I. INTRODUCTION

Consider three examples of problematic corporate decision making: first, in 2002, employees were “less likely to have employer-provided insurance than thirty years ago,” and the price of health care for those who do receive it is ever increasing. In fact, one-third of full-time employees do not have employer-provided health insurance, and this figure rises to over 85 percent for men and women in nonstandard employment.

Second, while many employees are without health insurance, the compensation for chief executive officers and other executive officers has increased dramatically. For example, between 1989 and 2000, the average compensation of CEOs increased by 342 percent. CEOs made twenty-six times more than the typical worker in 1965, which increased to seventy-two times more by 1989, and further increased to 310 times more by 2000.

Third, consider the well-publicized examples of corporate decisions to engage in fraudulent and unethical business practices. Managers have fixated on stock prices and profits, and, in the process, they have inflated their earnings, threatened the integrity of U.S. financial markets and destroyed major companies. Similarly, ongoing Medicare and Medicaid corporate fraud undermines the availability of health care for the poor and the elderly.

These problems will not be solved by glib references to market ideology that claim markets alone adequately regulate corporate behavior. Nor will these problems be solved by assuming that a few bad apples were responsible. Indeed, only by examining the environmental context in which
decision making occurs will corporate ethics in the health care marketplace be furthered.

This article is a brief overview of the importance of an organization’s structure, policies, and practices in the establishment of an ethical climate. An organization’s climate affects whether individual employees, as well as the leaders of the organization, make ethical or unethical decisions. Part II of this article begins by defining ethical climates and describes how they are ascertained. Part III discusses two contextual factors in more detail: workplace leadership and reward structures. Finally, this article concludes with some basic recommendations for motivating organizations to work toward creating ethical climates.

II. ASCERTAINING ETHICAL LEGAL CLIMATES

Ethical climates refer to the ethical meaning attached by employees to organizational policies, practices, and procedure. They are ascertained through employee and stakeholder questionnaires, focus groups, employee exit interviews, and the like. The Ethics Resources Center, a nonprofit organization, provides an example of an ethical climate-employee questionnaire that covers issues such as corporate values, corporate decision-making criteria, corporate leadership, reward structures, and monitoring.

Academic researchers have also developed an employee questionnaire that classifies corporate climates by their predominant ethical decision making criterion: self-interest, benevolence (caring), or principle. Not surprisingly, self-interested climates are associated with more unethical decision making than benevolent and principled climates.

Recently, Congress, the Securities Exchange Commission (SEC), and other governmental and non-governmental entities have responded to organizational wrongdoing by largely focusing on rules relating to conflicts of interest and codes of ethics. While these are important subjects, no attention has been given to utilizing employee questionnaires or other...
methods to ascertain ethical climates. Moreover, the efforts to establish rules for conflicts of interest and codes of ethics have not acknowledged that creating and maintaining ethical climates require attention to a broader range of issues, such as the criteria for organizational decision making, the values and actions of leaders, the organization’s reward system, and various methods for providing employee guidance and monitoring.

III. THE IMPORTANCE OF SOCIAL ENVIRONMENT TO ETHICAL DECISION MAKING

My research suggests that contextual factors are very important in ethical decision making. Both theory and research in corporate ethics demonstrate that most people’s behavior is affected by situational variables. Because of this, organizations cannot rely solely on individual integrity to produce ethical behavior. If an organization wants to ensure ethics within its workplace, it must provide a climate that discourages unethical behavior and fosters ethical conduct.

An examination of the components of individual ethical decision making points to the importance of situational variables. According to James Rest, ethical decision making involves four components: (1) moral awareness; (2) moral decision making; (3) moral intent; and (4) moral behavior. An individual’s moral awareness is enhanced by his or her environment; for example, if the organization’s consensus is that an action raises moral issues, an individual will more likely become aware of those moral issues. Similarly, if management frames issues in moral terms or encourages individuals to consider the adverse consequences of their decisions on others, individuals within the organization will become more morally aware.

