

ON THE NEED FOR ETHICAL BUYING AND SELLING



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PREFACE

The Center for the Study of Ethics in the Professions was established in 1976 to promote research and education relating to the professions, with special emphasis on the ethical and social responsibility issues associated with professional practice. In a continuing effort to fulfill its mandate, the Center has pursued a variety of activities and programs and has sought to disseminate its work to a larger audience through various forums and publications. In the Fall 1980 the Center launched a new program, the Professional Ethics Luncheon Seminar Series.

The Seminar Series establishes a unique forum for discussion of important issues relating to professional education and practice among a group of informed persons who, while sharing a common concern for the role of the professions in contemporary society, tend to view the issues from somewhat different perspectives. Seminar participants are drawn from government, academe, consumer groups, professional societies and practicing professionals throughout the Chicago area. The topics selected for discussion cover a very wide range of issues, reflecting the diverse group of professionals participating in the seminars and the complexity of the issues associated with their work.

The third seminar of the 1981-82 Luncheon Series featured a presentation by Robert C. Parker, founder of Parker Management Associates, Ltd. and a consultant on business ethics, on the ethics of buying and selling. The public image of business as well as the corporate profit margin is, according to Parker, influenced by industry buying and selling practices. In his paper, Parker urges management to take effective steps toward promoting high ethical standards for its employees, a move that will engender greater public respect and produce a more efficient and profitable match of buyer and seller.

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ON THE NEED FOR ETHICAL BUYING AND SELLING

In 1978 the Center for the Study of Ethics in the Professions at the Illinois Institute of Technology conducted a survey for the National Association of Purchasing Management to determine the real ethical practices of industrial buyers in the United States. These are the "professional customers" who collectively spend some 500 billion dollars per year for U.S. industry. Their effectiveness in finding the most efficient suppliers for the raw materials, components and services needed by their manufacturing operations has a significant impact on the financial health and competitive well being of their employer firms in the global market. The study disclosed a number of shocking facts about the ethical environment in which this business is conducted, and about the practices of the minority - although too large a minority - of these industrial buyers.+ The members of the N.A.P.M. Ethical Standards Committee who monitored the study were bothered by the observations of Ernest d'Anjou, then director of the Center, that the thirteen hundred respondents to the 80 question survey instrument "had thought often about these questions, but not very deeply".

From that point on, the Ethical Standards Committee became determined to think more deeply about the following areas as regards the ethics of buying and selling:

- * What are the roots of society's views about ethics in business generally, and the ethics of buying and selling specifically?
- * What changes are currently taking place in the actual practices in this field?
- * What can be done to improve the actual practices where improvement is indicated?

We should think first about the free market and its remarkable effect on the free enterprise system. The industrial buyer is looking for the best seller of

+Ernest D'Anjou, "IIT Center Completes Ethics Survey for N.A.P.M.," National Purchasing Review, January-February 1979, pp. 2-6.

goods and services from his point of view. He wants to find the seller with the right capability, including engineering know how and technology, the capacities sufficient to meet his needs, financial strength to carry inventories and handle his business smoothly, and a management team with sufficient strength to deal with the problems which will arise from this business. To provide a personal example, if you were to decide to buy a given make of automobile, you would then need to determine from which dealer to make that purchase. You would be looking for the dealer offering the lowest overall cost including trade-in and financing but you would also be concerned with the cost and convenience of service from that dealer after you have bought the car, and whether or not he is the dealer most likely to be around and in business to service your car while you own it. Anything which impedes your search for the best possible dealer will very likely cause less than the best pairing of buyer and seller in your case, and the long term effect of this must certainly be a higher cost to you, the customer.

In the case of the automobile purchase, if you were to buy the car from a dealer whose salesman promised the best personal service and in the process provides you with personal entertainment such as a lunch or dinner for you and your spouse, you very likely would be choosing the source who feels a need to promote the sale in this manner because they cannot, in fact, provide you with the best service and lowest overall cost. If you buy from this dealer you must recognize that somewhere in the transaction you have paid the cost of the lunch or entertainment and that you will probably not find the salesman able to give the promised service when your need arrives. Was the transaction in any way unethical? Not on the part of the customer because the customer is spending his or her own money and can do so in any way he or she wishes. It is unethical on the part of the salesman in this example if he has promised more than he can deliver.

