ORGANIZATIONAL DESIGN AND BUSINESS ETHICS

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Abstract

Organizational design theories are reviewed to determine their relationship to ethical decision-making and the development of moral reasoning. Empirical studies conducted to determine the affect that organizational designs have on ethical behavior and moral reasoning are reviewed. The analyses indicate that there is relationship between organizational design, ethical behavior, and the development of moral reasoning, however other factors such as organizational environments, corporate norms, values and cultures can play an important role in enhancing or discouraging ethical behavior and the development of moral reasoning.

Introduction

Society is becoming increasingly concerned about business ethics and the social responsibilities of business organizations. The attitude of the American public is changing and business organizations are expected to play an increasing role in the solving of social problems. It is no longer acceptable for a business organization to be motivated solely by profit and for the first time in history, society expects business institutions to behave morally (Fasching 1981).

Ethics is a discipline that studies moral reasoning and the goodness or badness of a particular behavior (White 2000). There will always be some conflict between personal morality and managerial obligations. This conflict is what makes humans moral creatures (Fasching 1981). For business organizations to remain competitive and ensure their survival, business owners and managers must make informed decisions about the organizational structures that are necessary to develop the ethical behavior and moral reasoning of its members. Ethical decision-making is necessary to ensure the future existence of capitalism and a free-market economy.

A structural level analysis of an organization can be performed using three different perspectives: rational, natural, and open systems. All three perspectives acknowledge a vital and complex relationship between an organization and the environment in which the organization operates. However, the open systems perspective views an organization's structure as a product of its environment whereas the rational and natural systems perspectives view an organization as a closed system where an organization's environment has little affect on organizational structure.

The rational systems perspective on organizational structure emphasizes specific goals and a formal, well-defined organizational hierarchy. Leadership roles are methodical and incorporated into the formal structure of an organization and each position in the organization is well defined. The power a particular individual holds in the organization is determined by the position a person holds and decisions are usually made by one individual. A well-defined hierarchy in an organization is used to accomplish stated goals efficiently and to discipline members of the organization. The formal control systems of the organization are used to channel and coordinate behavior to obtain specific goals (Scott 2003).

The natural systems perspective on organizational structure focuses on the behavioral aspects of an organization and acknowledges that there is a difference between the stated goals of an organization and its real goals. Organizations are viewed as social groups that adapt their structures to accomplish stated goals. There is more to the structure of an organization than prescribed rules and a formal hierarchy. Individuals hired by an organization bring their own set of unique values, interests, and abilities and these characteristics cannot be ignored when developing a structure of an organization. The natural systems perspective recognizes the importance of the intelligence and innovation of each worker and that the non-rational aspects of organizational behavior cannot be completely controlled by formal structures and well-defined rules. Informal structures develop among the workers of an organization and these informal structures are more instrumental in determining behavior than a formal set of rules (Scott 2003).

The open systems perspective on organizational structure focuses on the environments an organization operates in and these environments ultimately shape, support, and permeate organizational structures. An organization will take on a variety of structures of varying complexity that are determined by the variety and complexity of an organization's environments. An organization is viewed as a system of interrelated activities, some which are precisely connected, and some that are proximately connected. The best organizational structure is ultimately determined by the environments in which an organization operates (Scott 2003).

Business organizations operate in multiple environments; however, the economic environment a business organization operates in is the most likely environment to cause decision-makers to act unethically. Unrealistic profit expectations and the over emphasis of profits by stakeholders can circumvent business policies and organizational structures designed to encourage ethical behavior and develop the moral reasoning of a business organization's workers.

This paper presents a review of theories related to organizational structures and their affect on the ethical decision-making and the development of moral reasoning of the members of a business organization. Additionally, a review of studies conducted to determine if the structure of an organization could influence the business ethics and moral reasoning of a business organization's managers, employees, and directors is presented. While some elements of this paper could apply to all types of organizations, the focus of this paper is the correlation between the structures of business organizations and the moral reasoning and ethical decision-making by members of business organizations.

