THE ETHICS FOR MANAGEMENT

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The recent scandals involving Enron and Arthur Andersen have raised loud cries for effective teaching of business ethics in our business schools and management training programs. Such demands are understandable and well intentioned. They are, unfortunately, wide of the mark, for they fail to recognize that the problems lie much deeper than teaching all managers to be ethical in the same way, even if that were possible.

The problems are a direct reflection of deep-seated and chronic problems embedded in our governance and people-management systems and practices. These systems and practices both allow and require behaviors that are in direct opposition to requisite business ethical behaviors, and undermine such behavior. These problems include weak and nonarticulated accountabilities and authorities, lack of long-term ownership concern in shareholders and elected boards, compensation systems that alienate people and require selfish and even corrupt behaviors if you are to get ahead, and so on. Dysfunction-inducing systems like these cannot be repaired by teaching ethics. The systems themselves need drastic changes to bring them into line with ethical requirements. Given such changes, ethical behaviors can become the order of the day—regardless of the extent to which such behavior is in line with the private personal values of any individuals.

Indeed, we are dealing with an adult community, and personal ethical values should be left as a private matter of each one. But at the same time, it is essential that business organizations must estab-
lish organizational systems that require satisfactory ethical business behaviors from everyone concerned, regardless of differences in personal outlooks.

The organizations we are referring to are those organizations that get their work done by employing people in managerial hierarchies. In economically developed nations, such as the United States and Great Britain, over 85% of those who work for a living are employed in such organizations. They comprise for-profit industry and commerce (some privately owned, and some owned by diffuse investing shareholders) and public service organizations (federal, state, and local civil services and governmental, school, social welfare, health, and military systems).

Here, in outline, is what, at a minimum, needs to be done.

GOVERNANCE

The governance problems focus mainly on for-profit industrial and commercial organizations that are said to be “owned” by investing shareholders or by huge numbers of “partners.”

In the first case, diffuse investing shareholder companies, in fact, have no true owners. Shareholders, even those with up to 10% holdings, are short-term investors, with short-term investing concerns. They are simply not concerned with the long-term life and survival of the companies in which they invest, as are the true private owners of such companies. By the same token, neither are the boards of directors of such companies the elected representatives of the owners, for neither they nor the shareholders are the owners.

The governance of such companies needs urgently to be changed so that members of boards and senior corporate executives have more of a long-term, ownership-type commitment to the continuous, successful life of their companies. The following would be an example, and only an example, of what might be done to achieve such a result.

Directors should be appointed for, say, 5 years, with one fifth retiring each year and being replaced by decision of the continuing four fifths. Directors’ fees should be established on a per diem scale equivalent to the salary of the corporate CEO. These fees should be paid 50% in cash each year and 50% in the shares at current value at
the end of that year. The shares would become redeemable year by year commencing the year after retirement, which is to say, at their current value 5 years after issue, and no more than 20% of their total value in any one year.

By the same token, corporate and subsidiary CEOs should be required to maintain an annual investment of 10% to 20% of salary in shares redeemable only 5 years after they were issued. Again, the aim is to bring about a long-term interest in their companies.

With respect to partnerships, like Andersen’s, the current structures must be revised. Partnership law originally provided for face-to-face partnerships of no more than 20 partners. Such face-to-face groups could realistically work together to give meaning to their being accountable for the activities of the company they jointly owned. With the lid on numbers now lifted, we have partnerships with hundreds and thousands of so-called partners scattered over the world, most of whom have never even seen each other, let alone worked together.

In such huge partnerships, accountability is diffused out of all recognition. Partnership organization and governance need to be brought down to earth again—especially in the big law firms and in the big accounting and management consulting companies.

**MANAGERIAL ORGANIZATION STRUCTURES AND LEADERSHIP PROCESSES**

This section applies to managerial employment hierarchies of all types: for profit, public service, and not for profit. These are the organizations in which 85% or more of those who work for a living are now employed. There is not a single standard method of structuring and managing the people in such organizations that is not deficient in operational effectiveness and moderately-to-seriously harmful to the people who work in them (not to mention their families). The field is replete with short-term fads and dysfunctional panaceas.

Let me briefly illustrate, in a number of key managerial areas, how defects lead to behaviors that create mutual suspicion and mistrust between employees at all levels and between nonmanagers and “management,” alienate people, and encourage nonethical
behaviors. The fact that these systems have worked as well as they have is due to the innate constructiveness of people and the satisfaction they get out of doing good work and of working together, which leads them to override the flaws in the system.

VERTICAL STRUCTURING (LAYERING)

Most managerial systems have too many layers, so that managers are micromanaging and “breathing down their subordinates’ necks.” There can also be too few layers, so that managers feel “pulled down into the weeds” and cannot get on with their work. Subordinates feel a lack of sound leadership and get blamed for everything that goes wrong. They will come up with any tricks, ethical or unethical, to manipulate the situation to get proper career and pay recognition.

The solution lies in the discovery that there is a common pattern of optimal organization of layers for all managerial hierarchies worldwide. They may run from two layers in small shops to eight layers in our supercorporations. The number of layers is determined by the measured size of the top executive role by means of a simple, objective measure of size of job in terms of its time span. This structure gives a comfortable and effective relationship between managers and subordinates at all levels, because it provides for managers who are just the right amount more capable than their subordinates (Jaques, 1996).

