Revisiting ethics in strategic management

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Abstract

Purpose – *The purpose of this paper is to explore the challenges faced by corporations in incorporating ethics into their strategic management processes.*

Design/methodological approach – *The research is based on a survey of the issues and the literature published in Europe, North America and Asia.*

Findings – *Findings indicate a definite gap between the implementation of strategy and the moral and ethical obligations of corporations. Given the decline in business ethics and recent corporate scandals it is proposed that ethics be brought back to the forefront of strategic management and integrated into the strategic management process.*

Research limitations/implications – *The paper serves as a instrument for debate and future research in that the ethical issues faced by corporations will continue to gather momentum as will the issues faced by traditional strategists.*

Originality/value – *This paper allows researchers and practitioners to gain an understanding of the issues and shortcomings in strategy and ethical integration, which allows for future research.*

Keywords *Ethics, Strategic management, Stakeholder analysis*

Paper type *Viewpoint*

Introduction

Recent developments in the financial services industry, especially those directly connected with the global banking industry, have prompted many shareholders and other financial stakeholders to question the moral obligations of corporations. Moral obligations and business ethics are an integral and important part of the strategic management process (McManus and White, 2008). Corporate failures such as Lehman Brothers and scandals such as Adelphia Communications, Arthur Andersen, Enron, and WorldCom have done little to build and sustain shareholder and business confidence.

Early proponents of management, such as Barnard, highlighted the need for corporate CEOs to have a sense of moral responsibility (Barnard, 1938). Barnard laid down some of the founding principles of strategic management in his 1938 essay *The Functions of the Executive*; these included the management of individual and corporate goals. Barnard argued that the executive management process is not purely intellectual; it is aesthetic and moral, involving a sense of fitness, of appropriateness of responsibility. Barnard suggests that organisations endure in proportion to the breadth of morality by which they are governed. Executives have a moral responsibility to those they serve. Equally they have a responsibility to inspire through leadership and by creating trust through common understanding and purpose.

Early pioneers of strategy and strategic thinking such as Chandler (1966) and Ansoff (1965) were commanding advocates of ethical decision making. Ansoff, whose book *Corporate Strategy* set out to be a practical system for strategic decision making within a business firm,

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identified a prescriptive methodology to define a common ethical purpose in strategy formulation. Herbert Simon, the Nobel Laureate for Economics, shared the view of common purpose by explaining that administrative decisions in an organisational context always had an ethical as well as factual content (Simon, 1947).

In line with Chandler, Andrews wrote that corporate strategy is an organisation process, in many ways inseparable from the structure, behaviour and culture of the firm, which in essence provides the basis for enterprise strategy by defining the context under which the firms will operate both in human and economic terms (Andrews, 1971). Schendel and Hofer (1979) outlined a proposal for enterprise strategy that would relate the organisation to its social and political environment in much the same way that corporate strategy interfaced with the industry structure and the economic environment. Schendel and Hofer (1979) strongly argue for more pragmatic research in this domain. To some degree their argument represents a call for more rigorous understanding of the ethical and social characteristics that dominate corporate decision-making.

During the last decade a reasonable amount of journal literature in the fields of strategic management and ethics has been developed. According to Schendel and Hofer (1979), the term ''strategic management'' is of relatively recent origin and is currently the accepted term for the fields of business policy and planning. However, the field of ethics, as a separate field of study, is still evolving within the literature and to date does not seem to have over-troubled academics of strategic management. With the noted exception of Freeman (1984) and Freeman and Gilbert (1988), recent book publications in the field of strategic management have paid little attention to ethics and moral obligations of management. Freeman and Gilbert's view is simple: executives must learn to build strategy on a foundation of ethical reasoning, rather than pretending that strategy and ethics are separate. Freeman's (1984) seminal work on stakeholder theory was instrumental in highlighting the need for negotiation with different stakeholders as part of the strategic management process. Later work by Wicks *et al.* (1994) moved beyond the self-interest stakeholder position by taking the more radical position that the interests of stakeholders have intrinsic worth irrespective of whether these advance the interests of shareholders. Given this view, the success of an organisation is not merely an end in itself but should also be seen as providing a vehicle for advancing the interests of stakeholders other than shareholders.