Why Ethics is Important to Capitalism

Capitalism is an establishment created by society and is a mechanism for increasing the well being of society as a whole. Capitalism can be viewed as a self-regulating institution where ethical choices take precedents over economic decisions. Unethical decisions are made when greed is powerful enough to bypass the self-regulating system of capitalism. Greed is the source of most ethical problems in the current business environment.

Capitalism was created by society and it has been accepted as a mechanism for successfully providing material wealth to members of society. Business organizations must be self-regulating and develop structures and rules that promote ethical behavior and limit unethical behavior. Private enterprises are better than government only if they can monitor themselves and they must develop structures and rules that ensure social responsibility. If society were to view capitalism as doing more harm than good because of the unethical actions of members of business organizations, capitalism would become regulated by society to the extent that the institution could no longer provide material wealth or it may simply be eliminated by society.

Without a commitment to ethical behavior, business organizations may become self-destructive. Actions such as price-fixing, mishandled use of inside information, and illegal payoffs can have a destructive effect on the capitalist system. Unethical behavior can circumvent the laws of supply and demand and affect competition based on product quality, service, and price.

Micro-Ethics and Macro-Ethics

The social responsibility of business organizations can be divided into two areas: micro-ethics, which deals with educating business managers to make moral decisions, and macro-ethics, which deals with incorporating ethical concerns into the structure of a business organization.

Micro-ethics is concerned about educating managers and providing decision makers with the ability to make decisions. Ethical reasoning can only be taught to individuals who desire to know; ethics cannot make people moral. The members of an organization must have the courage to speak their mind and do what the believe is morally correct. The decisions managers make may not always be correct and moral decisions can cause pain because the process of moral decision-making often involves the sacrifice of short-term goals in pursuit of an organization's long-term goals. It may be necessary to terminate certain employees to ensure the long-term survival of an organization.

While micro-ethics focuses on the conscience of decision makers, macro-ethics focuses on the behavior of a business entity. Social responsibility may begin with the CEO and board of directors but to facilitate ethical decision-making and the development of the moral reasoning of decision makers the commitment to ethical behavior must permeate all levels of a business organization. Organizations must provide concise guidance to members as to what constitutes ethical behavior and organizations must be structured in such a way to give decision-makers the ability to make ethically correct decisions. A business organization must also develop an accountability system that rewards moral behavior, punishes immoral behavior, and attempts to identify individuals whose motivations are not oriented towards ethical behavior.

Every business entity has at least three fundamental moral obligations: to provide socially valuable products and services, to operate efficiently and effectively to make a profit and maintain the economic health of the organization, and to structure the organization to maintain the dignity of members of the organization and individuals outside the organization (Fasching 1981). To ensure that a business organization meets its moral obligations the following functions should be incorporated into the structure of an organization: an evaluation of the makeup of the board of directors (i.e. the ratio of inside directors to outside directors) and the establishment of committees on organizational responsibility, assigning oversight for organizational responsibility to a well-respected member of upper management, making the board of directors directly accountable for the corporate responsibility function, allocating sufficient staff to audit the effectiveness of the organization's structure in the operating and planning processes of the organization, and allocating staff to be responsible for ongoing ethics training for the organization's decision-makers (Fasching 1981). In short, the organizational structures that monitor corporate responsibility should be at least as sophisticated as the structures that monitor the organization's political, cultural, and economic environments.

Formal Structures and Ethical Decisions

To some degree, formal organization structures are necessary but not adequate in promoting the ethical behavior of a business organization's members. Corporate training and codes of ethics are not enough to promote ethical behavior. Managers should focus on developing organizational structures that do not undermine the ethical sensitivities and attitudes of workers and that reinforce ethical behavior (James 2000).