The second component, moral decision making, is explained by the social norms approach or the cognitive development approach. The social norms approach proposes that “moral development is a matter of acquiring a number of social norms, and being set to have those norms activated in
special situations." With this approach, organizations have, through developing workplace policies, procedures and practices, an opportunity to influence individual ethical decision making within the workplace. With respect to the cognitive development approach, most business persons are found to reason at the pre-conventional level or conventional-reasoning level. A person reasoning at the pre-conventional level determines right and wrong by what is either rewarded or punished; in other words, that person is influenced by organizational policies that reward ethical behavior and punish unethical behavior. On the other hand, a person reasoning at the conventional-reasoning level decides what is right and wrong by considering what is socially acceptable; that person is influenced by such environmental factors as the values and behavior of organizational leaders, the seriousness with which the organization addresses unethical violations, and the extent to which consequences to others are considered in organizational decision making. Finally, a number of contextual factors influence Rest’s third and fourth components of ethical decision making, moral intent and moral behavior. Whether ethical considerations triumph over other considerations in decision making and whether employees actually act in an ethical manner depend on such contextual factors as role expectations; whether responsibility for decision making is personalized or diffuse within the organization; whether employees are encouraged to identify and empathize with those affected by organizational decisions; and the employees’ perception of the nature of their relationship with the organization.

A. Role Expectations

Role expectations in the workplace are important to ethical decision making. Employees have proven to be “ethical segregationists” because their values change depending on whether they are at work or at home. Business managers, for example, reason at lower moral-reasoning levels in business situations than they do in non-business situations. One
psychologist notes that “managerial decisions will correspond more closely
to the humanistic, religious, cultural, and societal values of the society-at-
large only when these values are made part of the job environment.”

What is it about business roles that hinder moral decision making? It is
probably the limited purpose that managers and employees are expected and
required to pursue; they must maximize profits for the benefit of
shareholders. As we have seen in recent years, managers often take this
purpose to heart through a myopic focus on corporate stock prices. This
profit maximization purpose is supported by some conservative economists
and legal academicians, who often make the erroneous assumption that
serving shareholder interests maximizes social welfare. What these groups
fail to recognize is that the risk preferences of shareholders may differ from
those of other stakeholders and the distribution of shareholder wealth: only
1 percent of shareholders own almost 50 percent of all stock, whereas the
bottom 80 percent of shareholders own only 4 percent of all stock. Removing barriers to moral decision making means arguing for stakeholder
theory rather than shareholder-focused theories, which will change role
expectations and the values of the job environment.

B. Sense of Personal Responsibility for Decision Making

In addition to role expectations, another contextual factor that influences
ethical decision making is the employees’ sense of personal responsibility
for corporate decision making. In many organizations, responsibility for
conduct is diffuse and not readily attributable to an individual. Indeed, with
employees in the health care industry increasingly bound by detailed
bureaucratic rules grounded in efficiency, there is often too little discretion
left when dealing directly with clients or patients. In this context, the
mission statements of organizations become hollow aspirations not intended
to affect actual decision making.
C. Empathy for Those Affected by Corporate Decision Making

Similar to the second factor, a third contextual factor relevant to ethical decision making is the extent to which the organization’s environment encourages or discourages its employees’ empathy for the persons who are affected by organizational decision making. Feelings of empathy, including guilt-based feelings, can arise as an individual becomes aware of his or her ability to choose a course of action, realizes that his or her actions can affect others, and becomes more adept at imagining the effect that his or her actions have on others. Psychologist Martin Hoffman notes that “[m]ature empathy . . . reflects a sensitivity to subtle differences in the severity and quality of consequences that different actions might have for different people, and it may therefore contribute to informed moral judgments about behavior.”

Environmental factors such as business practices and procedures influence whether or not employees develop empathy. These practices may encourage employees to consider the consequences that their decisions have on stakeholders. In the health care context, this consideration may include the quality and degree of access to health care or medicines. These practices may also promote communication between employees and those who will bear the consequences of their decisions, which will ultimately result in greater organizational accountability.