Since 1988 authors such as Botten and McManus (1999) and McManus and White (2008) have built on the advice of Freeman and Gilbert to build corporate strategy on a foundation of ethical reasoning. Ethical analysis, in the view of the authors, is the only means available to resolve conflicts in values and goals and accordingly essential in the process of strategy.

Developments in corporate social responsibility have prompted a number of authors (Clarkson, 1995; Griffin and Mahon, 1997; Matten *et al.*, 2003) to question the moral sensitivity of their investment decisions. Sternberg (2000) argues that there is a human rights case against corporate social responsibility, which is that a stakeholder approach to management deprives shareholders of their property rights.

Focus of this paper

Whilst the works of Freeman and Gilbert have found favour with their followers, they have not had the desired impact one might have expected amongst those who teach ethics (McManus, 2006). With this in mind, this paper will consider the implications of building strategic management on a foundation of ethical reasoning. In addition the paper will question the worthiness of doing so by examining whether the integrity of common purpose should be included as a fundamental part of the strategic management process. The paper will commence with a brief overview of the emergence of strategic and ethical disciplines within general management. The paper will then consider what moral problems are and how these problems conflict with the moral obligations of managers. The paper will next focus on ethical principles, and how these principles impact on the moral obligations of managers. The paper will then move on to discuss the methods by which ethical principles can be integrated into strategic management and why they should be incorporated into the

strategic management model. Based on the premise that ethics do pay, the paper will conclude with a specific proposal for changing the strategic management paradigm and the resulting practical effort needed to support future research.

An overview of strategy and ethics as academic fields

Early models of strategic management were very much focused on resource application and external threats (Ansoff, 1965; Andrews, 1971). As mentioned previously, Ansoff's model set out to be a practical method for strategic decision-making within a business firm, and provided a series of detailed processes and checklists for accomplishing it. By the early 1970s, strategy technique was a thriving discipline within many US business schools. Andrews (1971) defined corporate strategy as the pattern of decisions in a company that determines and reveals its objectives, purposes or goals, produces the principles policies and plans for achieving those goals, and defines the range of business the company is to pursue.

The 1960s marked a changing attitude towards society and business. Multinational corporations were growing in size and importance, replacing many small and medium-sized businesses in the societal image of business (McManus *et al.*, 2009a, b). For most of the 1960s many business schools focused on social responsibility and social issues in management (De George, 1989). Writers such as Beauchamp and Bowie (1979) have long been advocates of business ethics, however, it was not until the late 1970s that ethics began to emerge as a management discipline (Beauchamp and Bowie, 1979; Barry, 1979).

While there are similarities between the disciplines of strategy and ethics (in that both use simple analytical procedures and assumed benevolent competitive conditions), there have always been academic misunderstandings between the two disciplines. For example, some ethicists have a deep distrust of business management, and accept a very fundamental microeconomic view of the firm that stresses profit maximisation at the cost of human values (Hoffman, 1990). Recent developments in management thinking have seen something of a convergence of the two disciplines. The notion that strategy and ethics are separate and distinct fields of study does hot hold true in a twenty-first century global and digital business economy (Donaldson *et al.*, 2002; McManus *et al.*, 2009a, b). Unless we acknowledge that ethical theory needs to be more closely integrated with management practice, we may experience far more scandals and business failures than those recently reported in the business press. That said, let us now discuss the nature of moral problems, the principles of ethical analysis and the advantages of integrating strategy and managerial ethics.

Morality and moral problems

Morality is concerned with the norms, values and beliefs embedded in social processes that define the right and wrong for an individual community. All individuals have morality, a basic sense of right and wrong in relation to a particular activity (Crane and Matten, 2007). The manager as a moral person is characterised in terms of individual traits; as a moral manager, he is thought of as conveying an ethics message that others take notice of in their views and behaviours. Moral problems are concerned with the harms caused or brought about by others, and particularly with the harms caused or brought to others in ways that are outside their own control. The harm principle has many sources, one of which is the utilitarianism of John Stuart Mill (1957). As a utilitarian, Mill held that right actions were whichever ones would bring about the most good in a given situation. From this moral viewpoint, it is easy to see why Mill would sign onto something like the harm principle. Harming others rarely promotes the most good, and the prevention of harm is the promotion of good in many cases.

