2. Reinforcing ethical behavior through organizational architecture: a hypothesized relationship

Raymond O.S. Zaal

1 INTRODUCTION

In today’s turbulent world, organizations can no longer assume that there is homogeneity of values, ethics and rules of thumb for appropriate behavior within their workforce (O’Brien, 2009). Many organizations actively pursue diversity (for example, gender, age, ethnicity), making their workforce no longer homogeneous. Additionally, falling trade barriers and increased international business have created opportunities for organizations to expand their operations internationally. This global economy has increased the complexity of dealing with ethical issues due to varying cultural perceptions of morality (Enderle, 1997). One potential source of confusion resides in the variability of ethical standards. What might have been acceptable behavior 10 or 15 years ago may not be so today. Social changes brought about by a broad spectrum of causes such as, for example, secularization, on the one hand, and corporate restructuring on the other, clearly have altered conceptions of socially accepted behavior. Moreover, the progressive globalization of corporations is increasingly forcing corporate employees to recognize and adapt to differences in national or regional cultural expectations. Given this large and, in some ways, growing uncertainty about what constitutes appropriate behavior within large organizations, corporate codes of ethics and training programs play a potentially important educational role by effectively communicating corporate expectations to employees and by demonstrating to them how certain kinds of behavior reduce the value of the firm. Moreover, in the process of globalizing and thus dealing with customers worldwide, companies might be forced to respond to increasing cultural differences – or an absence of shared expectations – among their managers and employees by providing more explicit communication of standards and expectations.
Research on business ethics suggests that ethical or unethical behavior in organizations is a function of both individual characteristics and contextual factors (Meyers, 2004). Therefore, in general, two approaches to promote ethical behavior are available to business managers. The first is to focus on the individual. According to this approach, managers assume that an individual's level of moral development and ethical sensitivity are the primary sources of motivation affecting the ethical behavior of employees. These sources are anchored to the internal drives and needs of the individual rather than triggered by situational forces. Under the individual approach, company policies and procedures reflect efforts to appeal to the employees' sense of right and wrong and to make employees sensible to ethical issues in the organization. Organizations do this in part by specifying and communicating ethical objectives through training and codes of ethics, instruments which were traditionally viewed by many managers as the most effective way of promoting ethical behavior within the firm (Metzger et al., 1993). Ample research has been done on the effectiveness of ethics programs and tools to manage ethical behavior. Kaptein and Schwartz (2008), for example, have thoroughly reviewed existing literature which reveals at least 79 empirical studies that examine the effectiveness of business codes. The results of these studies are clearly mixed: 35 percent have found that the codes are effective, 16 percent have found that the relationship is weak, 33 percent have shown that there is no relationship at all, and 14 percent have presented mixed results. Only one study has found that business codes could be counterproductive.

It seems therefore appropriate to focus on the second approach to promote ethical behavior, which emphasizes organizational aspects. Under this approach, individual behavior is assumed to be primarily affected by factors external to the individual, such as organizational structure, organizational culture, and other environmental conditions.

Brickley et al. (1995) propose to structure the firm's organizational architecture to encourage ethical behavior of employees. However, little is known about the effectiveness of dimensions of organizational architecture to reinforce ethical behavior of employees, as proposed by Brickley et al. There is much about how the formal organizational structure affects the ethical behavior of employees that is not yet fully understood. Specifically, very little research has been conducted into examining how decision-making assignments within firms affect the ethical behavior of employees.

This chapter takes up this challenge. The framework developed is an attempt to better understand how the organizational architecture of a firm relates to the ethical conduct of its employees. The primary purpose of this chapter is to generate more interest in advancing the theory how ethical
of behavior is affected by dimensions of organizational architecture and to propose research questions which need further grounding in empirical research.

2 ETHICAL CULTURE

In addition to organizational architecture, corporate culture plays an important role in promoting or discouraging ethical conduct. An important characteristic shared by most conceptualizations of organizational culture is the expected relationship between culture and ethical conduct. Culture helps to establish what is considered legitimate or unacceptable in an organization and can exert a powerful influence on individual ethical behavior. Whether defined as an informal organizational control system (Deal and Kennedy, 1982; Martin and Siehl, 1983) or an instrument of domination, organizational culture is thought to provide direction for day-to-day behavior. In recent years, a number of research studies have attempted to link various attributes of organizational cultures to ethical behavior (Frederick, 1995; Treviño and Nelson, 2004).