Unfortunately, the for-profit organization usually encourages empathy strictly for shareholders and limits empathy for others to instances that result in profit. Organizations may even actively discourage their employees from developing empathy to maximize their profits. For example, corporate norms at Ford dictated that employees who were deciding whether to recall the Ford Pinto not refer to the Pinto’s defects as “bursting into flames” and injuring people. Rather, employees were instructed to refer to the “condition” of the Pinto as “lighting up.”
D. Transactional and Covenantal Relationships

Finally, a fourth contextual factor that affects ethical decision making is the employees’ perceptions of their relationship to the organization. Employee-perceived relationships to an organization can be classified as either transactional or covenantal. On the one hand, transactional relationships are those in which an employee perceives that he or she is providing skills and abilities that are instrumental to the achievement of organizational objectives. On the other hand, covenantal relationships are based on the employee and the organization having a “mutual commitment to the welfare of the other party” and on “allegiance to a set of shared values.” Covenantal relationships encourage employees “to engage in proactive behaviors, such as organizational citizenship behaviors that promote the long-run interest of the organization.”

Research shows that the employees’ perceptions of covenantal relationships are associated with benevolent (caring) and principled climates, not self-interested climates. Unfortunately, the loyalty and trust that support covenantal relationships have been seriously compromised in recent years by massive corporate downsizing and employee layoffs. Moreover, covenantal relationships remain largely unacknowledged by conservative academicians who insist on describing business relationships in purely contractual and transactional terms.

IV. The Importance of Leadership and Reward Structures to Ethical Climates

Leadership and reward structures are of substantial importance in creating ethical climates. Although the remainder of this article focuses on these two contextual factors, it is important to keep in mind other relevant factors, which include organizational mission statements; codes of ethics; criteria for business decisions; handling of conflicts of interest; guidance provided to employees on how to deal with ethical issues; and corporate monitoring systems.
A. Leadership

Organizational leadership and the moral tone that it sets are very important. Consistency between ethical policies and organizational action appears to be the most important factor in reducing unethical conduct, which makes the leaders’ commitment to ethical behavior of paramount importance. The leaders are in a position to translate ethical codes into actions that will encourage and support ethical behavior within the organization.

The status and authority of leaders within the organizational structure make them important models and referents for other employees. For this reason, ethicists recommend that high-status persons oversee ethical compliance. Furthermore, ethicists recommend that boards of directors and board committees receive and discuss reports on ethical compliance.

Leaders play an important role for two additional reasons. First, if a group is led by a less-principled person, the group’s moral-reasoning level decreases, whereas if the group is led by a person with a higher moral reasoning level, the moral reasoning of the group improves or stays the same. Second, as will be further discussed below, leaders play an important role in the attraction, selection, and retention of employees. People tend to attract, select, and retain those who are more similar to themselves. Thus, an organization with less-principled leaders will see a lack of moral reasoning become endemic as its leaders hire and retain employees with their same values.

B. Reward Structures

This section will outline the characteristics of reward systems that contribute to ethical climates. Recent regulation by the SEC, Congress, and other governmental and non-governmental organizations has done little to address reward structures in the workplace. Enron’s reward structure, however, substantially contributed to its ethical problems, as this section will show.
The first characteristic of a reward system that contributes to an ethical climate is that ethical behavior should be rewarded and unethical behavior punished. Not surprisingly, unethical conduct is discouraged if punished. Relating this characteristic to Enron, unethical behavior was not punished, but rewarded, if it made profits. One employee, for example, used thirty million dollars in company hardware and enlisted the help of 380 Enron employees to develop a trading system that Jeffrey Skilling, the then CEO, opposed. The employee was not reprimanded because the trading system made money.

A second characteristic of importance is whether the compensation system is outcome or behavior based. Behavior-based incentive systems that consider how employees achieve their outcomes promote ethical decision making. Conversely, reward systems that are purely outcome based, that is, based on sales or profits booked, are associated with more unethical conduct in the workplace.

Employee compensation at Enron was outcome based, that is, based on profits booked. Emphasis was on “doing the deal” with little consideration for how the deal would work out in practice or for how it had been achieved. Relating this outcome-based system to the health care industry, a similar situation could occur in health maintenance organizations (HMOs) if doctors are evaluated solely on the basis of cost savings rather than on the steps they take in responding to the needs of their patients.

Along with the reward of ethical behavior and the emphasis on behavior-based reward systems, a third characteristic of reward structures that promote an ethical climate is one in which individual self-interest is not heralded as the prime employee motivator. As mentioned above, there is a direct connection between self-interested climates and unethical behavior. Examples of reward systems that make individual self-interest particularly salient are those that provide for large disparities in compensation within the organization and those that include employee ranking systems.
for instance, causes employees to believe that the organization’s main function is to serve individual self-interest.