Three characteristics of formal organizational structures that affect ethical behavior are: the structure of monetary and non-monetary reward systems, the performance-evaluation and individual monitoring systems, and the system of assigning decision-making rights to workers. These three characteristics must be balanced in order to avoid encouraging unethical behavior of workers (James 2000). Behavioral incentives can unintentionally encourage unethical behavior. This does not mean that workers are incapable of making moral decisions regardless of the organizational environment; it simply means that workers who are not developed morally could act unethically if incentive systems unintentionally encourage unethical behavior.

Organizational reward systems are a mechanism to reward the workers of an organization. These rewards can be monetary or non-monetary in nature. Monetary rewards include such items as wages, bonuses, fringe benefits, and profit-sharing plans. Non-monetary rewards include public recognition such as "employee of the week" and rewards of minimal economic value such as tickets to sporting events. One example of how reward systems can unintentionally encourage unethical behavior is an incentive plan implemented by a software development company. Programmers were paid $20 for each program bug that was corrected before the final release of software. The problem with this reward plan was that the programmers who corrected the bugs were the same programmers who created the bugs and programmers were intentionally creating program bugs to net higher bonuses. The unethical behavior by programmers could have been avoided if a reward system that encouraged programmers to create software bugs was not implemented. One could argue that the incentive plan could have worked if the programmers acted ethically but business managers have an obligation to develop structures that are free of obvious and potentially problematic barriers to ethical behavior (James 2000).

Poorly designed performance evaluation systems can promote unethical behavior. Management must establish guidelines to inform workers how they are to accomplish their stated goals. Management must make it clear to workers that profit is the end goal, but the means to that end is important. This philosophy must permeate all levels of an organization. An example of a failed performance evaluation system is the Sears Auto Centers. In an effort to increase revenues and market share Sears implemented a commission-based system that rewarded service representatives based on sales and minimum work quotas. Service representatives who did not meet sales goals faced the possibility of reduced work hours or even a loss of their job. Ultimately to protect their job and compensation base service representatives often performed unneeded repairs on customer vehicles and overcharged for needed repairs. Sears was sued by at least 40 state attorney generals. Not only did Sears create a culture that over-emphasized profit, it failed to establish an evaluation system that monitored how customer service representatives were meeting their sales goals.

The degree to which a worker can or cannot control the types of decisions they make can affect their ethical behavior. Business managers can promote ethical behavior by ensuring that a system is in place to empower employees with the most knowledge of a situation with decision-making rights. Workers may act unethically because their boss told them to or they may lack the decision-making authority necessary to choose ethical courses of action. An example of a situation where decision-making rights were not correctly assigned is the space shuttle Challenger accident. The space shuttle Challenger exploded minutes after take off because hot gases leaked from the seals that bound sections of the spacecraft's rockets. Engineers at NASA were adamant about not launching the shuttle in cold weather. Managers at NASA decided that it was acceptable to launch the shuttle in cold weather because launches in cold weather were performed in the past without incident. The space shuttle exploded because workers (engineers) with the knowledge relevant to the decision were not granted decision-making rights.

Ethical dilemmas that occur because of a failure to link decision-making rights with knowledge can occur in both centralized and decentralized organizational structures (James 2000). In centralized organizational structures, the decision-making power may be vested in individuals who lack the appropriate knowledge to make ethical decision. In decentralized organizational structures, problems can occur because workers often make decisions in groups and no one individual is responsible for making ethically sound decisions. If the decision-making process is not properly monitored in decentralized organizations, there would not be an incentive for workers to behave ethically.

In summary, the implementation of corporate codes of ethics and worker training programs will be effective in encouraging workers to behave ethically only if the are accompanied by properly implemented incentive plans, performance monitoring and evaluation systems, and systems that assign decision-making rights to individuals with the appropriate knowledge to make ethical decisions.

Rational Systems Approach to Ethical Decision-Making

There is very little literature that deals with the relationship of formal organizational structures and ethical behavior. If organizations are viewed as rational, deliberate systems then one must ask if guidelines already exist in organizational theory to enable business designers to develop organizational structures that promote and foster ethical behavior. If a business organization has reliable systems in place to accomplish stated organizational goals can these same systems be used develop organizational structures that promote ethical behavior?