Many researchers such as Hibbard (1998) and White (1998) have focused on values in defining organizational culture. Whereas values are important elements of organizational culture, research has demonstrated that organizations showed more differences in practices than in values (Wilderom and Van den Berg, 1999; Hofstede, 2001: 394). Organizational practices are therefore a common focus of culture measurement (Hofstede et al., 1990; Hofstede, 1998; Van den Berg and Wilderom, 2004). Van den Berg and Wilderom define organizational culture as shared perceptions of organizational work practices within organizational units that may differ from other organizational units. These practices reflect the shared knowledge and competence of the organization. By defining ethical culture as shared perceptions of ethical organizational practices within organizational units that may differ from other organizational units, the concept is similar to ethical (organizational) climate, which has typically been conceived as employees’ perceptions of observable practices and procedures (Victor and Cullen, 1987; Denison, 1996). An important distinguishing feature, however, is that climate relates to the evaluation of a current state of affairs and culture relates to the registration of actual work behaviors (Denison, 1996).

Ethical culture represents a subset of the overall organizational culture, combining formal and informal systems of behavioral control that work together to guide employee moral reasoning and ethical behavior (Treviño and Weaver, 2003: 221). These systems have the potential to influence
ethics and integrity to the degree that they are actually supportive. Therefore, ethical organizational culture helps to establish what is considered ethical or unethical in an organization and is thought to provide direction for daily employee behavior (ibid.: 235).

Thus, culture is an important organizational aspect which influences ethical behavior. It complements organizational structure by ‘filling in the gaps’ that exist in formal organizational structures (James, 2000).

In the remainder of this chapter, I shall emphasize the role of organizational architecture in reinforcing ethical behavior.

3 ETHICAL BEHAVIOR

According to Beauchamp and Bowie (2008), ethics pertains to good and evil, right and wrong, and thus what people are assumed to do or not. The domain of business ethics concerns the ethics of business organizations and of individuals and groups in business organizations. Lewis (1985) synthesized 38 different definitions and defines business ethics as comprising the rules, standards, principles or codes giving guidelines for morally sound behavior. Ethical behavior implies adherence to these moral norms, whereas unethical behavior implies the violation of these moral norms. Unethical behavior in and of business organizations is behavior which is morally unacceptable for the larger community (Jones, 1991). An essential feature of unethical behavior is that it concerns misbehaviors where fundamental interests are at stake. Contrary to rule breaking, criminal behavior and noncompliance, unethical behavior is not limited to violations of official and explicit standards, rules and laws, but includes violations of informal and implicit norms.

Business organizations and their employees bear ethical responsibilities. A much-used theory to ground these ethical responsibilities is stakeholder theory. Originally developed by Freeman (1984), this theory holds that business organizations have multiple relationships with all kinds of individuals, groups and organizations. These stakeholders enter into a relationship with business organizations to protect or promote their interests. Because a business organization and a stakeholder become interdependent, mutual expectations arise between both parties demanding that they engage with others’ interests in an ethically responsible manner. Kaptein (2008) states that because of the existence of different ethical responsibilities to each stakeholder group, different types of unethical behavior exist toward the most important stakeholder groups: financiers, customers, employees, suppliers and society.

Thus, ethical behavior can be defined as employee behavior that is
Reinforcing ethical behavior through organizational architecture

consistent with the norms and values, rules and obligations of the stakeholders of the organization.

4 ORGANIZATIONAL ARCHITECTURE AND ETHICAL BEHAVIOR

Jensen and Meckling (1976) and Brickley et al. (1995) developed organizational architecture out of a classical theory of the firm that has evolved from Coase (1937), Hayek (1945), Williamson (1964), and Alchian and Demsetz (1972), among others, and is rooted in the context of the ‘traditional firm’.