Decisions made by managers are often made in this context. A decision by Company XYZ in Europe to move its operations to China to lower its wage bill results in thousands of people losing their jobs. A decision to withdraw General Practitioner services at weekends means that X number of people go without treatment. Harms to specific individuals and groups in ways outside of their own control are the focal points of moral problems.

It could be argued that moral problems associated with strategic decision-making are complex because the harms to some individuals or groups are predictably associated with benefits to other individuals or groups. For example, the movement of operations to a low-wage economy obviously harms the displaced workers in Europe, but equally benefits the new employees in China and the existing shareholders and other stakeholders such as suppliers and creditors. The question is whether this transfer of European operations, which creates hardships in one area and benefits in another, is right and just and fair. Hosmer's (1987, 1992), teachings extend the debate from an economic perspective by accepting that some managerial actions have to be taken, regardless of the harms to some, in order to maintain or enlarge the benefits of others.

Ethical analysis

The doctrine behind ethical analysis is linked to the view that ethical principles are not subjective measures that vary with cultural and economic conditions; in essence they are the basic rules or first principles to ensure a good society (Rawls, 1971). The seminal work by Rawls helped make the application of ethics to economic and business issues more acceptable to academic philosophers than had previously been the case. Whereas most of those who wrote on social issues were professors of business, most of those who wrote initially on business ethics were professors of philosophy, some of whom taught in business schools (Crane and Matten, 2007). What differentiated business ethics as a field from social issues in management was the reality that business ethics sought to provide an explicit ethical framework within which to evaluate business, especially corporate activities.

Developments in the field of business ethics have been somewhat slow and hampered by those academics who (still) hold a pluralist philosophic viewpoint. Increasingly, normative ethicists such as Hoffman and Moore (1984), previously associated with philosophy departments, have had to become applied ethicists coming to terms with competitive issues in a global context (De George, 1999). In essence they have had to consider how to maintain a competitive posture and an ethical position jointly.

Although applied ethics has gained some ground within the last two decades, it is still under researched in management. Recent developments in business ethics have moved the debate away from normative ethics; rather than checking every single action according to its outcomes, or its underlying principles, discourse and post-modern ethical approaches look to the character of the decision maker (Crane and Matten, 2007). Multiple ethical theories used to gain insight and understanding do attempt to provide an answer to the question ''What should the decision maker do?''.

The ethical principles of analysis outlined in Table I are objective, not subjective and do not vary by culture, by country, or by time. The rule of Rawls, for example, that we not harm the least among us, those with the least education, the least income and wealth, the least ability to influence them, means exactly the same thing in any language. The evidence would suggest that moral standards and value judgements differ between people and groups (McManus, 2006). Although research is ongoing, the reasons for these moral value differences are not widely understood or proclaimed in the literature. What we may deduce is that there are religious, cultural, economic, and social influences to take into consideration. Empirical research undertaken by Lawrence Kohlberg has led to the conclusion that most people tend to think on a level that is consistent with what is expected by others or those around them (Kohlberg, 1981). The inference of Kohlberg's research is that most of us decide what is right according to what we perceive others to believe, and accordingly to what is expected by others. As stated previously, ethical principles do not differ between people. Ethical principles are the fundamental rules by which an individual can, if they choose, examine their own self. We can defend the notion of ethical principles as objective, consistent and timeless if we accept the proposed distinctions between morals, values and ethics, and if we appreciate only our moral standards and value judgements are subject to cultural, religious, social and economic influences.

