Traditionally there have been two distinct views on the role of ethics and, more broadly, “social responsibility” in business. The first, articulated most famously by economist Milton Friedman in 1970 in the *New York Times Magazine*, is that corporate executives’ sole responsibility is to increase returns to shareholders. This view deems social responsibility to be a cost outside the scope of legitimate corporate concern. The second view is that “ethics pays” — that ethical behavior improves financial results, and that acting in a socially responsible manner toward your stakeholders will automatically enhance shareholder wealth.

Recently, a third view has emerged, that the relationship between ethics and economic advantage is not a constant but varies from situation to situation. Further, executives have both social and financial obligations to their stakeholders, and they must actively pursue strategies that respect both responsibilities.

Lynn Sharp Paine, the John G. McLean Professor at the Harvard Business School, is an articulate member of the third school. In her...
newest book, Value Shift: Why Companies Must Merge Social and Financial Imperatives to Achieve Superior Performance (McGraw-Hill, 2003), she brings a timely addition to the current debate on the role of ethics in corporate life, and takes the other two positions to task.

Whether ethical behavior costs or pays, it always counts, says Professor Paine. She makes a compelling case that modern corporations can no longer be regarded as amoral actors operating in an “ethics-free” zone. But she firmly argues that applying moral values to business is by no means a sure ticket to financial success. In a real world of globalizing industries, where markets and societies often fall far short of the ideal, profit and ethics frequently clash. Professor Paine’s corporate examples are drawn from many different countries, and she uses multiple cultural perspectives in addition to the dominant Western paradigm. Her book is cogently and meticulously annotated in support of the claim that corporations are increasingly being regarded as humanistic rather than purely economic entities.

With corporate governance in disarray and executive behavior under close scrutiny, Professor Paine— who holds a doctorate in moral philosophy from Oxford University and a law degree from Harvard, was a Luce Scholar at the National Cheng Chi University in Taiwan in the late 1970s, and served previously on the faculties at Georgetown University’s McDonough School of Business and the University of Virginia’s Darden Graduate School of Business— brings her support of the third school of business ethics to the fore at a moment when society’s attention to the moral responsibilities of corporations has intensified.

She goes to some lengths to emphasize, however, that ethics at its core is not a list of precepts; it is a point of view. Her “Manager’s Compass,” to guide executives to what she calls center-driven decision making, consists of four primary points— purpose, principles, people, and power. These are the acid tests to which every management action must be put: Does it serve a worthwhile purpose— is there clarity around ends and means? Is this action consistent with relevant principles— norms of conduct, best practices? Does it respect the legitimate claims of the people affected? Do we have the power— legitimate authority, resources, and competence— to take this action? Professor Paine addressed these and other questions with strategy+business in March at her office at the Harvard Business School.

S+B: How does your background in studying both law and philosophy shape your perspective on business ethics?

PAINÉ: When I first started teaching in a business school, one of my big “ahas” was to discover that ethics was considered so alien to mainstream academic thinking about business. I entered the field assuming that because business is a human activity, ethics would be a natural consideration. If you’re trying to create wealth and use resources efficiently, why wouldn’t you try to do it in a way that furthers the common good and improves your own life? For me, this was a given, although I quickly realized I was out of step with orthodox thinking.

S+B: What was most striking to you about the differences in the way you looked at these issues compared with your colleagues?

PAINÉ: Vocabulary, of course, influences how you see things, and in
Recognizing that every com-
Yes. For example, a com-
presumes individuals have choices.

**The Corporate Personality**

**S+B:** In *Value Shift*, you discuss the concept of an “evolving corporate personality.” Can you explain what you mean by this?

**PAINE:** Having worked in the law, I had a general sense of how the concept of the corporation had changed, but doing the research allowed me to document the change and see how it unfolded. History shows there’s a very close relationship among the law, societal expectations, and evolving moral judgments. As society’s expectations change, they often coalesce into soft, self-regulatory norms. Those norms then often get encapsulated in law. So the law is continually evolving along with societal values.

In the 13th century, you have Pope Innocent IV saying that the concept of responsibility can’t apply to a corporation because a corporation is a legal fiction. It has no body, it has no soul, it can’t feel the pain of punishment. That idea eventually lost its religious underpinnings and was carried forward in jurisprudence, first in England and then in the United States.

