THE HIDDEN COSTS OF UNETHICAL BEHAVIOR

- ✓ *training programs*
- ✓ *consulting*
- ✓ *audits and surveys*
- ✓ *communications*

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You know that good ethics carries many benefits — and its opposite, many penalties. The problem is thinking that ethics is someone else's issue, that you and your company are basically fine, that everything is under control. There may be a lot you don't know. And when it comes to workplace ethics, what you don't know can definitely hurt you.

Only one organization has the expertise you need to go to a higher level and become part of a more successful company. Look at the research on the following pages, then give us a call.

The Josephson Institute of Ethics
uniquely effective training and consulting services to help you eliminate costly unethical behavior

✓ **UNETHICAL BEHAVIOR HARMS SALES.** In a 2003 survey by Wirthlin Worldwide, 80 percent of people said they decide to buy a firm's goods or services partly on their perception of its ethics.

✓ **UNETHICAL BEHAVIOR HARMS STOCK PRICE.**

- Seventy-four percent of people Wirthlin polled said their perception of a firm's honesty directly affected their decision about whether to buy its stock.
- Investments in unethical firms earn abnormally negative returns for prolonged periods. (D. Michael Long and Spuma Rao, "The Wealth Effects of Unethical Business Behavior," Journal of Economics and Finance, vol. 19, no. 2, Summer 1995, pp. 65-73)

✓ **UNETHICAL BEHAVIOR WORSENS THE RISKS FROM SCANDAL.** It can cause:

- ***Civil charges***, with the likelihood of bad publicity and large awards. An ethics program helps identify and halt misconduct early.
  - It can also help prevent future court costs, since today's ethical guideline is often tomorrow's legal requirement.
- ***Criminal charges***, with the possibility of fines up to $500 million and more, and jail time.
  - A judge can reduce fines by up to 95 percent, as well as jail time for executives, if a firm has an ethics program in place. (U.S. Federal Sentencing Guidelines for Organizations)
- ***Indelible stain.*** Once the public views a company as corrupt, the taint can be permanent. "It takes years to build a good business reputation, but one false move can destroy it overnight." — Edson W. Spencer, former chairman, Honeywell (in Robert Cialdini, Petia Petrova and Noah Goldstein, "The Hidden Costs of Organizational Dishonesty," MIT Sloan Management Review, v. 45, no. 3, Spring 2004, pp. 67-73)
- ***Bankruptcy.*** Enron, WorldCom, Global Crossing and others are only the best known of the firms that went bankrupt morally before financially.

✓ **UNETHICAL BEHAVIOR WORSENS EMPLOYEE FRAUD**, which is often hard to spot. Employee fraud:

- ***Costs firms $600 billion a year***, or six percent of the U.S. GDP. (Association of Certified Fraud Examiners, 2002 Report to the Nation on Occupational Fraud and Abuse)
- ***Costs employers 20 percent of every dollar earned***, according to U.S. workers surveyed in 2002 by Ernst & Young. (The CPA Letter, October 2002)
- ***Is nearly twice as common as consumer fraud*** (e.g., credit card fraud, identity theft). (KPMG Fraud Survey 2003)
- ***Is worsening rapidly.*** Fraud has grown by 50 percent since 1996. (Association of Certified Fraud Examiners, 2002 Report to the Nation on Occupational Fraud and Abuse) Since 1998, payroll fraud has quadrupled, theft of company assets has more than doubled and expense-account abuse nearly tripled. (KPMG Fraud Survey 2003)
- ***Would drop if managers were better role models*** and leaders, according to 58 percent of workers surveyed. (Ernst & Young, in The CPA Letter, October 2002)

✓ **UNETHICAL BEHAVIOR WORSENS PRODUCTIVITY.** "Nobody … should have any doubts of the linkages between poor ethics in the workplace and low productivity. . . . When workers don't trust each other and their supervisors, then morale is low, stress is high and output is undermined." — Kenneth C. Frazier, chairman of the Ethics Resource Center and vice-president and general counsel of Merck (2003 National Business Ethics Survey) *Consider:*

- ***Companies without a code of ethics do worse.*** In one study they generated significantly less economic value added (EVA) and market value added (MVA) than those with a code, experienced more P/E volatility, and showed a decline in average return on capital employed, while those with a code of ethics showed a 50 percent increase. (Simon Webley and Elise More, Does Business Ethics Pay?: Ethics and Financial Performance, Institute of Business Ethics, London, 2003)

Eighty percent of people say they decide to buy a firm's goods or services partly on their perception of its ethics. — 2003 survey, Wirthlin Worldwide

Investments in unethical firms earn abnormally negative returns for prolonged periods.

— D. Michael Long and Spuma Rao, "The Wealth Effects of Unethical Business Behavior," *Journal of Economics and Finance*

- ***Companies with ethics programs showed up to three times greater market value added*** than companies lacking them (Curtis C. Verschoor, "Corporate Performance Is Closely Linked to a Strong Ethical Commitment," Business and Society Review, Winter 1999).