Table I Objective ethical principles of analysis		
Egoism	Focus: individual desires or interests. man is limited by knowledge. Major contributor: Adam Smith	The premise of this argument is if we look after our own self-interests, without convincingly interfering with the rights of others, then society as a whole will be better off, for the members of society will be as free and productive as possible. The principle can be expressed as: ''Never take any action that is not in the long-term self-interests of yourself and/or the organisation you work for''
Utilitarianism	Focus: collective welfare. Man is controlled by avoidance of pain and gain of pleasure. Major contributors: Jeremy Bentham and John Stuart Mill	According to utilitarianism, an action is morally right if it results in the greatest amount of good for the greatest amount of people affected by the action. A more exact way of expressing the principle is: ''Never take any action that does not result in greater good than harm for the society of which you are a part''
Ethics of duties	Focus: duties. Man is a moral rational being. Major contributor: Immanuel Kant	The principle is based on a set of priori moral laws that humans should apply to all ethical problems – humans could be regarded as independent moral actors who make their own rational decisions regarding right and wrong. This principle may be expressed as: ''Never take any action that you would be willing to see others, faced with the same or a closely similar situation, also be free or even encouraged to take''
Rights and justice	Focus: rights. Man is a being distinguished by dignity. Major contributors: John Lock and John Rawls	Rights: the general significance of the notion of rights in terms of ethical principles lies in the fact that these rights typically result in the duty of others to respect them. These rights would include arbitrary actions of government and would ensure freedom of speech, interference with privacy, or deprivation of liberty without due process. The principle may be expressed as: ''Never take any action that reduces the rights of others'' Justices: in essence we are concerned with fair procedures and fair outcomes. Most views of justice attempt to achieve both types of fairness; however, this is not always the case. For example, education and the means of economic output are invariably not equal or just. The principle may be described as: ''Never take any action in which the least amongst us is disadvantaged''
Economic efficiency	Focus: shareholder supremacy, with the dictum ''The business of business is business''. The argument presented is that all economic systems are mechanisms to serve the needs of the population. Major contributors: Adam Smith and Milton Friedman	The principle is based on the premise that basic rights are meaningless if the basic essentials – food, shelter, and clothing – are not provided for. To this end we should aim to maximise output of needed goods and services within marginal economic costs. In theory achieving this goal optimises the efficiency of the economic system. The downside is that it is almost impossible to make any one person better off without harming someone else. The principle is always to act to maximise profits subject to legal and market constraints, maximum profits being evidence of the most efficient production
Non-egalitarian (entitlement theory)	Focus: justice in economic systems is ultimately a product of fair process and free markets. Major contributor: Robert Nozick	The principle is based on the premise that a distribution of wealth in society is just as long as it has been brought about by just transfers. The principle is: ''Never take any action that will interfere with the right of all people's self-fulfilment or self-development''

Ethical principles: their application to strategic management

If we accept the proposal that ethical principles of analysis are objective, not subjective, and they provide collectively a means of deciding what is right and just and fair in human actions and goals, the question is how these principles can be used in management, particularly strategic management, which determines the goals, mission, objectives, and position of the

firm. The ethical principles of analysis described in Table I provide different perspectives, different ways of looking at either the content or the process of strategic management decisions and actions.

Andrews (1971) identified four components of strategy, well ahead of his time in acknowledging the wider responsibilities of a business enterprise. One of these components was acknowledged obligations to people and society other than shareholder returns. In mainstream strategic thinking corporate strategy is measured using terms derived from neoclassical economics – for example, what effect will this proposed change have upon our return on investment and stock price? If we are to add our obligations to people and society we must begin to look at those proposed changes using the perspectives and the measures of the applied ethical principles.

As described by Chandler (1966) and Botten and McManus (1999), many firms use a top-down iterative approach to strategic planning that involves headquarters' approval. Clearly any company wanting to incorporate ethical considerations into the strategic planning process would do so as part of the approvals process (Botten and McManus, 1999). It is clear that ethical considerations can be part of a strategic approval process. The central issue, however, is not whether ethical principles *can* be included in the strategic planning process, it is whether they *should* be. It is stated that morality finds little favour in business (Friedman, 1962; Dunning, 2005) – being a moral manager may make us feel good or help mitigate business or legal risk against us, but is there an obligation to be moral? The argument is that it may or may not be practical to be moral, but that it is essential in business to be honest. Recent developments in stakeholder theory point to the competitive advantages to be gained from managing business relationships in an ethical way.