Reliability can be defined as the extent to which a procedure, design, or system produces the same results on successive trial. Reliable organizations perform functions without failure in specific environments for desired periods at a given acceptable error rate (Husted 1993). Reliability can be used as a framework to design organizations that promote ethical behavior.

Individual workers' interests may be best served by working against the general interest of a business organization. The goal of organizational design is to create institutions where individuals working in their own self-interest make ethically sound choices. An ethical system can also be a reliable system that takes into account stakeholders despite employees who put their own interests ahead of the interests of a business organization.

Reliability can be incorporated into organization design in two ways: redundancy and requisite variety. Redundancy refers to the number of backup systems that exist to ensure that appropriate actions are taken in the event of a failure of a particular decision-making group. Requisite variety refers to the need for organizations to match their internal control systems with enough variety to cope with the given complexity of an organization's environments.

The principles of redundancy suggest that the rational systems theory of organizational design is not an adequate structure to promote ethical behavior. Decisions are often made by one individual in an organization with a well-defined hierarchy. Redundant systems should be incorporated into the rational systems theory of organizational design to ensure that ethical decisions are made. Redundant systems are most important in tightly coupled organizational systems because mechanisms are not in place to easily adapt the decision-making process to accommodate unexpected situations. An example of a redundant system is the establishment of an environmental regulations department in a household products company. The in-house environmental regulations department frequently inspected facilities to ensure compliance with environmental regulations. By establishing a "pseudo-EPA" inside the company, the company was assured that at least two separate groups inside the organization were concerned with environmental regulations.

By introducing requisite variety into the decision-making process, business organizations can monitor and detect changes in the environments in which it operates and increase the capacity of decision-makers to generate alternative solutions. Findings suggest that more reliable and ultimately more ethical decisions are made when requisite variety exists among organizational decision-makers (Husted 1993). One example of introducing requisite variety into an organization would be to require the board of directors be made up of a diverse cross-section of individuals such as employees, customers, creditors, suppliers, members of the local community as well as stockholders. Another method of incorporating requisite variety into organizational structures is through the use of a devil's advocate. A devil's advocate is a procedure that involves the assigning of one or more individuals to the task of raising objections to anticipated courses of action and to introduce viable alternatives to planned courses of action.

The focus on reliability to design organizational structures that promote the ethical behavior of workers has its limitations. The ability to incorporate redundant functions into a business organization's structure may be limited by costs. The cost of establishing redundant systems may out weigh the benefits except in potentially high-risk environments. The concept of reliability must also be supplemented with a better understanding of how control systems could affect organizations structured primarily under the natural systems theory of organizational design. It is not practical to assume that business organizations do not have at least some of the characteristics associated with the natural systems theory of organizational design. Given human nature, workers will ultimately be tempted to place their own interests above the interests of the organization. More work is needed to view the limits of reliability under the natural systems theory, which takes into account the cultural and behavioral aspects of organizations (Husted 1993).

Studies Linking Organizational Design and Ethical Behavior

Several studies have been conducted to determine the affect that organizational design has on the ethical behavior and moral reasoning of an organization's members. This paper reports on two recent studies.

White study. Richard D. White, Jr. conducted a study to investigate the relationship between an organization with a rigid hierarchy and the moral development of members of the organization. The study used Kohlberg's six-stage moral development framework to analyze different levels of moral judgment and used Rest's Defining Issues Test (DIT) to measure the level of moral reasoning exhibited by the test subjects.

Kolhberg defines moral judgment according to how people reason and believes that all people pass sequentially from lower stages of moral reasoning to higher stages of moral reasoning. The top two stages of Kolhberg's moral development are: respect rights and values, and act in accordance with universal principles. Rest's Defining Issues Test (DIT) is series of multiple-choice questions that enable researchers to quantify moral judgment. Each question is a moral dilemma and a person must chose what course of action should be taken when confronted with a given situation. Individuals are assigned a DIT score based on the number of choices made that correspond to stages 5 and 6 of Kohlberg's moral development scale. Higher DIT scores indicate a higher level of moral development.