Organizational architecture refers to three key dimensions of the firm: (a) the assignment of decision rights within the organization, (b) the structure of systems to evaluate the performance of both individuals and business units, and (c) the methods of rewarding individuals. Brickley et al. (1995) argue that successful corporations assign decision rights in ways that effectively link decision-making authority with necessary information for making value-enhancing decisions. When assigning these decision rights, however, senior executives must ensure that the company’s performance evaluation and reward systems provide decision makers with appropriate incentives to undertake value-increasing decisions. They also state that the components of organizational architecture are fundamentally interdependent. The appropriate performance evaluation system depends on the allocation of decision rights and vice versa. Within a well-structured firm, the various components of organizational architecture are mutually consistent and reinforcing. They are like three legs of a stool: all three must be coordinated to ensure that the stool is functional.

Performance evaluation and compensation practices may create incentives or pressures for employees to behave unethically. How employees respond to such incentives or pressures depends in part on whether they have decision-making authority and control over the decision-making process. Business ethics and the organization’s organizational architecture are therefore inextricably linked. The joining of organizational architecture and ethics research generates many interesting questions which have not yet been explored empirically.

How do employees respond to questions of ethics when they operate in a centralized or decentralized organizational structure? Do employees behave in an ethical manner if their performance is closely monitored, also with regard to integrity behavior? Can reward systems be designed to guide ethical behavior? Is there a difference in ethical behavior for those who work in an organization with a highly developed organizational
architecture versus those who work in an organization with an organizational architecture that is less developed?

In the following subsections, I shall further elaborate on the three elements of organizational architecture and how they relate to ethical behavior.

**Assignment of Decision Rights**

In a hierarchical, vertically structured organization, authority for making critical organization-wide decisions is located or ‘centralized’ in the top apex of the organization among the executive officers. In contrast to centralized decision making, management’s intent in decentralizing is to allocate responsibility more widely throughout the structure, both vertically and horizontally.

Decentralization leads to a shift in responsibilities. Employees in the lower echelons are given greater responsibilities. The corporation, thereby, has become more dependent on, and therefore vulnerable to, the intentions and intuitions of employees.

In general, the need to organize ethics is partly a consequence of the increased decentralization within many companies. The primary rationale for decentralization in today’s complex and dynamic external environment is to equip the organization to respond more quickly to customers and rapidly changing competitive threats. Decentralization enables organizations to respond immediately to the situation, which can mean the difference between success and failure (for example, Pound, 1995; Hitt et al., 1998; Hankinson, 1999; Stanford, 2002).

The nature of decision-making rights and responsibilities affects the ethical sensitivities and behavior of employees. Compensation practices and performance evaluation may create incentives or pressures for employees to behave unethically. How employees respond to such incentives or pressures depends in part on whether they have decision-making authority and control over the decision-making process.

In a centralized structure, especially a highly centralized one, a positive relationship exists between the individual’s level of authority and the potential for opportunistic action to increase one’s personal interests: the higher the level, the higher the potential return when opportunistic actions are taken. The more decisions are shared, the fewer the opportunities to act independently in one’s own interests. A decentralized structure therefore diminishes opportunities to further one’s own interests. Considering the ethical ramifications of organizational decisions and providing opportunities for employees at all levels to participate in decision making can increase the likelihood that ethically suspect means of reaching
institutional goals will be questioned before they result in damaging con-
sequences (Cohen, 1993).

A number of theorists have stressed the relationship between decen-
tralized decision making and ethical behavior (Yukl, 1989; Metzger and
Schwenk, 1990; Ocasio, 1994; Daboub et al., 1995; Mayer and Davis,
1995). Among these theorists, the two who make the strongest plea are
Collins (1997: 504), who speaks of the ‘ethical superiority of participatory
management’, and Sashkin (1986: 74), who believes that ‘participative
management is an ethical imperative’.

