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The Hidden Costs of Organizational Dishonesty

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A brief scanning of *The Wall Street Journal* — or, tellingly, almost any other newspaper in the country — reveals the alarming prevalence and far-reaching impact of organizational dishonesty. Reports of malfeasance or criminal conduct in corporate governance, accounting practices, regulatory evasions, securities transactions, advertising misrepresentations and so on have become all too commonplace. It's no wonder that business schools across the country have been rushing to design and introduce courses that emphasize a subject traditionally given short shrift: ethics.[1]

This is not to say that, as a group, business people are inherently unethical. All other things being equal, most executives would unhesitatingly choose the high road. Except in hypothetical situations, however, all other things are never equal. In any organization, people are motivated by myriad factors — sales quotas, corporate economic health and survival, competitive concerns, career advancement and so forth — which can easily override their moral compasses. Indeed, in spite of the assortment of arguments contending that "ethics pays,"[2] the number and extent of the recent transgressions suggest that a significant portion of the business world has yet to be persuaded.

Of course, companies should always adhere to universal ethical principles because, after all, that's the right thing to do. But one additional reason for businesses to engage in honest practices is that the consequences of failing to do so may be much more harmful to the bottom line than has traditionally been recognized. Companies that deploy dishonest tactics typically do so as a means of increasing their short-term profits, and in that regard they might succeed. But the misconduct is likely to fuel a set of social psychological processes with the potential for ruinous fiscal outcomes that can easily outweigh any short-term gains. In other words, organizations that behave unethically will find themselves heading down a slippery and dangerous fiscal path.

In this article we chart that path, providing details of the extent of the damage and its insidious nature. Our formulation begins with a fundamental assertion: An organization that regularly teaches, encourages, condones or allows the use of dishonest tactics in its external dealings (that is, toward customers, clients, stockholders, suppliers, distributors, regulators and so on) will experience a set of internal consequences. These outcomes, which we call malignan-

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Companies that engage in unethical practices face consequences far more harmful than is traditionally recognized. The resulting damage can easily outweigh the short-term gains.

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cies, are likely to be surprisingly costly and particularly damaging for two reasons. First, they will be like tumors — growing, spreading and eating progressively at the organization's health and vigor. Second, they will be difficult to trace and identify via typical accounting methods as the true causes of poor productivity and profitability. Thus, they might easily lead to expensive misguided efforts that fail to target the genuine culprits of the dysfunction. The malignancies can be categorized into three types, according to the processes involved (see "The Consequences of Organizational Dishonesty").

Malignancy #1: Reputation Degradation

Perhaps the most obvious consequence of systematic organizational dishonesty is that a company will develop a poor reputation among current and prospective clients and business partners. To be clear, we are not referring to small-scale, localized or infrequent ethical infractions but rather to an organizational culture in which employees are socialized into an environment that either implicitly condones or, worse, explicitly teaches dishonest business practices. When anyone outside the company (such as customers, partners, suppliers, regulators or the media) uncovers the improper tactics, the fallout can be swift and devastating. As Edson W. Spencer, the former chairman of Honeywell Inc., once stated, "The businessman who straddles a fine line between what is right and what is expedient should remember that it takes years to build a good business reputation, but one false move can destroy that reputation overnight."[3]

For one thing, the damage to the firm's opportunities for new and repeat business can be considerable. According to a recent survey of the general public conducted by Wirthlin Worldwide of Reston, Virginia, 80% of respondents stated that their perception of the ethicality of a particular company's business practices has had a direct effect on their decisions to purchase goods or services from that firm.[4] And the financial damage could extend further. According to the Wirthlin survey, 74% of the respondents asserted that their perceptions of the honesty of a corporation's behavior had also influenced their decisions about whether to buy that company's stock.[5]

Dishonesty is a trait that, when discovered in one branch of a company, is immediately perceived to be underlying the behaviors across other domains.