You have ecclesiastical institutions and you have liberal institutions espousing this doctrine. Then the idea of the corporation as a legal fiction gets picked up in economic theory. It is still part of our law, but we have these other strands of the law that are starting to treat the corporation as a social entity with moral responsibility. For example, organizational culpability — the notion that an organization can be responsible, can be culpable, can be blameworthy — which appeared for the first time in laws introduced in the United States in 1991, is really new and novel.

**S+B:** But under these laws, if a company in legal trouble could show a prior good faith effort to advance its social obligations, it might get a lighter sentence.

**PAINE:** Yes. For example, a company convicted of wrongdoing that had programs in place to prevent and detect misconduct might get a lower fine than a company convicted of the same offense that did not have a preventive program. But whether you decide a particular company is culpable or not culpable, you are making a moral judgment. That’s what’s new.

**S+B:** Recognizing that every company has its own personality, there seems to be a fairly linear but irreversible progression toward standards that encourage corporations to become better at handling moral issues.

**PAINE:** If there’s one thing I hope the reader will take away from the book, it is an understanding of what I believe to be an emerging new standard for corporate performance that encompasses both moral and financial dimensions. From a broad historical perspective, the progression seems pretty steady, but there were certainly points along the way when the idea of the corporation as a moral actor was picked up and then dropped. A century ago, for instance, the legal scholar Frederick Maitland wrote about the corporation’s moral personality. But societal changes of this magnitude rarely unfold in a linear fashion.

**S+B:** Peter Drucker and Charles Handy, two giants of 20th-century philosophy and law the vocabulary is so different. Responsibility, rights, fairness, justice, and community: These are all words and ideas you gravitate to if you’re studying philosophy or law. But if your formal training is in economics, which is the case with most business school faculty, these words and concepts are not as natural. Of course, back when I started teaching, some business educators, and many other people in society, felt that business ethics had to be addressed seriously. Yet it was not an accepted part of the mainstream curriculum.

Another thing that is very different about my disciplinary background is the type of research we do and the questions we ask. A lot of business research focuses on cause and effect. In economics the question is: What caused this event, and which was the most important cause? Someone who comes from philosophy is more inclined to look at human beings as decision makers and choosers rather than objects governed by external forces. So you are drawn to questions about motivations, values, and beliefs.

**S+B:** How does that influence analysis of business activity?

**PAINE:** Right after Enron, we had a faculty seminar and I was struck by how much of the discussion was about the external factors that caused the collapse — the market bubble, flawed accounting rules, and so on. I am very interested in those questions, but I also wanted to know why people made the choices they made. What were the values and beliefs that allowed Enron’s board to waive the company’s code of ethics? How did the CFO justify his self-dealing? The philosopher presumes individuals have choices.
“Moral analysis is rarely a defined part of management decision making. Ethical issues are generally managed by exception.”

management thinking, never waver in their writing on the idea that the fundamental purpose of business is to meet needs in society.

PAINE: Yes, there have been strong voices supporting corporate responsibility for some time. But now we are having that conversation much more frequently, and it has entered the mainstream.

In the period of my own research, the change in rhetoric has been dramatic. When I began working in this area, many people said, “Well, we can’t really go down that path because the company can’t be competitive, can’t be successful if it takes ethical considerations too seriously.” And yet today you’re much more likely to hear — at least in the United States and in the industrialized world — that ethics does pay, and there are many benefits to the organization.

S+B: More executives also seem more conscious of how values support productive behaviors and management.

PAINE: One of the most striking aspects of the research for the book was the extent to which we found people saying that values contributed to knowledge sharing, to people’s willingness to work together, and to creativity. Managers also talk a lot about corporate reputation and risk management.

No Promises

S+B: Your voice in the dialogue on corporate social responsibility is very distinctive because you don’t try to defend the position that “ethics pays” is an absolute. You say instead “ethics counts” — meaning you always need to examine the ethical dimensions of business decisions. Some will pay, but it is just as important to understand circumstances where the ethical decisions don’t pay financially.