Now consider the industrial buyer of transportation for a major steel company who must buy four thousand cars for fleet use. If he buys those cars from the source who offers him entertainment and personal attention such as the example above, he most likely will cost his employer a good deal of money in the transaction and his actions are therefore in conflict with the best interests of the stockholders. This illustrates the simple fact of the industrial buyer's life: He must at all times act in a way totally consistent with the interests of the person whose money he is spending - namely the stockholder. "Conflict of interest" describes most of the ethical hazards to be found in the business of buying and selling, and a very large share of the ethical hazards to be found in business in general. In fact, even clean air and water are in the stockholders interests in the very long term.

This brings us to point of wisdom #1 which has been driven home most recently by Peter Drucker. Dr. Drucker reminds us that in the Fifth Century B.C., Confucius put forward the concept of interdependence. He pointed out that when two people have a relationship of significance they would do well to maximize the joint benefit growing out of that relationship rather than either first trying to maximize their individual benefit. He reasoned that this would create more benefit to share among all people. This advice applied whether the two individuals were father and son, master and servant or buyer and seller. In the case of the industrial buyer, the two parties whose benefits should be jointly maximized in the transaction are the seller and the true owner of the money being used in the purchase - again the stockholder. The industrial buyer should at no time be attempting to maximize his or her personal benefit in the transaction. And this is what the Japanese do so remarkably well - they find the common interest and pursue it with great vigor.

One step closer to home is a Judeo-Christian tradition which will also shed light on our business system. Paul Johnson, who was editor of the New Statesman in the late sixties and wrote books such as A History of Christianity and Enemies of Society, tells us that capitalism has a moral quality because it is rooted in the free interplay of human conscience, in significant contrast to the rigidity of collectivist systems. They can be changed too - but only by force. They respond - but only to revolution. They lack a self-correcting mechanism because they do not, and by their nature cannot, accord rights to the individual conscience. Such systems therefore lack a moral base - not so much as ideas but as realities - and, lacking a moral basis, they are doomed to revert to the chaos from which they sprang. Democratic capitalism, on the other hand, is destined to survive, though its transformation in the future may be extensive. But Democratic capitalism will always in some way maintain the notion of the individual freehold, for it is this, the physical manifestation of the individual conscience, which provides its economic and political strength and, not least, its moral legitimacy.

Capitalism differs from socialism in its use of the free market in making all of the market decisions. It lets the customer decide what will be produced and when, rather than some central planning agency. This can be illustrated by the tale of the 4/H exchange students who were visiting Russia in the Spring and were horrified to see the farm commune workers preparing to plant wheat in a pouring rain. When asked why they would plant wheat under such terrible conditions and almost certainly lose a good portion of the seed that was being planted, the farmworkers replied that the master plan presented them from the planning agency in Moscow required that planting of wheat begin on April 20th and today was April 20th. The plan allowed, apparently, no room for individual judgment. Which brings us to a further point of wisdom when we consider that Immanuel Kant stated in his extensive writings on practical reason that "morality is the business of respecting

people as ends in themselves rather than as means or objects".

PUBLIC OPINION AND THE IMAGE OF AMERICAN BUSINESS

So how is the business person perceived by the consumer and taxpayer in his application of ethics to the practice of business? Each year the Gallup poll asks a sample of consumers to rank a number of major elements of society in order of their "application of ethical values" in their normal activities. Business people rank well down in the bottom third of the list below T.V. and Newspaper reporters, funeral directors, lawyers and senators. The businessman did rank just above a congressman - where we can recall the ABSCAM problems rather vividly - above state and local office holders, and above the same car salesman - who ranked dead last.

What is it that bothers the public so much about the application of ethics in business? It appears that the public is most troubled when they see someone in a trusted position gain unfairly at their expense. This can be seen in the public reaction to the Medicaid abuses, the abuse of offices of authority, and to kick-backs and other financial double dealings. The papers feed us a steady diet of misbehavior identified by the press which apparently bothers the public immensely. A recent Time magazine article noted that the Securities and Exchange Commission had decided that a certain major bank did not need to disclose specific activity which it had found was "illegal to a limited extent" because that bank had never told its stockholders that its senior management possessed "honesty and integrity". Apparently we are not even expected to believe that business men and women are honest unless they have specifically told us so.

From the beginning of the study mentioned above, the N.A.P.M. Ethical Standards Committee has been attempting to think more deeply on the matter of conflict of interest and has developed a number of views which may be helpful

1. Sound ethics in buying and selling requires:
 - a. An open search for the best buyer or best seller in order to maximize the benefits to both.
 - b. Honest dealings in both directions in a purchasing/selling transaction.
 - c. Avoidance of even the appearance of a conflict with the interests of the stockholders.