More importantly, the damage could be irreparable. An organization that has historically been successful but is currently suffering from inefficient operations, a lack of creativity or even incompetence still has the ability to regain people's confidence by demonstrating the early stages of a turnaround (for example, by hiring a well-respected consulting group, by developing an alliance with a highly regarded organization or by impressing industry insiders with an innovative new product line). But companies that are perceived to be corrupt will find it much more difficult, if not impossible, to shed themselves of that stigma. Past research has found that, by nature, people react more adversely to deceitfulness than to any other attribute.[6] And even if only one branch of a company is caught in the wrongdoing, the whole organization might suffer because dishonesty is a trait that, when discovered in one domain, is immediately perceived to be underlying the behaviors across other domains.[7]

Consequently, once outsiders perceive that dishonest policies and practices have become central to the way a company does business, that organization will face a long, uphill battle. Research suggests that a disreputable company attempting to recover lost trust needs to demonstrate its newfound integrity consistently on numerous occasions (many more than the number taken to display its dishonesty in the first place) to stand even a chance of convincing wary others that it has changed for the better.[8] During the recovery process, which could easily take years, customers and clients who have defected are likely to commit themselves to another, more respectable, organization. To speed its rehabilitation, a company may need to replace top management quickly in an effort to convince others of its sincerity and eagerness to attack the root cause of the dishonesty.
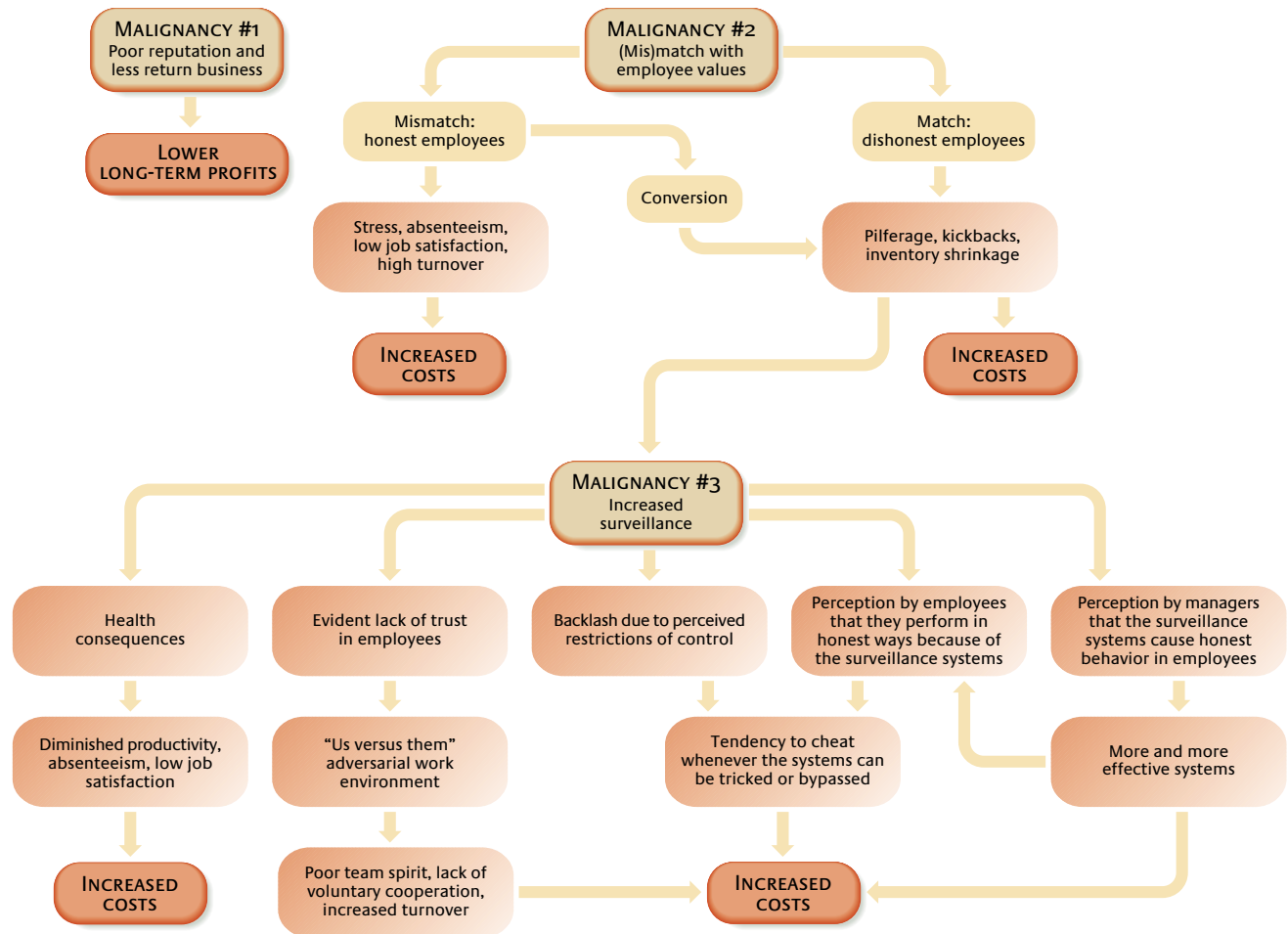
Malignancy #2: (Mis)matches Between Values of Employee and Organization