Organizational structure may also serve to diffuse responsibility for the
consequences of action by promoting external definitions of responsibility
based upon formal role definitions, hierarchy, and authority jurisdictions.
Individuals can avoid guilt by believing that they had no choice and, there-
fore, are not responsible for their actions or the consequences (Kelman
and Hamilton, 1989). Employees who feel compelled to act unethically –
either because a manager tells them to or because they lack the author-
ity to propose or choose more ethical alternatives – are more likely to act
unethically. Kanter (1983) argues that a culture dominated by restrictive
vertical relationships, where duties are finely specified and honoring the
chain of command is of utmost importance, is a culture that protects
against individual action. In such a segmented structure, the isolated indi-
vidual is encouraged to do as he or she is told, to work without troubling
others, to see only local manifestations of a problem, and to take responsi-
bility only for his/her limited, compartmentalized actions. It appears that
the advantages of a flat hierarchy are counteracted by cultural messages
that discourage upward communication about problem areas. Even well-
intentioned organizational characteristics (for example, decision-making
authority) can ‘backfire’ on the ethical front when the culture reinforces
the belief that value conflicts experienced down the line are not a priority
concern for top management (Kram et al., 1989).

Structure of Performance Evaluation

Agency theory states that broadening the scope of an agent’s activities by
delegating more decision rights provides the agent with substantial degrees
of freedom to make trade-offs among these activities (Jensen, 2001;
Prendergast, 2002). This creates a need for performance measures that
allow for (more) discretion, but at the same time creates a need for con-
straining the agent’s actions to prevent the extraction of private benefits.

Prendergast (2002) argues that this delegation-incentive problem can be
addressed by tying pay to an aggregate measure of performance. The
use of an aggregate measure provides incentives for the agent to make
trade-offs among all available activities, supporting the delegation of decision rights. The aggregate measure also allows the principal to constrain the agent’s actions to those in the principal’s interest by tying this measure to pay. As a result, an aggregate performance measure can complement the delegation choice by allowing discretion to those with decision-relevant information (the agent) while also providing those lacking this information (the principal) with an instrument to constrain the extraction of private benefits. Comprehensive financial (accounting) measures, such as the net income or return on assets, represent the most aggregate performance measures because the full consequences of every action the agent takes ultimately flow through the financial statements.

In contrast, using specific measures for subsets of the agent’s available actions reduces the ability to make trade-offs, which effectively reduces delegation (Jensen, 2001; Abernethy et al., 2004). Moreover, since the benefits of delegation are highest in settings where the principal has no idea what the agent should be doing, it is difficult to tie pay to multiple specific performance measures because the principal is unable to identify the specific actions the agent should take and, therefore, the specific measures and their weighting (Prendergast, 2002).

A number of authors have argued that broadening the set of performance measures enhances organizational performance (for example, Lingle and Schiemann, 1996; Edvinsson and Malone, 1997). The premise is that managers have an incentive to concentrate on those activities for which their performance is measured, often at the expense of other relevant but non-measured activities, and greater measurement diversity can reduce such dysfunctional effects (Lillis, 2002). Analytical studies have further identified potential benefits from using performance measures that are subjectively derived (for example, Baker et al., 1994; Baiman and Rajan, 1995).

However, the literature has also noted potential drawbacks from measurement diversity. It increases system complexity, thus taxing managers’ cognitive abilities (Ghosh and Lusch, 2000; Lipe and Salterio, 2000, 2002). It also increases the burden of determining relative weights for different measures (Ittner and Larcker, 1998; Moers, 2005). Finally, multiple measures are also potentially conflicting (for example, manufacturing efficiency and customer responsiveness), leading to incongruence of goals, at least in the short run (Holmstrom and Milgrom, 1991; Baker, 1992), and organizational friction (Lillis, 2002).

Despite these potential drawbacks, there is considerable empirical support for increased measurement diversity. For example, Van der Stede et al. (2006) have found evidence that firms with more-extensive performance measurement systems, especially ones that include objective and subjective nonfinancial measures, have higher performance.
Performance monitoring processes are important determinants affecting the ethical sensitivities and behaviors of employees because they are the primary means of informing employees about what is expected of them. Ethics concerns can be made part of a firm’s performance measurement system. Poorly designed and implemented performance and evaluation processes will not only fail to detect unethical behavior, but also inadvertently encourage such behavior by creating the expectation that unethical behavior is tolerated or necessary in order to achieve corporate goals. In effect, employees may misbehave because they believe that their superiors and the organization expect such behavior of them. Ethically sensitive performance and evaluation processes are increasingly important as organizations become larger and more complex, and as the interactions between individuals within organizations and organizational subunits become increasingly formal, complex, and impersonal (Vaughan, 1983).

