The Power of Ethics to Create Greater Profits and Morale in Engineering Companies

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Introduction

Managers in all kinds of companies—big and small—are unknowingly leaving huge profits on the table through a mistaken view of ethics. They are liable in fact to commit two fundamental ethical errors.

- The first is a belief that integrity is merely something we should talk about, but not necessarily practice. Following this mistake they then leave sustainable profits on the table that would have arisen from true integrity.

- The second error is a mistaken belief that personally striving to become a member of an "inner circle" will lead to long-term success and fulfillment.

My interest here is in a broad view of how organizations and their leaders can successfully apply ethical principles in strategy and leadership. An encompassing definition of ethics includes the application of moral principles to guide one's behavior. In the last century the topic was brilliantly handled, along with many of the foundational concepts in modern organizational life, by the late management writer and economist Peter Drucker. In fact reading one of Drucker's books remains a startling experience as many concepts of modern strategy and management draw from his material [1]. Drucker spoke about a rounded commitment to a career as a professional manager. He was constantly aware of the ethical responsibilities that form part of an executive's character.

But many people today still believe that there is a tradeoff between ethics and profitability. And they also believe that small compromises on issues of ethics have only trivial consequences. I have seen however that while cutting corners can appear successful in the short term, managers are not aware of high potential sustained gains from doing the right thing.

In the belief that they should pay only lip service to the so-called "touch-feely" values of ethics and integrity, they've mistaken what's needed to actually run a sustainably successful company today. And they actually end up de-motivating both customers and their employees.

So the first error is not to realize that integrity can pay enormously. How about 50% more profit over a decade? But there's a catch. Always a catch! The employees in organizations of any kind need to believe integrity matters, and in turn must act on this conviction. When this is the case, there are significant gains in a firm's valuation. (A large MIT Economics study of over 1,000 US firms in 2013 by Guiso and others, showed that a 1 standard deviation increase in integrity as perceived by employees is associated with a 0.19 standard deviation increase in a firm's Tobin's Q, which is a measure of their market value over book value) [2].

The second related mistake is that many managers have slipped into unethical behavior based on the false belief that integrity has no real career value. Younger managers often have to agree to join unstated but compelling "inner circles" where they are slowly led into a culture of secret power, influence and possible corruption [3]. This needs to be exposed and whistleblowers need protection.

The Financial and Morale Values of Integrity

Most companies think they can simply get away with statements about integrity. Seventy percent of the S&P 500 companies feel they should claim integrity and respect in their "principles" and "culture" statements, without necessarily practicing them. However, as many of us would expect, there is no correlation of these advertised values with enhanced performance in Guiso's study. So cynicism is confirmed and standards continue to sink to the point where we can't trust many companies without a careful read of the small print. Examples include some telecoms, financial services and insurance companies.

There are other studies that show a professional firm can boost profits by a significant amount if they concentrate on the tough task of earning repeat business and referrals. This of course demands actual realized integrity over a sustained time frame. The now retired President of the former Keen Engineering of North Vancouver, Tom Johnston, had the vision and courage to persist with a client-centered approach to earning a reputation for integrity and then repeat business and referrals. There are over 10 professional engineering firms in Western Canada that have spun out of that original firm. These companies continue to work out what it takes to boost repeat business with their unique client mix. I worked with Keen, and occasionally help some of the spin offs, such as AME Group, and can testify to the amount of effort and focus it takes. I also see the lasting rewards for both clients and the staff who actively seek to work in these environments.

Tom tried many approaches, which I can't go into in this discussion, but here is an example of one of the most enduring. Clients are invited into management meetings (which include middle managers) to provide clear and honest feedback on what's working and what needs improvement in terms of the project partnership. Within a few days the professional firm sends out a summary of the meeting plus a list of tight commitments concerning who will do what, by when, to deal with every issue. This list becomes the basis of task planning and persists until commitments to the client are met. There's the odd complaint that's unreasonable; that perhaps needs further discussion and negotiation between senior managers. But, whatever the case, all issues are taken up.