The extent to which the values of an organization coincide with those of its employees is another issue. Whether that match is good or not, companies with dishonest practices are likely to incur substantial costs.

A Poor Fit for Organizational Dishonesty An organization that encourages deceptive business practices by rewarding the use of duplicity with outside contacts is likely to be met with moral opposition by a number of employees whose values do not comport with those espoused by the company. Many of these individuals will find their moral standards continually clashing with workplace expectations, leading to constant stress from the ever-present conflict.[9] The resulting costs to the organization can be considerable: greater instances of illness and absenteeism,[10] lower job satisfaction,[11] decreased productivity and higher turnover.

The Consequences of Organizational Dishonesty

A company with dishonest business practices toward customers, vendors, distributors and other outsiders might achieve higher short-term profits, but it would incur various costs from three types of malignancy.

MALIGNANCY #1
Poor reputation and less return business
→ **LOWER LONG-TERM PROFITS**

MALIGNANCY #2
(Mis)match with employee values

Mismatch: honest employees → Stress, absenteeism, low job satisfaction, high turnover → **INCREASED COSTS**

Conversion

Match: dishonest employees → Pilferage, kickbacks, inventory shrinkage → **INCREASED COSTS**

MALIGNANCY #3
Increased surveillance

Health consequences → Diminished productivity, absenteeism, low job satisfaction → **INCREASED COSTS**

Evident lack of trust in employees → "Us versus them" adversarial work environment → Poor team spirit, lack of voluntary cooperation, increased turnover

Backlash due to perceived restrictions of control → Tendency to cheat whenever the systems can be tricked or bypassed → **INCREASED COSTS**

Perception by employees that they perform in honest ways because of the surveillance systems

Perception by managers that the surveillance systems cause honest behavior in employees → More and more effective systems

Increased absenteeism. Corporate expenditures on illness and absenteeism amount to far more than the costs of "get well" cards and Mylar balloons. A recent survey on unscheduled absences in the workplace revealed an all-time high of $789 per employee annually, which amounts to more than $3.6 million in yearly losses for larger corporations. This number reflects only the direct payroll costs for the absent employees. It does not include the cost of lost productivity and the expense of covering for the absent individuals, including overtime pay for other employees and the hiring of temporary workers.[12]

Lower job satisfaction. An even greater concern arises when the mismatch between the moral standards of some employees and the unethical practices of a company leads to lower job satisfaction among those individuals. From a strictly utilitarian perspec-

tive, an organization should be concerned about worker job satisfaction only to the extent that it affects employee productivity and turnover. Clear evidence has existed for the latter (to be discussed shortly) but not for the former until relatively recently. Specifically, traditional studies on the relationship between job satisfaction and productivity suggested only a weak connection between the two.[13] But subsequent research has qualified this finding, revealing that the correlation between job satisfaction and performance is rather weak only for workers with low skill levels, presumably because those individuals do not have the capability to produce high-quality work even when they are quite content with their jobs.[14] But for employees who are highly skilled, job satisfaction actually makes a substantial difference: Those who were satisfied with their jobs outperformed those who were not by a margin of 25%.