PAINE: When I was first talking about this project, some people said I would never find a publisher unless the book promised that ethics would lead to profits. Others suggested that I would have better luck as a corporate critic. The message was clear: You could sell a lot of books by being a muckraker or a panderer. But the idea of actually having a nuanced discussion was the path to oblivion.

In a way, this comes back to the focus on cause and effect in business research. Here you see people wanting to prove that if you do this, it will cause that. I’m trying to deepen the conversation and make it more realistic. If you take a cold, hard look, you can easily see there isn’t a perfect correlation. There are plenty of companies that make lots of money through moral indifference, and there are companies that are quite concerned about ethics and social responsibility that aren’t big moneymakers.

It’s more complicated to think about performance through a different lens. That’s one of the difficulties we have to overcome. And as things stand now, moral analysis is rarely a defined part of management decision making; ethical issues are generally managed by exception. I want to capture what I see in the real world and show there are healthier ways to think about performance for the organization and for society as a whole.

S+B: The “Manager’s Compass” you introduce in Value Shift is a framework executives can use to sort through ethical questions. You say, though, it is “not a moral algorithm or a theory of right action so much as a prompt to focus managers’ attention on the moral aspects of decision
making.” What do you mean?

PAINE: This framework tries to exploit the power of questions to engage people’s moral faculties. For example, when managers evaluate a potential investment or propose a new product from an economic point of view, they ask: “How big is the market? How attractive are the profit margins? How much will we have to invest, and what will the return be?” So I’m asking what questions might help them inject a moral point of view, too.

The Compass directs you to four primary dimensions of moral analysis. The first one is purpose. Will this action serve a worthwhile purpose? What are we trying to accomplish? What are our short- and long-term goals? Are they worthwhile? This analysis tries to clarify both means and ends. This includes the quality of our goals and the efficacy of the methods we choose to achieve them.

The second dimension is people. Who is affected by what you do? What are the claims of those affected parties? What interests are at stake that we need to pay attention to? This is very similar to what is sometimes called stakeholder analysis or social impact analysis. The only real difference here is that this category sometimes includes people who aren’t regular stakeholders. They might be people affected by what you do even though they’re not people with whom you deal directly on an ongoing basis.

The third dimension is principles — the norms and preset standards that could be applicable to what you’re doing. These might come from the law; they might be company standards; or they might be customary practice in the industry. This dimension encompasses not only basic obligations, but also your aspirations and ideals.

The fourth dimension of the Compass is power. It asks you to consider whether the action you want to take is really within the scope of your authority, your ability, your clout, and your resources.

S+B: How might you apply the Compass to address a typical decision?

PAINE: Let’s say you’re assessing a new product development proposal. Going around the Compass, and asking these questions, can unearth relevant ethical issues so they can be addressed as part of the design process. But the Compass raises questions that can and should be asked whenever a significant decision of any sort is being made. It’s also a useful tool for mapping differences. If we have conflicting opinions, we can examine the four dimensions to begin to understand why our views differ, and to find a starting point to resolve them. If our differences are irreconcilable, at least we know why we don’t see eye to eye.

S+B: You interviewed executives from the world’s top corporations and emerging multinationals from North America, Europe, China, India, and Latin America. Those conversations were another strong affirmation that corporate attitudes and corporate standards are changing all over the world. What sorts of rationales for their interest in values and ethics did they tell you about?

PAINE: Four themes emerged in these conversations: risk management, organizational functioning, market positioning, and civic positioning. The risks they talked about were particularly associated with misconduct but are also associated with carelessness, neglect, and insensitivity. By focusing on the values that guide people’s behavior, these executives told me they hoped to minimize the incidence of malfeasance and its consequences. In the past decade, we’ve seen a significant number of multimillion-dollar, even multibillion-dollar, cases of corporate misconduct. In addition, there’s individual misconduct. In the United States, for instance, individual misconduct is said to cost companies some 6 percent of revenues annually. Between 1997 and 2000, retailers in the United States saw their losses from employee theft jump by 34 percent to an estimated $12.8 billion.