Enron utilized an elaborate ranking and bonus system. There were substantial disparities in bonuses, and those who were ranked the lowest ran the risk of getting fired. Every six months the entire organization focused on extensive individual performance reviews. Accordingly, the reward system and self-interest were ever present and highly salient at the company. Not surprisingly, Enron attracted individuals who wanted to make a lot of money fast.

In the health care context, hospitals and insurers must keep the effect of bonuses and ranking systems in mind as they convert from non-profit to for-profit status. For-profit health care entities often seek to emulate public corporations by providing large compensation packages and perks to their top executives without giving attention to the appropriately commensurate compensation of lower-level employees, which contributes to employee perceptions that self-interest is at the heart of organizational decision making.

Another characteristic of a reward structure that contributes to an ethical climate is one that promotes teamwork and caring among employees. Large disparities in compensation and employee ranking, for example, discourage employees from sharing power, authority, and information with other employees as they compete to become star players. The result is a lack of trust, dishonesty in employee dealings, and a diminished empathy for others, which often spills over into disloyalty to the organization and its stakeholders. Again, these effects were seen at Enron in the lack of trust and teamwork among employees. Employees did not share information. They locked their desks and reportedly were even afraid to go to the bathroom for fear other employees would steal their work.

In addition, characteristics of reward structures that promote ethical climates are those that diminish politics within the organization, value diversity of perspectives, and do not permit retaliation for constructive
criticism and the reporting of ethical violations. Reward structures, such as employee ranking and the availability of disparate bonuses, tend to politicize corporate decision making to a higher degree than otherwise found in organizations. For example, the most visible consequence of Enron adopting a ranking system was “the amount of time people spent at the local Starbucks buttering up superiors and bad mouthing peers.” Moreover, managers successful at obtaining high ranking for their employees developed what were referred to as “entourages” and “fiefdoms.”

In addition, an ethical climate is also encouraged where retaliation is not allowed in response to good faith reporting of ethical violations to the appropriate person within the organization. Retaliations for challenging managers were prevalent at Enron. This retaliatory climate was probably condoned by CEO Kenneth Lay, evidenced by the fact that the day he met with whistleblower Sharron Watkins, a memo was delivered to Enron from its lawyers on “[t]he possible risks associated with discharging employees who report allegations of improper accounting practices.” Enron employees were reportedly fearful of criticizing powerful players, which enhanced the hubris of top management and diminished their accountability. CEO Jeff Skilling, for example, was described as developing a sense of infallibility over time.

Adding to the highly politicized culture of unethical workplaces, the discouragement of dissenting views results in the hiring, retention, and promotion of those who fit in or agree with existing managers. Thus, a workplace homogeneity is created. In turn, homogeneity decreases the quality of decision making and magnifies a group polarization phenomenon that may lead to riskier and unethical decisions. Homogeneity also exaggerates decision-making biases, such as the egocentric and confirmation biases, which may result in less accountable decision making.
At Enron, homogeneity was encouraged. Employees described the importance of being in the “in group” and that this required a sort of “group think.” Enron’s homogeneity is captured by employee descriptions of Enron’s culture as arrogant and supportive of “yes” men.

A few additional characteristics of reward systems that affect ethical climates are worth noting. First, it is important that employees perceive reward structures as fair. Employee ranking, for example, is often considered unfair when performance measures are subject to manipulation and employees have different strengths that they contribute to the organization. In addition, a system that places unreasonable expectations and pressures on employees may also be viewed as unfair. These unreasonable expectations are often found in organizations rampant with unethical conduct, such as Enron. Second, a reward system that evaluates managers on the basis of the ethical or unethical behavior in the units that they oversee also contributes to an ethical climate.

V. CONCLUSION

How do we get organizations to care about ethical climates? Of course, one can appeal to organizational self-interest by warning companies to avoid another Enron. Another possible avenue is to become “norm entrepreneurs” in seeking to establish norms of behavior that corporate leaders and employees may internalize. Governmental and non-governmental agencies may assist in this endeavor by establishing standards for creating and maintaining ethical climates and by encouraging the development of stakeholder theory in corporation law. Of course, to be effective, norms of behavior must be adhered to and carried out in the workplace. Finally, the development of methods to facilitate dialogue between organizational decision makers and affected groups may also foster an interest on the part of organizations in ethical climates. This interest in ethical climates, as this article has shown, is key to resolving corporate ethics issues within the health care industry.