These findings have serious implications. When moral employees are required to engage in immoral behaviors, the productivity of the most competent and proficient workers will suffer most. This outcome should be extremely troubling to many organizations for two reasons. First, companies generally earn a sizable portion of their revenues (and enhance their reputations) based on the highest efforts of their ablest workers. If those individuals aren't motivated, revenues (and reputation) could easily suffer. Second, because the most capable workers are usually the ones better able to find other jobs, dishonest companies bear a large risk of losing their best employees.

Higher turnover. Because of the high direct costs of recruiting and training new employees, any organization should be concerned if it has trouble retaining people. Dishonest companies should take particular note, though, because their turnover will be selective in nature. Research has shown that workers who do not share the values of their organizations tend to be less satisfied with their jobs, less committed to their organizations and significantly more likely to quit.[15] Thus, over time, an unethical corporation is likely to have employees who are disproportionately dishonest. Moreover, policies that promote dishonest business practices are likely to drive the most productive workers into the offices of more honest competitors, where those individuals can find greater job satisfaction and be more at ease with their work environments. In other words, once a dishonest organization has unwittingly thrown out the baby, all that will be left is the dirty bath water.

A Good Fit for Organizational Dishonesty We have already discussed how honest workers select themselves out of dishonest firms by leaving to work for companies with values more consistent with their own. It should be noted that this "moral dilution" also occurs at an earlier point in the employment process. Specifically, job seekers tend to be attracted to organizations with attributes that are congruent with their own personality profiles.[16] For example, in a recent survey, 76% of respondents said that their perceptions of a company's integrity would influence their decision about accepting a job there.[17] Of course, selection through the filter of value congruency also occurs on the employer's side. That is, companies that regularly require their workers to engage in unethical practices tend to seek people who are willing (if not eager) to play ball in that system. As these various forces attract unethical prospects and repel ethical employees, the low standards of a dishonest organization can be self-reinforced in perpetuity.

Unethical corporations do not merely select and retain dishonest employees; they create them as well. Honest employees can be converted into wrongdoers in various ways, but the process often begins with peer pressure or a supervisor's direct request.[18] After transgressors have had the opportunity to reflect on their recent misconduct, the incongruity between their values and behavior will strongly motivate them to rationalize their actions. (Otherwise, they would need to change their views of themselves in light of what they've just done.) Counterintuitive as it may sound, many of these individuals will continue to engage in dishonest business practices in an attempt to bring a sense of legitimacy to their original offenses. These workers are likely to find further comfort in the vast system of justifications embedded in the corrupt ideology of the organizational culture.[19] As the practice of rationalizing their misdeeds becomes routine, the employees gradually adopt that ideology for themselves.[20]

Regardless of whether a company's dishonest workforce comes primarily from turnover, recruitment or conversion, an organization that consists of dishonest workers is certain to suffer from various internal consequences, such as employee theft, fraud and delinquency. After all, if workers are cheating customers and others outside the company, why shouldn't they also be bilking their employer?

Consider the experiences of a former employee of a consulting firm whose manager suggested that she withhold information from a client. "I was constantly on guard to what I was 'supposed' to tell them," says the former employee. "I felt dishonest." Later, the employee found herself regularly cheating on her travel expenses. "We were allotted a set amount of money per day that was the maximum we would be reimbursed for," she recalls. "I began charging this amount to my expenses each day, regardless of my actual expenses. This was the accepted practice for most people on the project, but it was unethical." Since leaving the firm, the employee has had some time to reflect on her actions. "Looking back," she says, "I have to wonder if the dishonesty that I felt at the client site as a firm representative had anything to do with the ease with which I was able to be dishonest with the firm in another way."