For some managers, the turn to values is less about preventing mistakes and more about organizational performance. It is an attempt to build or rebuild a better-functioning company — a high-performance culture. A third cluster of themes is market-oriented. Managers here are working on shaping their company’s identity and reputation, building its brands, and earning the trust of customers, suppliers, and other business partners. Civic positioning is distinct from market positioning in that the key issue is elevating the standing of the company as a citizen of the community, which may or may not have a significant impact on its position in the marketplace. The primary goal is to win the support of civic constituencies such as governments, NGOs, and local community groups.

There is also a fifth theme: the better way. For these executives, it is just better for companies to be honest, fair, responsible citizens. If I were writing the book today, I’d probably add a sixth rationale, because I see more companies starting to take ethics seriously to satisfy
their investors and to boost investor confidence. It’s really a post-Enron phenomenon.

S+B: When you were doing your research, did you encounter people who were addressing values in a way you considered superficial or ineffectual?

PAINE: I can think of two especially disappointing moments. I tell the story of receiving a phone call from a manager whose company was going to press with a new code of ethics. He asked me to provide an endorsement of the code, just a couple of words to say that ethics pays. And I thought, oh, I can’t do that — for all the reasons we’ve already discussed. Another anecdote I tell in the book is about a company that called me because their top management wanted help with implementing its values. They had generated their list of values. The CEO said, “Great, we want to roll these out, and we want to do it quickly, but we don’t want to interfere with anything people are working on.”

S+B: Because there’s this underlying fear that ethics doesn’t pay.

PAINE: Perhaps. But I think this is just another example of not having thought through what it really requires in terms of implementation. People are used to thinking of ethics as very personal. But you’ve got to think of whether the organization as a whole can behave responsibly, not just the individuals who make up the organization. You can have a group of very conscientious individuals, but if the organization isn’t structured to promote responsible behavior, and if the organization’s decision-support processes don’t account for ethical and social considerations, the group won’t act according to the best ideals of individuals.

S+B: That’s why it is so tough for large established corporations to change.

PAINE: Well, yes, it is very difficult to change, and many people in the field of corporate culture have documented that. But the point I want to emphasize is that companies cannot change their values without also changing the system and structure through which they operate. There’s a common idea that organizational structure and management systems are hard and neutral. Then, on top of that, you have something called culture, which is the values of the corporation, and they’re somehow independent from your structure. In fact, your culture is really a reflection of your systems and structures. It doesn’t exist separately. So, companies can’t change without actually addressing questions like, How do we pay people, whom do we hire, who gets ahead, what are our information systems, how do we measure performance?

S+B: Shell and BP seem to represent two corporations that are trying very hard to shift their value systems.

PAINE: Shell is a company I discuss in the book. They’ve developed a road map for change that is continually revised. And they’ve asked the hard questions — about their planning processes, their management systems, their performance metrics, their reporting processes. They are addressing all of those points, and I think the likelihood of their success is much greater than what we see in a typical situation where a company says, “We want to change our values, but we’re not going to change anything else.” I think that Shell and BP will both benefit from what they’re doing.

S+B: At most companies that have articulated a concern with ethics, the issue has tended to be the province of the CEO, or of someone with a title like VP of corporate social responsibility. Are you finding it more institutionalized throughout companies now?

PAINE: System and structures haven’t caught up to the new expectations, and I don’t see widespread understanding of the macropicture. Many companies respond incrementally to appeals for, say, diversity, environmental responsibility, or, more recently, truth in accounting and financial reporting. Everything is treated as a special issue, with its own minibureaucracy.

I’m suggesting that these appeals all flow fundamentally from the same idea — that a corporation should be a responsible agent, a moral actor, whatever term you want to use. Whether the activity is accounting, or hiring, or manufacturing, it needs to be handled in a way that is consistent with basic ethical standards of fairness, truthfulness, and civic responsibility.

It’s actually much simpler to understand, and to manage, if you think of ethical issues and values under one umbrella, instead of as a series of special programs tacked onto this engine of commerce.

S+B: That’s actually not just a legacy of the amoral character of the corporation, but it’s a reflection of the “silo-ization” that is endemic in many large companies.

PAINE: Sometimes you find both a corporate social responsibility group and an ethics group, and they think...
of themselves as totally separate. Of course, they address different issues insofar as corporate social responsibility tends to deal with civic and external issues, whereas the corporate ethics office tends to deal with individual employee issues. But these are still different manifestations of the same underlying phenomenon.