The test was administered to a cross-section of 480 members of the US Coast Guard and compared with a large adult sample of society-at-large. The military was chosen to participate in the study because it is an organization with a stereotypical rigid hierarchy. Additionally several sectors of the US Coast Guard were chosen because some sectors of this organization, such as a coast guard vessel, have a more rigid hierarchy than sectors of the US Coast Guard that are assigned to on-shore operations.

The overall DIT scores of the Coast Guard members were compared to the overall DIT scores of the adult sample of society-at-large. The test found that the overall mean DIT scores of members of the Coast Guard were significantly lower than the overall DIT scores of adults from society-at-large. An analysis of the test results also indicated that the DIT scores of members of the Coast Guard assigned to vessels were significantly lower than the DIT scores of members of the Coast Guard assigned to on-shore duties.

The research conducted by White implies that there is a significant relationship between a rigid organizational hierarch and the moral development of an organization's members. The research suggests that an individual's moral reasoning is adversely affected by organizations that employ a rigid hierarchical structure.

White's research supports previous studies performed by theorists that believe that there is a negative relationship between moral reasoning and rigid hierarchical structures. Previous scholars contended that a rigid hierarchical structure can stifle judgment and lead to an over emphasis of organizational regulations. Bureaucracies and other rigid organizational structures can stifle the moral development of an organization's members and lead to unethical behavior because no individual is responsible for the moral consequences of their actions and they are just following the rules implemented by an organization.

Schminke study. Marshall Schminke conducted a survey to determine the affects that a rigid business organizational structure has on the ethical behavior of workers. Schminke proposed two hypotheses: structurally decentralized organizations will be associated with stronger ethical predispositions and organizations with low structural formalization will be associated with stronger ethical predispositions.

The study consisted of mailing surveys to 285 individuals from organizations that included insurance, telecommunications, food processing, manufacturing, accounting and architectural firms, hospital, university, and city government organizations. The survey questions that addressed centralization inquired about the frequency that an individual participated in decisions regarding the adoption of new programs and policies and how frequently an individual participated in decisions regarding the hire of new staff and the promotion of current staff. The survey questions that addressed structural formalization inquired about the number of rules and regulations that were in place, the availability of a procedural manual, the availability of written job descriptions, the procedures in place to document job performance, and the availability of a formal orientation program for new members of the organization.

The results of the surveys were tabulated and an individual's ethical predispositions were measured using the Measure of Ethical Viewpoints (MEV) method for measuring ethical predispositions. Contrary to the expected results, individuals who were members of decentralized organizations were only marginally more predisposed to ethical behavior than individuals who were members of centralized organizations. Additionally, individuals who were members of organizations with a high level of formalization were significantly more predisposed to ethical behavior than individuals who were members of organizations with a low degree of formalization.

Schminke's study contradicts White's study and previous theories regarding the affects that a rigid organizational hierarchy has on moral development and ethical behavior. One possible explanation to Schminke's conclusions is that politics plays an important role in formal organizational structures. Individuals will find ways to accomplish goals and that unsanctioned behavior, or actions that are not governed by formal organizational procedures, will emerge and take precedence over the formal set of rules in place to govern organizational behavior.

Ethical Behavior in Strategic Alliances and Networks

Recently there has been a shift in corporate strategy from vertically integrated firms to strategic alliances. There are an increasing number of problems associated with the lack of control in network organizations (Daboub 2002). Traditional methods of monitoring ethical behavior are no longer effective as traditional organizations shift to boundaryless organizations and organizations must utilize social factors to control the behavior of their business partners.

Organizations must use "clan control" which emphasizes social factors to promote ethical behavior of the various members of a strategic alliance. To promote ethical behavior business partners should share similar values and a commitment to controlled behavior. Trust, self-control, and ethical values are becoming increasingly important as organizations become more flexible.