According to a recent survey, fraud perpetrated by employees is the most common type of fraud that afflicts companies. In fact, it is nearly twice as widespread as consumer fraud, the next most

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prevalent type.[21] The financial burdens of internal fraud, including employee theft, are mind-boggling. According to the Association of Certified Fraud Examiners, U.S. companies lose roughly $400 billion dollars a year to internal fraud.[22] Years ago, a government legislative committee noted that nearly one-third of all business losses in the United States were the result of internal larceny.[23] More recently, in 2003 nearly two-thirds of corporations surveyed reported they had suffered from employee fraud, and the trends suggest that the situation is likely to worsen.[24] For example, compared with data from half a decade ago, theft of company assets has more than doubled, expense-account abuse has nearly tripled and fraud through collusion between employees and third-parties is also on the rise.[25]

In response to this growing problem, many organizations have overlooked any role that their own dishonest policies and practices might have played. Instead, they have focused on the symptoms of the problem, implementing a host of specific preemptive and reactive measures. Of these, the use of stronger internal controls, such as increased security and more sophisticated surveillance systems, is growing at the fastest pace.[26] But the unintended consequences of such countermeasures can sometimes be nearly as deleterious as the problems they are aimed at solving in the first place.

Malignancy #3: Increased Surveillance

The direct expenses associated with the installation of surveillance systems are staggering. Between 1990 and 1992, for example, more than 70,000 U.S. corporations spent over half a billion dollars on surveillance software.[27] But the indirect costs — degradation of the work environment that leads to adversarial relations between employer and workers, diminished productivity and other dysfunctions — can also be considerable.

Health Consequences Employee monitoring is associated with a host of mental health problems,[28] including high levels of tension, severe anxiety and depression.[29] Employees are also more likely to experience physical disorders, such as carpal tunnel syndrome, when they perceive their organization's surveillance system as encroaching on their privacy.[30] These types of psychological and physical ailments are linked directly to increased absenteeism and diminished productivity.

Lack of Trust in Employees Workers often perceive the installation of surveillance software and other devices as clear indications that their organization doesn't trust them. This perception eventually harms any existing companywide esprit de corps, often creating an atmosphere of antagonism between employees and management.[31] In addition, workers who feel insulted that their integrity is being questioned are more likely to quit or retaliate with a variety of counterproductive behaviors, ranging from the simple

withholding of voluntary support to outright acts of revenge and sabotage.[32] This type of dysfunctional environment has been described by a former manager of a company that was trying to curtail inventory shrinkage due to employee theft: "Senior management brainstormed the best way to solve the issue and came up with the use of expensive video surveillance equipment in the stockrooms to monitor employees leaving and also the process of opening new shipments. This implementation did not decrease shrinkage, but did have a negative impact on employee turnover."

Backlash to Perceived Restrictions of Control People who feel that their sense of freedom is being threatened will often try to reassert some control over their environment.[33] In the workplace, employees might attempt to empower themselves through both corrective and retributive means — that is, by trying to regain the control that was previously taken away and by committing deliberately hostile actions to retaliate.[34] Consequently, in an organization with excessive control systems, some employees might be more motivated to steal from the company.[35] Of course, employee theft and other dishonest behaviors are only likely to motivate management to procure even higher levels of surveillance technology, further perpetuating the vicious cycle.

Undermining of Positive Behavior Another potential consequence of surveillance equipment is that many employees might come to believe that the systems are warranted even when they're not. That is, honest and dishonest workers alike might assume that the monitoring must reflect both the corrupt dispositions of fellow employees and the large rewards of cheating. Unfortunately for the company, actions that convey expectations of wrongdoing (either implicitly or explicitly) may in fact lead to a rise in misconduct for both honest and dishonest workers by creating self-fulfilling prophesies for the former[36] and self-perpetuating ones for the latter.[37]

Surveillance technology can also undermine employee behavior in subtler ways. Specifically, when individuals are being monitored closely, they might begin to attribute any of their

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honest behavior not to their own natural predisposition but rather to the coercive forces of the controls. Eventually, they might view their actions as being directed less by their own moral standards and more by the prying eyes of management.[38] When that happens, they might lower their ethical standards and be more inclined to try to outwit or elude the surveillance system and engage in misconduct when they aren't being monitored.[39] This, too, will spur supervisors to find more effective (and more expensive) control systems.