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These workshops frequently delve into sensitive issues and, like all meaningful strategy sessions, they need to be facilitated by someone with experience and sensitivity. This is one case where an outsider can be of real value, as the CEO should **not** run these sessions [4]. The standard of preparation and facilitation for problem solving meetings is a real cause for concern, which many, including myself, have been trying to rectify. An example of this kind of effort is in some courses I offered to engineers at the University of British Columbia for some years until 2015. I now focus more on in-house Colleges.

Success in client commitment leads to a culture of repeat business and referrals, which has a major impact on a firm's bottom line. There is no longer a need for extensive marketing (the classic cry here is "half of advertising is wasted, but which half?") or PR, or expensive junkets. In my career I have seen big cost savings along the lines below.

Here are the components of the savings as broken down in a number of studies [5]. Both Figures 1 and 2 are based on the work of Reichheld. The first diagram uses figures from SLI Int. and the second is from Reichheld's own work (Figure 2).

Quantifying the potential profits is industry specific. The following is taken from real numbers in the credit card industry. It's possible to see a profit increase of over 50% over a ten year period. But each company needs to compile its own model, which can be a highly informative and formative process.

Dramatic gains are not confined to only small firms. The giant engineering firm of Jacobs in Pasadena, with sales of $13 billion, offers the following in their values statement: "Our people consistently deliver for clients, which is why more than 90 percent of the work we do comes from repeat business through our long-term relationships."

I have taught at Jacobs's in-house college and can testify to this focus. They've proven building a culture needs to be done with senior managers who are appropriately dominant in their College. In a challenge to academia The Economist noted (May 2015) that in-house colleges are providing a greater threat to university executive and post grad courses [6].

Loyalty is based on appropriately earned respect between managers and clients, but an often-neglected fact is the powerful positive impact on all employees, both professional and support staff. Spouses and partners of people working for genuinely client-focused companies often comment on the positive changes in their own relationships. Now their partners feel an important sense of accomplishment at work, which ends up favorably impacting many lives. In the modern age of the alienated Dilbert-identifying worker, this is a significant social achievement.