Competitive influence: a stakeholder perspective

Since Freeman (1984) published his seminal work on stakeholder theory, academics of business management have increasingly used stakeholder theory as a conceptual framework to discuss the ethical dimensions and implications of organisational activity. Freeman began the discussion by arguing that successful managers must systematically attend to the interests of various stakeholder groups, ''stakeholders'' being defined as those individuals or groups who are affected by and can in turn affect the achievement of the firm's objectives. In Freeman's view the success of the firm is not merely a profit-making entity but should be seen as providing a vehicle for advancing the interests of stakeholders other than shareholders. It could be argued that Freeman's use of the term ''stakeholder'' was meant to be inclusive (and cooperative) rather than exclusive. Given this point of view, it leads academics and others to argue the point that companies should be run for the benefit of a range of stakeholders, including employees, customers, suppliers, creditors, the general public and the government, and not merely for the benefit of shareholders alone (Botten and McManus, 1999).

Clearly any stakeholder or group of stakeholders can have both a positive and negative influence on the firm's competitive position. The need for cooperation among stakeholders is inherent in the definition. The question, however, is whether cooperation is enough. The issue with cooperation is that it ignores the fact that different stakeholders do not perceive benefits in exactly the same way and will therefore seek different solutions and use different criteria to assess the desirability of intervention. Increasingly cooperation is both desired and needed in global business.

Many MBA academic texts stress the need for cooperation and innovation (Teece, 1990). Teece argues that innovation is often driven by entrepreneurial stakeholders both within and outside the firm. An essential role for management is to be able to adapt, integrate, and reconfigure internal and external stakeholder and organisational skills and resources to match the changing requirements of the marketplace. Strategic and competitive innovation is often seen as a means to an end. Achieving strategic intent requires enormous creativity with respect to means. The question often asked is does innovation come from within the firm (Porter, 1985; Hamel and Prahalad, 1989; Mintzberg, 1994). Alternatively does the

explanation for competitive success come from any and all types of stakeholders? In this context it seems reasonable to make the assumption that creativity and inventiveness should come from any and all stakeholders.

If we accept the proposition that competitive advantage accrues through stakeholder engagement and if we also accept the assumption that stakeholder dependency extends beyond mere cooperation to acts of ongoing intervention and motivation, we are then faced with the possibility that we need to motivate stakeholders in creative way.

Motivation, a word that lies at the heart of management did not figure in the early prescriptions of management functions. It was not until the 1930s/1940s that work within the behavioural sciences began to gain academic acceptance (e.g. Mayo, 1949; Hertzberg, 1969). Within behavioural sciences much of the research undertaken is focused on the need to cooperate within the formal structure of the organisation, reward through innovation often taking a backseat in favour of Taylorist-style incentive programmes. Incentives to motivate creativity and improvisation by individuals and groups outside the formal hierarchy of the firm have not been reported extensively in behavioural research.

To gain a broader appreciation we need to move the discussion to the more general approach of agency theory, which can be applied to any principal-agent relationship, including those relationships outside the formal boundaries. Agency theory, developed in the 1970s, focuses on the way central management of a firm manages its relationships and the way it enters into those relationships. Issues such as remuneration, accounting techniques or risk-taking are among the major concerns of both parties in this relationship (Fama and Jensen, 1983; Barnes, 2000). Agency theory is used to explain complex inter-relationships beyond those of owner manager. It has been used to design governance systems that limit the self-serving behaviour of any agent under conflicting circumstances.

In essence principal agent agreements tend to be based on either behaviours or outcomes. Eisenhardt (1988) argues when a position consists largely of nonprogrammable tasks, those that involve a degree of improvisation and creativity it is often difficult to control the behaviour of the incumbent because of the complexity involved in establishing performance criteria and rewards. Non-programmable tasks are sometimes measured on the basis of outcomes however, outcomes involve risk and risk is often transferred to the agent. The question here of course is what can be done when it becomes too expensive to transfer risk to the agent or measure the outcomes associated with risk? The options are clearly limited – one solution is to overcome the moral hazards by building trust, commitment, and effort among the agents who are of course, the stakeholders of the firm.