Overestimated Influence of Monitoring Management, too, can begin to overestimate the power of surveillance systems. That is, people who are responsible for the implementation, maintenance and strengthening of control systems are likely to assume that the desirable conduct of the monitored workers is primarily a result of the surveillance equipment even when that behavior would have occurred without the use of such systems.[40] This misconception may help explain why internal controls continue to rise in popularity in corporate America despite the dramatic increases in supervisors' workloads when new systems are first established.[41] After these systems are in place, management may come to see them as more effective and more vital than they truly are. And once again such mistaken assumptions might lead to greater expenditures to purchase even more sophisticated systems.

Toward the Honest Organization

Beyond moral grounds, we have discussed sound utilitarian reasons for organizations to conduct themselves ethically. We focused primarily on what the costs might be for those businesses otherwise tempted to teach, condone or merely allow the systematic use of dishonest practices with external contacts.

Although many of the effects of organizational dishonesty are difficult to trace, the damage done is no less real. Consider the following account of how the unprincipled practices of a company helped cost it nearly $1 billion in losses. According to a former employee, "The CEO … abused ethical principles on a regular basis. … People believed him in the short run, but as the truth would leak out, the company's reputation deteriorated. Few companies are willing to do business with him now — those that do will only do so on onerous terms."

Eventually, that culture of dishonesty had permeated the entire organization. "The marketing department was coerced to exaggerate the truth," says the former employee. "The PR department wrote mostly false press releases, and salespeople coerced customers." Moreover, the misconduct was directed internally as well as externally. "Taking a cue from the executives, employees would steal from the company whenever they could, usually via travel and expense reports. Some would cut side deals with suppliers," recalls the employee.

To make matters worse, a security force was hired to roam the building routinely, ostensibly to protect employees, but many workers instead felt that they were being spied on. That suspicion only intensified when reports of even minor infractions, such as people taking long smoking breaks, were sent to the CEO. Not surprisingly, job satisfaction at the company was bad, morale terrible and turnover high. "People were attracted to the company by high salaries, which the CEO saw as justification for treating employees poorly, but left as soon as they could find work elsewhere," recalls the former employee.

The various costs of organizational dishonesty — decreased repeat business, low job satisfaction and performance, high worker turnover, employee theft, expensive surveillance mechanisms and an atmosphere of distrust — have often been cited as severe business problems. But many organizations have failed in their efforts to address those issues, often because they are unaware of a root cause: their own tendencies to conduct business with customers and others unscrupulously. So, instead, corporations often launch wrongheaded efforts to control one fiscal hemorrhage (for example, losses from employee theft) by creating another (namely, investments in increasingly expensive security systems).

The more effective solution is to staunch the wound at its self-inflicted site, with an unblinking examination of corporate dishonesty and a true commitment to end it. But achieving ethical standards requires more than just implementing institutional codes of conduct[42] or more effective security systems because increased control often leads only to even more negative outcomes. Instead, the effort must begin at the top, with senior executives setting the right example and then implementing policies to encourage the same behavior from employees in their dealings with clients, customers, vendors and distributors as well as with other employees. For example, top managers should incorporate customers' ratings of the ethicality of specific employees into the incentive structures of those individuals. Also, the ethical reputation of the organization as a whole should be measured regularly and included in the annual assessments of the company's performance. With such policies in place, companies can maintain high standards of conduct and attract (and retain) honest employees, and by doing so they can avoid the various hidden costs of organizational dishonesty.

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