I believe that when employees don't trust that integrity is really valued it can impact long-term investments even in blue chip companies. Several knowledgeable senior executives, some of whom have taken my Course or read the segment in the associated new
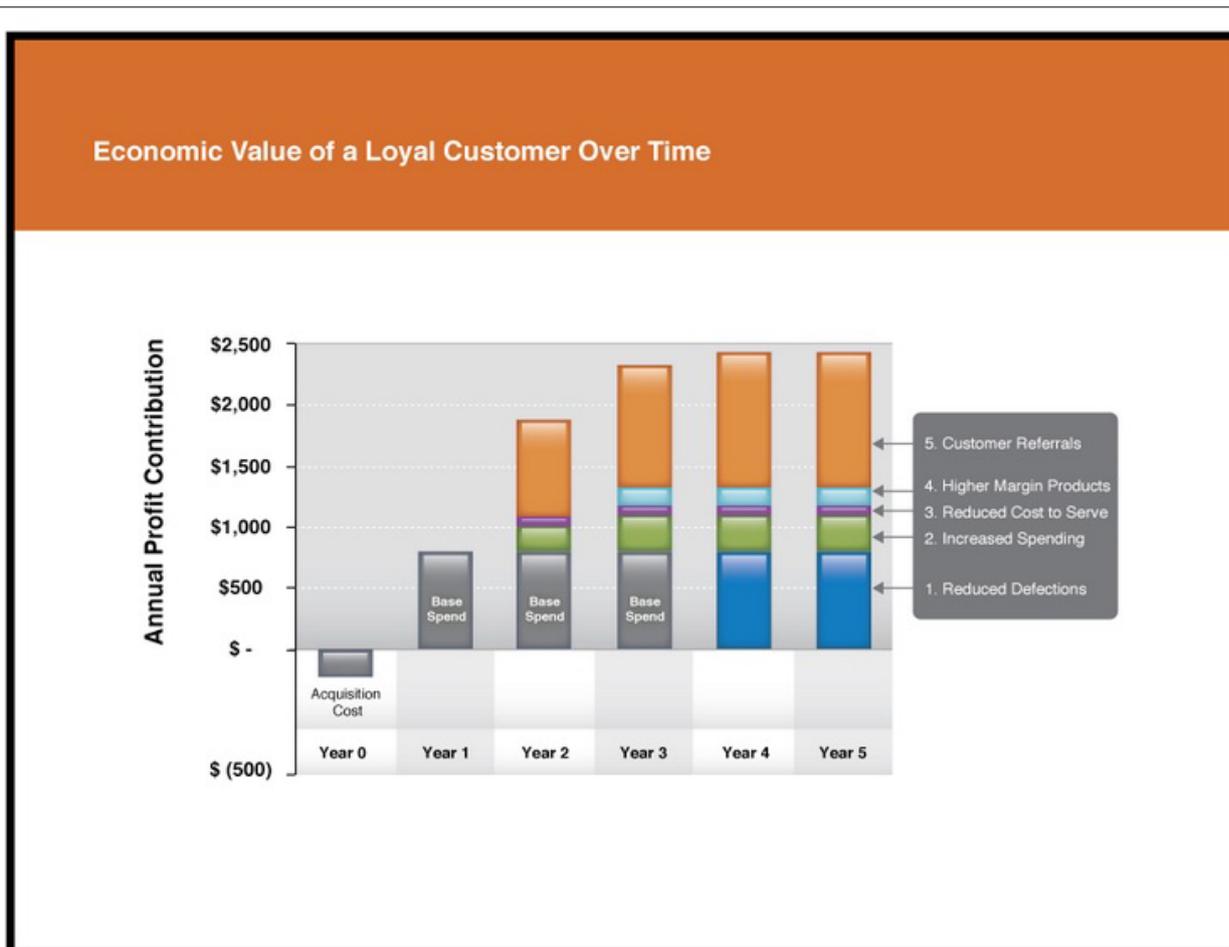
Figure 1: One version of the potential added economic value of a loyal customer over time. The above figure is from the website of SLI Int, and the concept is in turn attributed to the work of Reichheld [5].
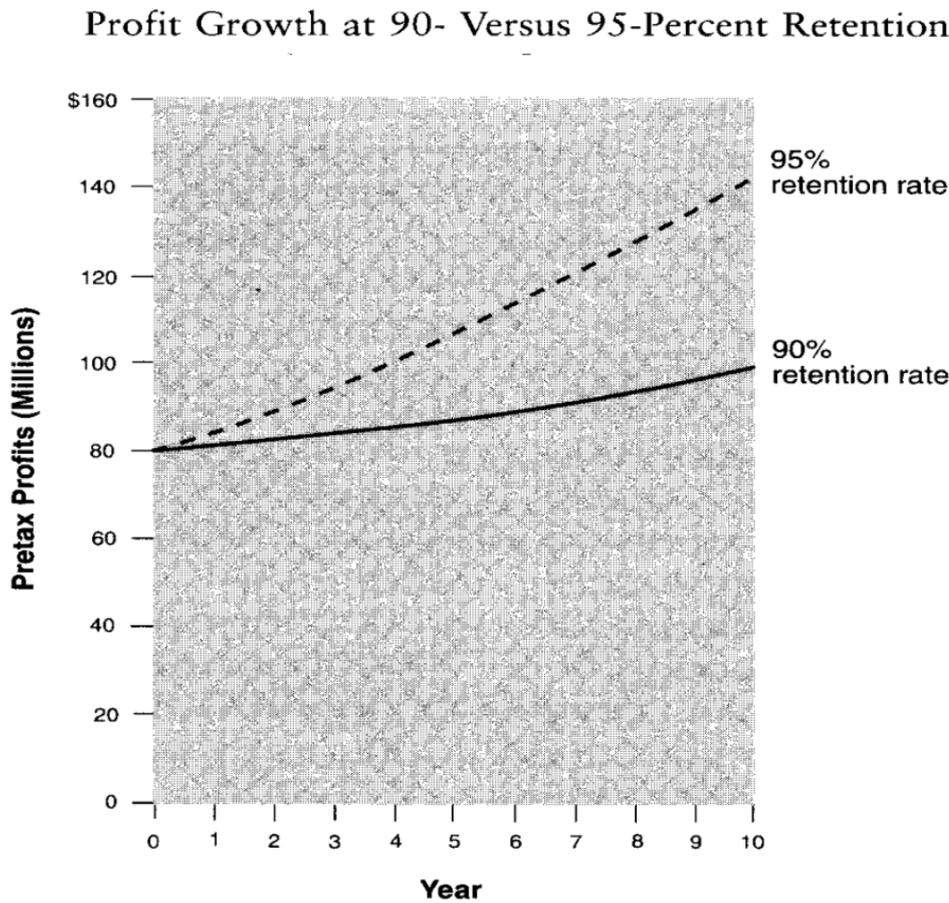
Figure 2: The ten year impact of a 5% increase in retention rate for a hypothetical firm. From "The Loyalty Effect" by F.R. Reichheld. Measured increases in actual organizations are also covered in the text.