Business managers can promote ethical behavior within firms by ensuring that the processes by which employees are monitored and evaluated do not create ethical tensions within the organization. Ethical tensions arise when managers, as well as stated policies and procedures, create pressures for workers to comply with decisions that they believe are ethically questionable (Carrol, 1975).

Evaluation of employee performance must reinforce the expectation that ethical behavior is desired and that unethical behavior will not be rewarded. This occurs when management establishes guidelines specifying how employees are to achieve stated corporate goals, when managers monitor the ethical performance of employees through feedback and other appropriate control processes (Treviño and Nelson, 2004), and when they remove obstacles impeding employees from making ethical decisions (Vidaver-Cohen, 1998).

Ethics programs can be developed as a form of organizational control based on the propagation of rules and the use of behavioral monitoring and discipline, affecting behavior through rewards for rule compliance and punishment for noncompliance (Adler and Borys, 1996; Weaver et al., 1999). Alternatively, ethical behavior can be achieved in more encouraging and noncoercive ways, appealing to employees’ sense of obligation and their aspirations to act ethically (Weaver et al., 1999). These approaches, which in the literature are referred to as ‘compliance’ and ‘values orientations’, respectively, are not mutually exclusive. Research has found that many companies combine these approaches in some way. However, in most companies, an emphasis on a compliance orientation predominates (ibid.).

Weaver and Treviño (2001) state that if concern for ethical behavior is not incorporated into performance appraisal, an organization will be less
able to articulate a values orientation that is integrated across the organization. If this happens, employees may suspect that some organizational processes and individuals are not accountable to the ethical ideas of the organization and they may be tempted to test the organization to see if they are among those who are excused from ethical behavior. To support a values-oriented, integrated ethics program, performance evaluation processes should incorporate concern for ethics and fairness, both in the evaluative criteria used and in the way that appraisal is conducted.

Individuals who have decision authority which is appropriately collocated with their knowledge and who feel that their performance is evaluated and linked to an appropriate reward system are likely to conform to the desires of the stakeholders of the organization. Role theory helps us to understand the way individuals behave ethically. Role theory posits that human behavior is guided by norms and expectations held both by the individual and by other people. The norms and expectations for functionally differentiated sets of behaviors among employees are referred to as ‘roles’, which add structure to interpersonal relationships at work (Katz and Kahn, 1978). Roles consist of a set of rules or norms that function as plans or blueprints to guide behavior, specifying what goals should be pursued, what tasks accomplished and what performances are required in a given situation. In a firm, these rules and norms are specified by the assignment of decision rights and the performance evaluation system. These elements of the organizational architecture provide a structure where employees are held responsible and need to justify their behaviors to managers with reward and sanction authority, where the rewards and sanctions are perceived to be contingent upon the evaluation of such conduct.

**Reward Systems**

Reinforcement theory states that employees are more likely to do what is rewarded and avoid doing what is punished (for example, Skinner, 1953; Paine, 1994; Kaptein and Wempe, 2002; Storr, 2004; Dunn and Schweitzer, 2005).

Francis (1990) argues that the dominance of financial rewards in the traditional workplace is a key obstacle to transforming business into a moral practice. If performance evaluation systems are solely based on financial measures and rewards, workers and managers are encouraged to take actions that lead to favorable individual evaluations, but that may be detrimental to the organization’s overall goals. It is therefore important to incorporate ethical considerations into performance evaluation and reward systems.
However, ethical behavior may respond in a different manner to rewards. Treviño and Youngblood (1990) failed to find that providing indirect rewards for ethical behavior increased ethical decisions. From a practical point of view, it is not easy to reward ethical conduct in organizations. Most ethical conduct is simply expected, and employees do not expect to be rewarded for not cheating on their expense reports or not harassing co-workers. Rewards for normally expected behavior may conflict with some employees’ beliefs that ethical behavior should be its own intrinsic reward, and that ethical behavior is diminished in stature if it is rewarded (Weaver and Treviño, 2001). Although people do not expect rewards for doing the right thing, they do not want to feel ‘punished’ for doing so because others get away with misconduct or are rewarded for it (Treviño and Ball, 1992).