The moral character of a company really is about shaping strategy at its core. What business are we in? How are we going to run the business? What are our tactics? How are we going to develop people? All of these traditional questions for the business must be seen through this additional ethical lens.

**Governance and Trust**

**S+B:** Is the CEO really the only “chief ethics officer” you need?

**PAINE:** The CEO is certainly the “chief ethics officer,” but corporate responsibility is not a one-person job. I think it is helpful to differentiate the stages of change. If you’re launching something new, you need champions. Once the company manages to integrate these ideas into its core management systems, the need for that officer diminishes. Fundamentally, the responsibility resides with all of line management. Still, a commitment to corporate responsibility does entail a certain amount of work that may require additional staff that can do specific kinds of research and analysis, can gather new types of information, and have different problem-solving capabilities. Ultimately, of course, you want everyone in the company to be an “ethics officer.”

**S+B:** The story you tell about the Johns Manville Corporation is a fascinating example of how a shift in values changed a company. In 1982, Manville was a global supplier of asbestos fiber facing $2 billion lawsuits over asbestos-related deaths and disease. Few people know that four years after it emerged from bankruptcy, it faced another liability crisis with fiberglass and handled the situation quite differently than it had with asbestos.

**PAINE:** The company’s executives were stunned when they learned of early findings from a major study suggesting a possible risk of cancer from fiberglass. They immediately went into crisis mode. They gathered information from a wide array of stakeholders and debated every option extensively — even the possibility of exiting the business. They decided that even if the risks were still unproven, the company needed to disclose them to customers and employees. But they didn’t want to scare people either. Working with their lawyers, they came up with a creative program to indemnify the company’s customers against court judgments and legal costs associated with fiberglass-related injuries. In other words, Manville agreed to foot the bill for such claims. This example shows that lawyers can play a positive role in dealing with ethical challenges. The problem comes when you have lawyers who focus only on prohibitions and punishments, and don’t appreciate broader questions and different situations.

Earlier we were talking about the process by which soft norms become legally enforceable standards. The law department can help by anticipating this. So often you find lawyers asking, “Why should I care about ethics? Isn’t the law what’s really important?” My response is, are you talking about today’s law or tomorrow’s law? In many cases, today’s ethics are tomorrow’s laws, and if a lawyer sees...
what’s coming, the company can be better prepared, and then maybe it won’t be so overwhelming.

S+B: You were a member of the Conference Board’s Blue-Ribbon Commission on Public Trust and Private Enterprise. What were some of its key recommendations?

PAINE: In June 2002, we set to work trying to identify steps the private sector could take to restore confidence in U.S. capital markets and corporate America. We issued two sets of recommendations. The first, which came out in September of 2002, addressed the matter of executive compensation.

The second set, on corporate governance and auditing and accounting, came out in January 2003. Here we focused on board structure, including the controversial question of separating the role of chairman and CEO, ethics oversight, and the importance of independent advisors. For example, when a board engages lawyers for an investigation that might implicate company executives, it should not hire the company’s regular outside counsel, or any law firm that gets a material amount of revenue from the company. This sounds like common sense, but it’s not always the way things are done. We also suggested that boards should in some cases consider changing auditors; not just individual partners, but the entire audit firm.

Another big theme was how to encourage a longer-term focus in management and also among the investor community.

S+B: What are some ways we can accomplish this?

PAINE: One recommendation is that companies do more to cultivate investors that already pursue long-term holding strategies, such as pension funds. We also advised companies to put more emphasis on longer-term corporate goals and strategies in their investor communications. Although we did not get into specific proposals, we did recommend that policymakers consider tax policies to encourage longer-term investing. And we advised institutional investors to establish compensation systems that reward portfolio managers for taking a longer-term focus.

S+B: It is interesting how the desire to get people to become less focused on the short term is being addressed in a dialogue on restoring trust in our financial system.

PAINE: Do we want to live like short-term traders? That is an ethical question.

Measuring Ethical Performance

S+B: In the August issue of Business Ethics, Marjorie Kelly wrote: “...all the things CSR [corporate social responsibility] has been measuring and fighting for and applauding may be colossally beside the point.” For example, she admitted supporting Enron as a regular on the list of “100 Best Companies to Work For,” based on its policies on climate change, human rights, and even corruption. What do you think this says about the priorities of CSR advocates?