In the real world, there are few mechanisms available to control the ethical behavior of strategic partners. Organizations must increasingly rely on trust and the good character and reputation of its business partners. The best course of action may be simply to do business only with organizations that have good character and reputation, because no amount of rules and regulations can prevent an organization or its members from behaving unethically.

Conclusion

Appropriate ethical behavior is necessary to ensure the long-term survival of business organizations. While formal business structures appear to have an influence on the ethical behavior and moral development of members of business organizations other factors such as organizational environments, corporate norms, values and cultures can play an important role in enhancing or discouraging ethical behavior and the development of moral reasoning.

Most business organizations have some elements of the rational, natural, and open systems theories incorporated into their structures. While the rational theory of organizational structure can attempt to formally control the unethical behavior of workers, it is not practical to assume that this methodology alone can completely eliminate unethical behavior and enhance the development of moral reasoning among workers. The rational theory of organizational design does not take into account human factors, which are accounted for under the natural systems theory of organization design and environmental factors, which are accounted for under the open systems theory of organizational design.

The establishment of corporate codes of ethics and employee ethics training can play a role in developing ethical behavior but they are not sole solutions to the problem of unethical behavior. They can be used as tools to channel individuals into making appropriate ethical decisions but they cannot eliminate unethical behavior because moral reasoning cannot be taught.

Business organizations can promote ethical behavior by establishing realistic profit goals. Corporate cultures that over-emphasize making a profit at all costs foster an environment where unethical decisions could be made. Profit and sales goals should be achievable by utilizing current business practices. Unrealistic goals promote an environment where workers view the means to the end as unimportant. The method of achieving organizational goals should be considered as important as actually achieving them.

Organizational cultures should be considered in developing a corporate framework to minimize the likelihood of unethical behavior. Cultures exist in all organizations and they are important because they fill in the gaps that exist in formal organizational structures. Some theorists believe that the moral climate of an organization is extremely important in promoting social responsibility and discouraging unethical behavior. To establish a moral climate social responsibility must be a firm, deep-seated belief of the management. Social responsibility cannot be viewed as an expense item that increases or decrease based on the economic performance of a business. Management must make a long-term commitment to social responsibility and must not underestimate the power of nonverbal communications. "Do as I say" not "Do as I do" will never promote a healthy moral climate. Managers must also recognize that a carrot is a more effective motivator that a stick (Fasching 1981). Some theorists such as Boland believe that the rational systems approach to organization structure fails to develop a moral climate because it does not properly identify how an organization functions.

An organization's mission statement should be utilized to promote ethical behavior in an organization. A mission statement should appeal to employees by highlighting the importance of high standard relationships between an organization's members and stakeholders. Ethics should be a key element in every organization's "guiding vision", similar to the goal of "zero defects" in a manufacturing environment (Collins 2000).

Trust is viewed by Hosmer as the missing link between organizational theory and ethical behavior. Trust can be viewed as the dependence upon the behavior of other people. Part of the definition of trust is that the expectation of loss if trust is broken will be greater than the expectations of gain if trust is maintained (Hosmer 1995). Some level of trust must permeate an organization to induce ethical behavior.

Ethical behavior and moral reasoning are complex factors that must be incorporated into the structures of business organizations. Organizational structures can have an affect on the ethical behavior and moral reasoning of workers. However, organizational structures alone cannot prevent unethical behavior and promote the development of moral reasoning. The responsibility of managers should be to ensure that organizational structures do not encourage unethical behavior and stifle the development of moral reasoning.

Business organizations must develop cultures, corporate norms and values that promote ethical behavior and the development of moral reasoning. The appropriate organizational structure to encourage ethical behavior and the development of moral reasoning should consider all aspects of a business enterprise. Ultimately ethical behavior is rooted in individuals. Institutions do not define managers; managers define institutions (Fasching 1981). The development of a theoretical ethical framework that considers organizational cultures, corporate norms, values and organizational environments in conjunction with organizational design theory would prove useful in gaining a better understanding on how to best lead members of business organizations down the path of ethical behavior.

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