The question posed here is that trust amongst stakeholders may be built on ethical principles grounded in the strategic decision processes of the firm. Trust is both an emotional and logical act. Emotionally, it is where we expose our vulnerabilities to people, but believing they will not take advantage of our candidness. Trust in managerial terms may be described as the belief that agents or stakeholders of the firm will avoid harm by applying the ethical principles of analysis in addition to the more conventional economic criteria (Gert, 1998). The ethical principles of analysis (Table I) do address what is right or what is just, and of course what is fair in the relationships between the firm and its assorted stakeholders, and was intended to eliminate short-term self-interest as decision criteria by the representatives of the firm. In essence this ethical process of analysis benefits the organisation by ensuring a cooperative, innovative, and directed effort on the part of all of the stakeholders of the firm.

Trust: the rationale for ethical commitment

It could be argued that positive and mutually supportive stakeholder relationships encourage trust, and stimulate collaborative efforts that lead to positive exchanges and economic outcomes (De George, 1999; Crane and Matten, 2007). By contrast, conflict and suspicion stimulate formal bargaining and limit formal exchange and innovation within the firm. While this may be common sense, the question still remains as to why we should accept the proposal that the application of ethical principles to strategic decision making builds stakeholder trust. Although the work by Robin and Reidenbach (1987) did attempt to tackle

this issue, Clegg (1997) and Crane and Matten (2007) suggest that no contemporary methodology fully embraces both corporate strategy and ethics.

It could be argued that given the different conceptual frameworks and the inherent confusion that exists between both bodies of knowledge, this is not too surprising. Given the lack of empirical evidence and the dearth of case examples, a more abstract approach that moves beyond the current idiom may be useful. At this point a return to the premise of the paper may prove useful – which is that of ethics, trust and commitment on the part of all stakeholders of a firm. According to Freeman (1984), the broader view of responsibility towards several stakeholders assigns a new role to management in that rather than being simply agents of shareholders, management has to take into consideration the rights and interests of all legitimate stakeholders rather than just maximising the interest for one group at a time. Unfortunately, clear research findings relating to the effect of rights and their implementation on decision-making and behaviour are still relatively limited. Moreover, recent years have witnessed the emergence of a stream of literature that is more critical of ethical behaviour and distribution of benefits amongst the firm's principal, agent and its stakeholders (Schwartz, 2001).

As alluded to previously, stakeholders expect right, just and fair treatment, and those expectations can be destroyed by actions that are subjective and do not follow the known principles of ethical analysis that tend to give the consideration to the self-interests of the agent as to the self interests of the principal. Actions of the principal that give absolute credence to their own short-term self interests (profits, share price, and dividends) and neglect those of the agent (remuneration and esteem) would seem to destroy the trust and commitment of the agent through reducing the long-term utility of their future co-operation and innovation. The argument here is that we can justify the ethics, trust commitment proposition if we assume that the principals in any principal-agent exchange will sometimes act in ways that may be seen by the agents to be unjust or unfair. As Sternberg (2000) suggests, in the final analysis good ethics are good business because just and fair behaviour will increase the utility of the business to both its principals and agents.

Conclusions and implications

As the literature would suggest, many academics of business ethics have made an effort to open up a dialogue with those engaged in business strategy with some success. The conjoint field of ethics and business/corporate strategy however, has received less attention. It could be argued that the opposition by those academics engaged in normative ethics is the implied over simplification of dealing with moral problems. Analysis would suggest that the use of ethical principles whilst apparently leading towards the betterment of society over the short term, in reality lead towards the betterment of the decision maker over the long term.

The strategic decisions of any large-scale economic enterprise in a competitive global environment result in both benefits and harms. It is the responsibility of senior managers to distribute benefits and allocate those harms among stakeholders of then company. Some firms do this arbitrarily when or if done in a more thoughtful manner the ethical principles offer the only form of analysis that is applicable. From an academic perspective evidence suggests that commitment to the future of a firm will ensure efforts that are both cooperative and innovative. Looking to the future, one can see that there is still a lot to do in this area. In this the twenty-first century globalisation is changing the way business is done – the ethical issues faced by business will continue to gather momentum as will the issues faced by traditional strategists. Perhaps, for the non-traditionalist strategists, the use of a combined heuristic methodology for ethical and strategic planning is the way ahead.

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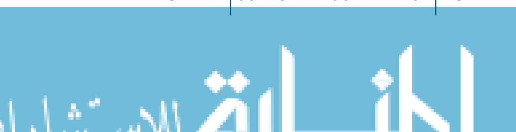

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