* There is substantial evidence that violating these rules as a customer produces bad decisions, expensive situations and uncompetitive prices in the final marketplace similar to the bad situation which would arise if you brought your automobile from the wrong dealer. In one example, a plant manager accepted a three thousand dollar kickback from a supplier in order to steer business to him. It was later determined that the work could have been done for three-hundred thousand dollars less had it been placed in one of the better competitive sources. It is amply clear that good ethics, in buying at least, is truly good business.
2. The ethical climate within which a stockholder's funds are being spent is abrasive and hazardous.
 - a. Twenty-seven percent of the buyers had been pressed by fellow employees to do unethical things.
 - b. Twenty percent are sometimes placing business for the wrong reasons.
 - c. Twenty-four percent of the buyers perceive a dual standard in their firm whereby they are held to tighter ethical standards than other activities.
3. Thoughtful employers are doing something positive about this.
 - a. Clear standards are being issued by the better companies.
 - b. Seminars on ethics are being held in more and more companies and there is considerable discussion taking place between peers under the encouragement of management.
 - c. Individuals who offend these standards are being disciplined more publicly, including being fired in many cases. This has a strong therapeutic effect on others who might be tempted to stray from the standards so clearly laid down by management.

4. There are useful guidelines emerging for buyers. And even for this rather specialized management function, it is clear that managers can greatly influence the ethical behavior of their employees if they emphasize the right things:
 - a. Keep your job and your private life separate.
 - * Don't expect favors.
 - * Don't expect special treatment from the people with whom you are doing business in the name of your stockholders.
 - b. Keep the social amenities in balance.
 - * Don't accept anything you could never reciprocate at your own employer's expense.
 - * Don't become the habitual guest.
 - * Maintain equal stature with the other party.
 - c. Expect guidance from your management just as you would in problems of finance, law, technology, etc.
 - * Don't do anything you clearly would not do if your boss were standing there watching.
 - d. Talk about it regularly.
 - * Keep the matter open and easy with your peers.
 - * Make it a topic of discussion at company training sessions.

ESTABLISHING AN ETHICAL CLIMATE: SOME NEW DIRECTIONS

From all of the above experience we do have some feeling for what is coming down the road in the near future. The Ethical Standards Committee has been in touch with many individual manufacturing firms and many buyers and sellers over these past few years and believes that we can expect the following in the future:

1. It is likely that someone will develop a study of the ethics of selling to match the thoughtful work done in determining the true ethical practices in buying. Such a study would determine for all time whether good ethics in selling is in fact good long term business and whether it enhances long term margins.

2. We can expect better tools to be developed for use by the chief executive in managing the ethics of his employees. It is clear from the N.A.P.M. study that firms with powerfully stated standards generally enjoy better actual practices and lower levels of temptation put upon their employees by sellers. This is very encouraging proof that managers can actually manage in the field of ethics.
3. There will be increasing efforts to bring the facts and any new and better tools to the chief executive for use in this effort. A number of trade associations and professional groups are looking at this question in one way or another and we can expect them to help encourage the use of these tools by senior management where appropriate.
4. There will very likely be a concerted effort to convince the chief executive to eliminate the dual standard about which there are so many complaints. This subject is the most frequently mentioned problem from the buying side, and is also a source of great discomfort on the selling side where salesmen are put in the position of having to guess whether or not the management of a customer firm is serious about the rules it has laid down.

One approach that might be considered to advance the above cause involves asking a large selection of U.S. manufacturing firms to rank the ethical buying practices of their industrial customers as well as the ethical selling practices of their industrial suppliers. Done in sufficient depth under the CEO's encouragement and with a guarantee of anonymity to the individual salesman and buyers involved, this method could well develop the first hard, empirical data on the actual ethical practices prevailing in industrial buying and selling as seen through the eyes of both parties to the transactions.

It is already clear that good ethical practices in buying will reduce significantly the probability of choosing the wrong supplier for the wrong reasons. Most senior individuals who have spent their lives on the road as industrial salesmen or managers of such salespeople believe strongly that good ethics on the selling side is good business in the long run. They argue that the firm who never promises more than it can deliver earns a reputation for keeping its word (a prime element in ethical selling) and will therefore be able to command slightly greater gross

margins in its sales prices over time. If this can be proven with hard evidence, the chief executive will naturally direct more management attention and organizational discipline to the selling practices of his firm.

Should it prove possible to make this happen on a broad-enough scale, we might even find gainful employment for the Confucian concept of interdependence when trading partners seek to maximize their joint benefit as partners are prone to do, in place of each searching for ways to benefit at the expense of the other. The resulting efficiencies made possible by this form of teamwork would surely be a happy use of an ancient and honorable Oriental concept to help slow the advance of the current Oriental juggernaut.

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