these questions been open for discussion, they would have given many of us a chance to express some of our deeply held convictions about our work—and some of our misgivings as well. And I believe that the exercise – if undertaken as part of the way we did business and trained our upcoming managers – would not have distracted us from the hard work of making revenue targets and deepening our client relationships. Rather, it would have given us a competitive edge,” McGaw concluded.

**A Moment of Opportunity**

The Chinese symbol for change contains symbols for both danger and opportunity. The widespread public concern about ethics in business suggests danger if the voice of the public is not heard, but this concern also contains a positive opportunity for change that can improve the quality of management practice and the quality of life in general.

As Nancy McGaw reflected on four years of work, she observed: “So much has changed since Aspen BSP started our ‘Developing Balanced Leaders’ program in the late 1990s. The international, political, economic and social picture looks far bleaker now. So it is fair to ask vis-a-vis developing balanced leaders, ‘Is this a time of great peril—or one of promise?’”

McGaw continued, “Let me share a finding from a 2003 research report.” This study is a follow up to research we [Aspen BSP] conducted between 1999 and 2001 with M.B.A.s at leading international business schools. We undertook that work to learn about M.B.A. students’ attitudes about the role of business in society and the influence of an M.B.A. education on these attitudes.

“Recently, we went back into the field to survey students’ attitudes in the wake of corporate scandals, terrorist attacks, a severe economic downturn and threats of war,” McGaw continues. “One question we asked in both stages of the research was ‘Which M.B.A. courses should address issues related to the social responsibility of companies?’ In the spring of 2001 – when, as you will all remember, things were quite a bit rosier – roughly one-third of the students said they thought accounting courses should have this content. A similar percentage thought such content belonged in finance courses. In November, 2002, 84 percent of students said yes to accounting, and 57 percent said finance courses should address these issues as well. In fact, with the exception of economics, every discipline showed an increase in the percentage of students who thought social responsibility content belonged in the courses.

McGaw continued, ‘There is much to be said about what these findings mean, but I would like to posit this. We are at a propitious moment. There is openness on the part of the purchasers of management education for content that has not previously been sought or, in fact, on offer, and management
education should seize the day. It [management education] could then take a key role in contributing to a restoration of confidence in leadership’s ability to lead with honesty, integrity and consideration for all stakeholders. Then we’d begin to produce more of the balanced leaders who are now in short supply,” McGaw concluded.

SUMMARY AND CONCLUSIONS

While the rich discussion continued long after the formal session ended, it is impossible to capture all of the thoughts and ideas presented at the Forum. However, it was clear that corporate executives as well as representatives from academia, consulting firms, and a leading NGO saw tremendous opportunity in the midst of an unparalleled public concern about ethics and integrity in business.

The major strategies suggested and summarized by the participants at the forum include the following:

- The importance of balanced executive leadership that embraces complexity, diversity, and social responsibility rather than being overwhelmed by it.
- The need to institute a culture of corporate responsibility at the very highest executive levels as well as within middle management.
- Achievement of a greater balance between the pursuit of higher performance and profitability and the institution of codes of ethical conduct.
- The incorporation of values and responsibility in the process of executive succession management rather than an overemphasis on performance at all costs.
- The importance of boards of directors as facilitators and enforcers of responsible corporate governance.
- Cultivation and investment in middle managers who have the primary responsibility for implementing the corporate vision and values structure.
- The need for more concerted education and training of executives in management and leadership skills.
This article is based on comments made at Pepperdine’s 4th Annual Executive Learning Forum, which focused on “The Challenge of Developing Ethical Leaders” and included presentations on “Ethical Leadership and Organizational Effectiveness,” and “Current Challenges in Leadership Development.” Among those speaking at the forum were: Linda Livingstone, dean of the Graziadio School of Business and Management; Dan Burnham, chairman & CEO, Raytheon Co.; Blair Shepard, CEO, Duke Corporate Education; Nancy McGaw, Aspen Institute Initiative for Social Progress in Business; Robert M. Fulmer, Graziadio School of Business and Management; Jay Conger, London School of Business; Mila Baker, director of organizational effectiveness, Pfizer, Inc.


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