PERFORMANCE APPRAISAL AND COMPENSATION

Given the requisite vertical relationships, it becomes possible to hold managers accountable for the results of the work and working behavior of their immediate subordinates. For in reality, it is managers and not their subordinates who determine what their subordinates are doing, what resources they shall have, and what to do if ongoing conditions make it impossible to succeed in given assignments.
TABLE 1: Current Felt-Fair Differential Pay Ranges for Organizational Layers

<table>
<thead>
<tr>
<th>Time Span</th>
<th>Organization Level-Stratum</th>
<th>Felt-Fair Differential</th>
<th>Current U.S. Urban ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>50 years</td>
<td>Super corporation (VIII)</td>
<td>64×</td>
<td>5.0 million</td>
</tr>
<tr>
<td>20 years</td>
<td>Large corporation (VII)</td>
<td>32×</td>
<td>2.5 million</td>
</tr>
<tr>
<td>10 years</td>
<td>Executive vice president (VI)</td>
<td>16×</td>
<td>1.25 million</td>
</tr>
<tr>
<td>5 years</td>
<td>Business units (V)</td>
<td>8×</td>
<td>640,000</td>
</tr>
<tr>
<td>2 years</td>
<td>General manager (IV)</td>
<td>4×</td>
<td>320,000</td>
</tr>
<tr>
<td>1 year</td>
<td>Unit manager (III)</td>
<td>×</td>
<td>160,000</td>
</tr>
<tr>
<td>3 months</td>
<td>First-line manager (II)</td>
<td>55%×</td>
<td>80,000</td>
</tr>
<tr>
<td>1 day</td>
<td>Shop and office floor (I)</td>
<td>31%×</td>
<td>44,000</td>
</tr>
</tbody>
</table>

Such an arrangement is markedly different in its effects than the standard arrangements in which subordinates are held accountable for the results of their work and paid all kinds of results-based “incentive” bonuses, including commission pay. They will inevitably manipulate such incentive systems, even corruptly, in order to appear to be doing well. Thus, for example, under current practices, employees will dishonestly let substandard work get sent out if they can get away with it. The manipulation of short-term company results in order to maximize short-term financial gains through stock options strategies is the expression of corrupt practices at the top that are driven by the same systems that drive corruption at the bottom.

An ethical behavior-inducing practice would be to change compensation systems completely, paying fair differentials for differences in levels of work. This system includes fair compensation from shop-floor to top-executive levels. The concept of “fair differentials” refers to findings first noted over 50 years ago, and consistently found since then, that the same relative differentials are experienced as fair worldwide for given differentials in level of work measured in time span. These differentials are illustrated in Table 1 by current felt-fair differential pay ranges for the various organizational layers in large cities in the United States. The actual figures will vary from country to country and change with inflation.\(^1\)

A very simple fair-differential compensation system, based on felt-fair differentials, can then be arranged by dividing each organizational layer in three work bands—low, medium, and high, each with its fair-differential pay range. Each person is then paid within
the pay range for the work range within which the time span of his or her role falls. Where within this pay band the person is actually paid is determined by his or her manager's judgment of his or her level of effectiveness within the work range. It will be noted that CEOs of larger corporations could be paid somewhere between $1.3 million and $5.2 million currently but not the $10 million and above that has been so widely obtained.

SELECTION PROCESSES

Our current selection processes make it a matter of chance whether a person selected for a vacant role is the right person of the right size for the size of the role. This fact exists because standard selection procedures do not include any method with which to measure accurately either the size of the vacant role or the size of the person. What tends to happen is that there is some overpromotion of people the nearer you get to the top of the hierarchy, including CEOs, and underrecognition and underemployment of people toward the bottom.

Overpromoted CEOs and senior executives who are not big enough for their roles undermine accountability in the system and will manipulate results in order to look better than they are. Underrecognized employees will be alienated and get involved in marginally unethical manipulations in order to correct their positions and achieve decent careers.

On the solution side, it has now become possible to measure accurately both the size and complexity of roles, as well as the size and ability of individuals to handle complexity. Selection based on such measurements (Jaques & Cason, 1994) by itself, without any other changes, consistently produces shifts in behavior toward ethically sound practices.

CONCLUSION

There are many other equally serious flaws, including unclear task assignment and context setting, wrong concepts of leadership in terms of personality, completely unformulated cross-functional
working relationships, management meetings and “team working,”
career and talent pool development, disciplinary measures, and
others. All of these induce dysfunctional, untrustworthy, stress-
producing, and, in the end, corrupt behaviors.

In short, ethical training and exhortation miss the point. The
name of the game should be: Change the governance and manage-
rial systems and practices and leave the people alone. The people
are fine, given proper ethical organizational conditions within
which to work. The undertaking necessary to achieve change is an
arduous one. The results will be a major contribution to creating a
good, free-enterprise, capitalist democracy.

NOTE

1. Correlations of .85 to .95 between time span and felt-fair pay have been
found consistently worldwide. The total spread from bottom to top is 256 times.

REFERENCES


*Elliott Jaques, at the time of his death, was research professor of manage-
ment science at George Washington University.*