PAINE: Enron offers lessons not only for CSR advocates, but for anybody who studies organizations. It’s a powerful reminder that what’s visible is not always what’s really going on at the core — especially when you’re talking about large organizations. But it also shows that high-profile voluntary civic activities can sometimes mask unfulfilled civic responsibilities, such as obeying the law and paying taxes, which are also fundamental to good corporate citizenship.

Enron is a real case study in the difficulty of getting accurate information. But actually few companies have reliable systems for tracking and communicating ethical performance.

S+B: More companies are issuing annual reports evaluating social performance. And there are also many initiatives going on around the world to develop better measures of social performance and reporting standards. Progress on both fronts
seems to be steady but slow. Do companies need to put more support behind these efforts?

PAINE: There are two separate dimensions of this issue. One is managerial. Do managers need a better way to understand the social aspects of their performance? I think they do. I frequently encounter managers who speak glowingly about their company’s high ethical standards, and yet they have no way of knowing what’s actually going on in their organization, because there’s no attempt to gather and measure any information. I’ve often said to people, “How would you react to a manager who told you that sales were better than ever, but had no sales data of any kind to prove it?”

The other aspect has to do with external audiences. Do investors and others have the information in this area they need? The information needs of managerial and external audiences are not unrelated. If managers don’t have good information about what’s going on, it’s unlikely that external parties will be in a better position to make valid judgments.

S+B: Because they don’t have good information or ways to measure performance either.

PAINE: Right. You can send your form to some person in a company who may fill it out, but then what information are they using to answer your questions? I do think measurement and assessment are crucial, but this whole discipline is only in its infancy. We have some methodologies, but they strike me as not really methodologies. They’re more like laundry lists of topics.

You see this problem not only in various attempts by external groups but also inside companies. How do you get your mind around what it is you’re doing and decide what metrics are most important? No company can pay attention to everything. Plus, there’s a wide discrepancy between what CSR groups say is important and what a typical ethics officer would say is important. For example, truthfulness and candor are essential in virtually every corporate activity — sales, accounting, research. But you rarely find this is an explicit part of CSR agendas. Obviously, we need a more coherent and comprehensive framework for evaluating ethical performance.

Business Schools and Ethics

S+B: What role should business schools play in inculcating this broader view of corporate social responsibility and ethical behavior?

PAINE: Until now business schools have not done a great job of preparing students for these challenges. Part of the reason has been this disconnect between the economics discipline and the ethics discipline. It goes right back to the training of faculty members. You get people who are trained in ethics or law or moral philosophy who don’t feel well prepared to deal with the financial side, and you’ve got people trained on the financial side who don’t feel very comfortable on the ethics side. The poor students are caught in the middle.

Some schools have taken a very theoretical approach to teaching ethics, which makes it difficult to connect ethics with day-to-day management concerns. An overly theoretical approach can be a problem in any discipline, but I think it’s been a particular problem in the ethics area. To get academic credibility requires a theoretical orientation, but to get student and practitioner credibility requires a practical orientation. Merging the two is very challenging, and it can’t happen overnight.

But I do think we’re at a crucial moment now. In fact, here at Harvard Business School, we’re in the process of designing a new required MBA course that will cover issues of leadership, values, and corporate accountability. For a number of years, we have had a very successful nine-session module on leadership, values, and decision making, but this will be the first time we’ve had a full-length course in the core curriculum. Our challenge is to build a strong course so that research and teaching in this area become institutionalized rather than drifting back to the margin.

S+B: What will prevent these sorts of courses from drifting back outside the core?

PAINE: The central challenge at this point is faculty acceptance. For that, you need a research program that addresses important business issues and that other faculty respect. And you have to develop career paths for young academics. Unless you can attract, develop, and offer tenure to people in this area, it cannot become institutionalized.

S+B: What’s next on your research and teaching agenda?

PAINE: I’m planning to look more deeply at global business standards and cross-cultural value conflicts. In Value Shift, I talk about an emerging set of global standards for business. I want to explore and test this idea further. I also have in mind a book on cross-cultural dilemmas of management.