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2. Id. at 255.
3. Id. at 7.
4. Id.
5. Id. at 8-9; Victor & Cullen, *supra* note 12, at 103.
6. Id.
8. *E.g.*, Robert Weissman, Posting of Robert Weissman, rob@essential.org, to corp-focus@essential.org (Feb. 11, 1999), at http://lists.essential.org/corp-focus/msg00004.htm (last visited Nov. 17, 2004).
9. Dallas, *supra* note 1, at 3. Other methods for ascertaining ethical climate include newcomer studies that focus on the experiences of new employees and leader interviews. Dallas, *supra* note 1, at 25, 43.
10. Id at 23-25.
14. Id at 4-5. The exception is the U.S. Sentencing Commission, which has focused more broadly on the development of ethical culture. Id. at 5-6.
18. Id. at 10.
19. Id. at 10-12.
20. Id. at 12-17.
21. Id. at 12 (citing James R. Rest, *The Major Components of Morality*, in MORALITY, MORAL BEHAVIOR, AND MORAL DEVELOPMENT, 24, 31 (William M. Kurtines & Jacob Gerwitz eds., 1984)(emphasis omitted)).
22. Id. at 16.
23. Id.
24. Id. at 15.
25. Id. at 17-22, 30-31.
27. Id.
28 Dallas, supra note 1, at 16.
29 Bommer, supra note 25, at 268.
30 Dallas, supra note 7, at 1370.
31 Id. at 1364-65.
32 MISHEL, supra note 3, at 277.
33 Dallas, supra note 1, at 19.
34 Id. at 19-20.
35 Id. at 19.
38 Id.
39 Dallas, supra note 1, at 30-31.
41 Dallas, supra note 1, at 31.
42 Id.
43 Id.
44 Id.
45 Id. at 31-32.
48 Dallas, supra note 1, at 3.
49 Id. at 40-42.
51 Dallas, supra note 1, at 41.
52 W. Michael Hoffman et al., Integrating Ethics into Organizational Cultures, in BUSINESS ETHICS 38, 48 (Chris Moon & Clive Bonny eds., 2001).
53 Id. at 43-44.
56 Vicky Arnold et al., Understanding the Factors Underlying Ethical Organizations: Enabling Continuous Ethical Improvement, 15 J. APPLIED BUS. RES. 1, 9 (1999).
57 Dallas, supra note 1, at 34.
58 Id. at 45-46.

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60 Id. at 34-35.
61 Id.
62 Dallas, supra note 1, at 46.
63 Id. at 36.
64 Id. at 29-31.
65 Id. at 36.
66 Id. at 46.
67 Id. at 46-47
69 Cf. Dallas, supra note 1, at 36.
70 Id. at 36.
71 Id.
72 Id. at 50.
73 Id.
74 Id. at 39, 50.
75 Id. at 50.
76 Id. at 37 (citing James Lardner, Why Should Anyone Believe You?, BUSINESS 2.0 (Mar. 2002)).
77 Dallas, supra note 1, at 34.
78 Id. at 39.
79 Id. at 47-48.
80 Id. at 52 (citing Peter Behr & Susan Schmidt, Enron CEO Skilling Knew of Deals & Risk, Aides Say, WASH. POST, Feb. 20, 2002, at A1).
81 Id. at 47-48.
82 Id. at 48-49.
83 Id. at 37.
84 Id.
85 The egocentric bias is the assumption that others share one’s own views. Id at 54-55.
86 The willingness to see only information that confirms one’s own opinions is referred to as the confirmation bias. Id.
87 Id. at 37.
88 Id. at 49 (citing Joe Stephens & Peter Behr, Enron’s Culture Fed Its Demise, WASH. POST, Jan. 27, 2002, at A10).
89 Dallas, supra note 1, at 49 (citing John A. Byrne et al., The Environment Was Ripe for Abuse, BUS. WK., Feb 25, 2002, at 120).
90 Dallas, supra note 1, at 37-38.
91 Id. at 38.
92 Id.
93 Id.