- ***Firms not explicitly committed to ethical dealings had worse profit/turnover ratios***, 15 percent lower than others. (Simon Webley and Elise More, Does Business Ethics Pay?: Ethics and Financial Performance, Institute of Business Ethics, London, 2003)

- ***Employee dissatisfaction translates into lower profits.*** (James L. Heskett, Thomas O. Jones, Gary W. Loveman, W. Earl Sasser, Jr. and Leonard A. Schlesinger, "Putting the Service-Profit Chain to Work", *Harvard Business Review*, March/April 1994)

- ***Workers less generous with their time are less productive.*** Others help them less and they have lower social standing. (Francis J. Flynn, "How Much Should I Give and How Often? The Effects of Generosity and Frequency of Favor Exchange on Social Status and Productivity," Academy of Management Journal, vol. 48, no. 5, 2003, pp. 539-553)

UNETHICAL BEHAVIOR ESPECIALLY WORSENS PERFORMANCE OF THE HIGHLY SKILLED. They show the greatest drop in productivity — as much as 25 percent — because of others' unethical behavior. (P.E. Varca and M. James Valutis, "The Relationship of Ability and Satisfaction to Job Performance," *Applied Psychology: An International Review*, v. 42, no. 3, 1993, pp. 265-275) These people are the linchpin of the firm, contributing the most to its revenues and reputation. (Robert Cialdini, Petia Petrova, and Noah Goldstein, "The Hidden Costs of Organizational Dishonesty," MIT Sloan Management Review, v. 45, no. 3, Spring 2004, pp. 67-73) The highly skilled can also switch jobs more easily.

UNETHICAL BEHAVIOR WORSENS EFFICIENCY. For instance:

- ***It increases misconduct.*** In one survey, 71 percent of employees who saw honesty applied rarely or never in their organization had seen misconduct in the past year, compared with 52 percent who saw honesty applied only occasionally, and 25 percent who saw it frequently. The figures were similar for respect and trust. (2000 National Business Ethics Survey)

- ***It increases conflict*** and often drives it underground to smolder. Hence Sears gained a 4-to-1 return by starting an in-house dispute resolution mechanism, according to vice president William Giffin. (CIO, June 15, 1999)

UNETHICAL BEHAVIOR WORSENS COMMUNICATION.

- ***It reduces the incidence of reporting misconduct.*** In the 2003 National Business Ethics Survey, 39 percent of employees at firms with no ethics programs reported misconduct when they saw it. By comparison, 52 percent did so in organizations with ethical standards alone, 67 percent with standards and either ethics training or an advice line/office, and 78 percent in firms with all three.

UNETHICAL BEHAVIOR WORSENS RETENTION AND RECRUITING. In the 2000 National Business Ethics Survey, 79 percent of employees said their firms' concern for ethics was a key reason they remained. Overall, ethical firms have lower turnover, so they tend to hold onto important skills and waste less time training new employees. They also attract top-flight talent more easily.

Companies without a code of ethics experience more P/E volatility and a decline in average return on capital.

— 2003 study, Institute of Business Ethics, London

Companies with ethics programs showed up to three times greater market value added than companies lacking them.

— *Business and Society Review*, Winter 1999

- ***Companies with the highest employee retention have the highest customer retention.*** (Bain and Co., cited in "The Success of the Socially Responsible Business and Investment Movements," speech given by Gordon Davidson at the World Future Society Conference, July, 2003)
  - ***Just a five percent improvement in customer retention consistently improves profits by 25-100 percent.*** (Frederick Reichheld, Bain and Company, The Loyalty Effect, Harvard Business School Press, 1996)
- ***Turnover is expensive.*** The average company loses approximately $1 million with every 10 managerial and professional employees who leave the organization. (J. Fitz-enz, "It's Costly to Lose Good Employees," Workforce, 50, 50, 1997.)

UNETHICAL BEHAVIOR WORSENS EMPLOYEE ABSENTEEISM.

- ***Absenteeism is 17 percent higher*** among companies with poor or fair morale than those with good or very good morale.
- ***It's more costly.*** Low-morale firms set aside 5.3 percent of their budgets to cover the costs of absent workers, while high-morale firms set aside 3.7 percent.
- ***It's a more prominent problem***. Forty-one percent of low-morale organizations feel absenteeism is a serious issue, while just 20 percent of high-morale firms feel the same.
- ***It's more likely to be growing.*** Thirty-four percent of low-morale companies said their unscheduled absences increased over the past two years and 38 percent believed they would increase in the future. Just 15 percent of high-morale firms reported increased absenteeism and only 14 percent believed absences would rise in the future. (All the above from a poll conducted by Harris Interactive, in CCH Human Resources Management Ideas & Trends, October 22, 2003)
- Unethical behavior worsens "presenteeism," that is, workers showing up when ill, thus infecting others, performing ineffectively and reducing productivity.
  - Fifty-two percent of low-morale firms said presenteeism was a problem, compared to 38 percent of high-morale firms.
  - Low-morale firms reported that 33 percent of unscheduled absences were due to personal illness, compared to 39 percent at high-morale companies. (All from a poll conducted by Harris Interactive, in CCH Human Resources Management Ideas & Trends, October 22, 2003)

UNETHICAL BEHAVIOR WORSENS SABOTAGING BEHAVIOR, such as:

- ***Underdelivering*** on commitments because another person's priorities don't matter to you.
- ***Overpromising*** to win a customer, gain support for a pet project or avoid a confrontation.
- ***Turf-guarding:*** Wasting time and energy to maintain control in your bailiwick.
- ***Goal lowering:*** Aiming for adequacy, because you fear the consequences of failure more than you value the rewards of success.
- ***Budget twisting***, such as padding the budget in anticipation of cuts or going on end-of-the-year spending sprees to match estimates to actuals.
- ***Sharp-penciling:*** Fudging reported results to stay competitive for pay and promotions.
- ***Fact hiding:*** For instance, allowing the boss to fail by withholding information and not pointing out risks, or not telling people you need more time or don't fully understand.
- ***Detail skipping:*** Paying insufficient attention to the small things.
- ***Praise pinching:*** Inadequately acknowledging the good work of others.
- ***Credit hogging:*** Taking credit for others' work, as when an individual claims responsibility for a group report.
- ***Blame buffering:*** Wasting time and energy, as by writing endless memos, to distance yourself from potential bad decisions.
- ***Scapegoating:*** Faulting others for your own bad decisions or poor results.

(The Online Ethics Center for Engineering and Science at Case Western Reserve University)