ENVIRONMENTAL LEADERSHIP

Perverse Trade-offs

Ethical considerations in sustainable development

In their 2001 book *Perverse Subsidies,* Norman Myers and Jennifer Kent laid out in exacting detail how governments around the world support economic and environmental policies that have the exact opposite effect from their stated objectives of improving the economy and the environment.[1]

For example, subsidies for corn-based ethanol fuels in the United States have impacted food prices around the world. Moreover, the energy balance from using ethanol based on corn "is actually so close that several factors can easily change whether ethanol ends up a net energy winner or loser."[2] Life-cycle analyses for corn-based ethanol depend on a number of underlying assumptions—and the initial assumptions that brought subsidies and positive media coverage were far from realistic.

The Public Policy Process

Economic and environmental policies are established by processes that vary in transparency and inclusivity. Big money is at stake. There can be winners and losers, which motivates stakeholders to gear up their influence machinery. Some agendas are obvious, while others are hidden.

A skeptic observing the process might conclude that "Figures do not lie, but liars figure," as each stakeholder adds their spin to the mix. In democracies, there are protocols (such as notices of proposed rulemaking) that are designed to bring fairness and balance to the process. The system is far from perfect, but it is the best that civil society has to offer.

Corporate Decision Making

But what about the decision-making processes at corporations? Within business organizations, decisions that have far-reaching health, safety, environmental, and economic impacts on entire communities (if not nations) can be made unilaterally, sometimes literally by one individual.

Corporate managers are in the business of making trade-offs—weighing one choice against another. But can those trade-off decisions become so faulty as to be perverse? In this context, we define "perverse" to mean morally and ethically reprehensible. Dozens of high-visibility disasters caused by business activities provide ample evidence that corporate decision makers can become corrupted and unethical.

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This column explores the business decision-making process relative to sustainable development. What are the internal mechanisms that ensure ethical decisions? Clearly, some companies are extremely good at making ethical judgments. Others have disastrous track records—an indicator that their trade-offs process had reached the perverse level.

Do Regulations Define Right and Wrong?

The most common question that managers ask before making any business decision is "Is it legal?" For the vast majority of decisions, the answer to this question can provide reassurance and protection against future lawsuits (or even imprisonment).

Companies find it notoriously difficult to make decisions that involve environment, health, and safety.

Companies avidly explore legal loopholes. Indeed, some have touted their ability to seek competitive advantage by being clever at such practices. When organizations become too aggressive in this respect, the result can be financially devastating. "Creative" accounting practices and scandals have brought down or greatly diminished the brand of companies such as WorldCom, Enron, Tyco International, Qwest Communications, Lehman Brothers, and many others.

But at least the damage from financial and accounting decisions is largely limited to the economic sphere. Yes, individuals, employees, shareholders, and possibly communities suffer monetary loss. But they do not literally suffer direct loss of life.

Making Decisions When Environment, Health, and Safety Are at Stake

When decisions involve environmental, health, and safety (EHS) issues, the losses can be much more serious—and often irreversible. The damage resulting from unprincipled corporate decisions may extend over generations. It can injure innocent parties who may have a direct stake in the outcome but no control over the decision. It can have a disproportionate impact on vulnerable individuals who are more at risk than the general population. It can include intangibles, such as access to natural beauty.

Companies find it notoriously difficult to make decisions that involve environment, health, and safety. The issues may be abstract, they may cover uncharted territory, and they may have no precedent. The business decisions often require nuanced judgment calls.

Moreover, the consequences of a bad EHS decision may not become apparent for decades. Hence, the issue on which a decision must be made may not even be covered by applicable laws and regulations. By definition, regulations represent "closing the barn door" on problems that already have been relatively well defined.

Crossing the Line

Reducing the decision-making process to a binary "yes/no" choice that hinges on legality clearly is not wise. But companies and trade associations sometimes go even further: They cross the line to perverse conduct by influencing the rule-making process itself with tactics intended to delay or neuter regulations. Or they seek to obfuscate public awareness of dangers. One obvious example here is the tobacco industry, which spent large sums on advertising and pseudo-scientific research supporting its position on the safety of smoking.