Therefore, short of customizing rewards to the specific motivations of individual employees, rewards for ethical conduct might be best presented in the form of long-term rewards such as promotions, or as symbolic rewards (for example, recognition and praise) rather than pecuniary rewards (for example, bonuses), so as to not diminish the status of ethical behavior in the mind of the person who acts ethically. It is essential for employees to feel that, over time, people of integrity are the ones who get ahead in the organization.

Rewards and punishments can inadvertently increase unethical behavior when they positively reinforce unethical conduct or punish ethical behavior (Hegarty and Sims, 1978; Treviño, 1990). Conflicts between espoused ethical values and an organization’s reward system, result in ethical ambivalence, increasing the potential to undermine management’s ethical intentions (James, 2000). An ethical culture should include a reward system that supports ethical conduct and punishes unethical behavior. However, research suggests that employees’ perceptions that ethical behavior is rewarded were more important than were perceptions that unethical behavior is punished (Treviño and Nelson, 2004).

It may be extremely difficult to formally measure and consequently reward how well employees follow appropriate standards of conduct, since typically, appropriate behavior reflects the absence of illegitimate practices (Treviño, 1990). However, some organizations have successfully linked performance appraisal to observance of company codes of conduct, while others reward ethical conduct by publicly recognizing employees who detect ethical problems in the organization or those who have made exceptional contributions to the community (Business Roundtable, 1988). Numerous suggestions have been made in the literature as to how effectively organizational preferences toward ethical actions have been enforced. Murphy (1989) calls for blunt and realistic sanctions to create
an ethical business environment. Gellerman (1989) advocates unusually high rewards for good performance, unusually high punishments for bad performance, and an implicit sanctioning of explicitly forbidden acts. However, these suggestions suffer from a lack of empirical validation. In contrast, Baucus and Beck-Dudley (2005) state that the heavy reliance on rewards and punishments creates organizations that operate at the lowest levels of moral reasoning (Colby and Kohlberg, 1987), resulting in unethical behavior. Cohen (1993) argues that anomie in an organization is often directly related to the criteria used for administering punishment or reward. In organizations that operate exclusively on performance-outcome-based incentive systems, rewards in the form of compensation, power and status are administered in direct proportion to goals achieved. When performance goals are excessively demanding, the message conveyed to employees is that any means available may be used to achieve these goals, regardless of the legitimacy of those means, and anomie ensues (ibid.).

5 CONCLUSION

Over the past few decades, ethics programs have proliferated. These programs have proved useful in informing employees about legal requirements of the organization, addressing specific concerns and serving as guidelines for required practice within the organization. However, unethical conduct continues to occur as is evidenced by a variety of sources, varying from, for example, the regular survey results of the Ethics Resource Center (Arlington, VA) to frequent media attention which results from ethical incidents in the corporate world.

Organizations do not behave unethically, people sometimes do. An organization can only be as ethical as the people who own, manage and work for it. However, its organizational architecture can be more or less conducive to ethical conduct. One way to ensure that employees behave appropriately is for the organization to provide an effective organizational architecture. If employees at all levels are provided with opportunities to participate in decision making, realize that their performance is measured and embedded in an effective reward structure and know exactly what the organization expects from them in terms of ethical behavior, then there should be more ethical behavior on the part of these employees.

The three dimensions of organizational architecture presented in this chapter – assignment of decision rights, structure of performance evaluation, and reward systems – have significant research implications which need further grounding in empirical research.
By understanding how ethical behavior is affected by dimensions of organizational architecture, researchers can assist managers in creating a more ethical environment in organizations, ultimately allowing them to be more successful.

REFERENCES


Reinforcing ethical behavior through organizational architecture