book "The Secret Sabbatical: What Should I Do with the Rest of My Life?" on mid-life and retirement planning, certainly have expressed these same kinds of fears [7]. They also agree that the imaginations of many of the younger managers have been seriously undermined in the current workplace and in our leisure hours. Although I don't know the following to be a fact it's argued that two thirds of young people in the US are addicted to the Internet in either a gaming or darker sense, according to one startling estimate [8].

The meetings I'm recommending can form part of customer loyalty generating processes. They focus the attention of these prospective managers on the real and decidedly non-virtual worlds of the clients. This is not a game. Anything that can direct attention from the self is not only to be welcomed, but is a cornerstone of strategic thinking.

And now to my second point reflecting where executives can be wrong or may be misguided.

From Morale to Morality: Recognizing the Seductions of Belonging

C.S. Lewis was a British writer who found fame with a series of accessible books on applied ethics. Later he was to achieve international acclaim with his Narnia books which all had a fundamentally sound base stressing integrity. He was a master at detailing how the desire

to belong to an unspoken but powerful inner circle, or "ring" (as he called it) can lead to a distortion of one's own integrity [9]. Slowly but steadily, according to Lewis, an entire team can find themselves condoning practices and values that individuals would never have agreed to in earlier days.

One of Lewis's lectures begins with a quote from the Russian novelist Tolstoy's War and Peace. It's a masterpiece of the realities of both domestic life and war. In my view, this novel was over a century ahead of its time at identifying what has come to be called chaos theory and the implications of this complexity for leaders and investors.

Lewis's opening quote reveals a startling moment of a General bowing to a Captain, who at the time is paying attention to a character called Boris—a mere Lieutenant. There is something much more potent than "rank" at work here.

"Boris now clearly understood—what he had already guessed—that side by side with the system of discipline and subordination which were laid down in the Army Regulations, there existed a different and a more real system. … Boris decided at once that he would be guided not by the official system but by this other unwritten system" [10].

Lewis stressed to his young university audience that they would be tempted throughout their careers by the desire to be part of those inner circles. Lewis went on to say:

"We hope, no doubt, for tangible profits from every Inner Ring we penetrate: power, money, liberty to break rules, avoidance of routine duties, and evasion of discipline. But all these would not satisfy us if we did not get in addition the delicious sense of secret intimacy."

Lewis points out that this road can lead to doing things we would never have considered, and that the temptations come in almost indiscernibly small doses. But more subtly and dangerously, that one can never really ever feel at home in these places because they are not about being oneself**.** When Lewis gets on a roll, any paraphrase diminishes his impact. He has to speak for himself to make clear his prophetic conclusion:

"The quest of the Inner Ring will break your hearts unless you break it. But if you break it, a surprising result will follow. If in your working hours you make the work your end, you will presently find yourself all unawares inside the only circle in your profession that really matters. You will be one of the sound craftsmen, and other sound craftsmen will know it."

Conclusion

The only free lunch, which is the most incredible of all imaginable, is the Universe itself. But down on this little planet it seems most of us still need to earn our bread. The effort involved in both the areas I have chosen, corporate integrity and personal esteem, pays off mightily if we can maintain our belief and commitment through the hard times. It can lead to the lifetime development of one's personal and professional skills in the context of truly win-win relationships.

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