Regulatory Capture and Its Consequences

Industries clearly seek to influence the regulatory agencies that govern them, and their influence has grown in power. Some charge that trade organizations are engaged in regulatory capture of

agencies charged with protecting the public interest—and that industry consultants are defining science and reviewing each other's work for profit.[3]

Numerous instances can be cited where industry has delayed the promulgation of regulations. For example, the dangers of asbestos, chlorofluorocarbons, and lead in gasoline, and the link between aspirin and an increased risk of Reye's syndrome in children, were all well established years (if not decades) before regulations were adopted or warnings required.

In the United States, industry has pressured government agencies to produce increased documentation and meet industry's definition of "sound science" before moving forward with regulations. These demands have created what many believe to be unreasonable standards of evidence that interfere with agencies' ability to regulate.

For example, the United States Environmental Protection Agency (US EPA) initiated its first risk assessment of polychlorinated biphenyls (PCBs) in the 1970s. Yet the debate on PCBs—and the regulatory challenges—continue to this day. So entangled is the regulatory process in the United States that US-based multinationals look to Europe for guidance in determining the acceptability of certain practices.

Cost-Benefit Analysis

Savvy companies know they must do more than just comply with applicable regulations. They recognize that they will be held to higher standards of performance. When making the inevitable trade-offs involved in any major business decision, regulatory compliance can at best serve as an initial screening test.

So even if a proposed action is legal or is not covered by current regulations, business managers must ask further questions before making their decision: Do the benefits of the action outweigh the costs? What is the anticipated rate of return?

With most business decisions, the costs and benefits of the various options are relatively easy to define. When there are risks, they tend to be associated with factors such as changing economic conditions, customer acceptance of a new product or service, and uncertainties in the regulatory environment. This is Management 101, supported by models such as Porter's "five forces."[4]

Making the Business Case for Sustainability

For decades, environmental professionals have attempted to influence the corporate decision process by "making the business case" that the costs and benefits of environmental (or, more recently, sustainable development and social responsibility) issues should be deciding factors when evaluating certain business options.

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If the decision clearly involves compliance-related matters, the discussion can be brief—and favorable to the position of the environmental professional. Companies rarely make a conscious decision to defy legal requirements.

But most of the time, regulations cannot provide support for the environmental professional's position. Often, the factors under consideration involve intangibles that defy precise quantification. Yet intuitively, managers may recognize that such factors have significant potential to affect the company—by, for example, impacting the company's brand or reputation.

Pricing the Intangible

Not surprisingly, the process of trying to put a price tag on intangibles has received considerable attention from academicians. For example,

Alan Holland claims that cost-benefit analysis is based on the (perhaps faulty) assumption that all people are consistently reasonable and have preset values at which they would be willing to buy or sell things like health, safety, or water quality.[5]

Others claim that cost-benefit analysis turns all intangibles into commodities for sale—something most of us would not approve of in the case of disease prevention or safety.[6] Finally, some argue that, by its very nature, cost-benefit analysis tragically decreases the value that society places on the intangibles in question. If an intangible good like worker safety is for sale, why should employers unconditionally strive to protect it?

Forcing the Issue

Criticisms notwithstanding, cost-benefit analysis has virtues that make it highly valuable to decision makers. It forces them to take a cold, hard look at the consequences of their potential courses of action. It also allows them to examine the priorities inherent in the decisions they make.

Seeing the cost of their actions in dollars and cents can bring home to decision makers how crucial their choices are.

Difficult decisions always involve placing an implicit price tag on intangibles, even if decision makers prefer not to admit it. By forcing decision makers to assign an explicit price, cost-benefit analysis requires them to come up with a number that can help guide their decision.

Having an explicit number to work with (instead of just a vague intuitive sense) can encourage decision makers to act in a way that is socially or morally acceptable—by, for example, valuing environmental quality more than the new corporate expansion. Seeing the cost of their actions in dollars and cents can bring home to decision makers how crucial their choices are. It can be an effective way to prevent them from putting themselves to shame in front of their friends and family.

Cost-benefit analysis forces decision makers to frankly compare the importance of all things involved. Its transparency, reliance on explicit valuation, and focus on consequences make cost-benefit analysis a tool that can challenge perverse trade-offs in cases where regulation is lacking or absent.

The *Real* Decision-Making Process in Corporations: Confronting Culture and Governance Issues

Regulations and establishing the business case may dominate the open or transparent side of management decision making, but many other, less obvious factors are also in play. These factors are every bit as important when seeking to understand the ethical dimensions of the potential trade-offs involved with sustainable development.

The real decision-making processes that go on within companies may be complex—and often far from transparent. The sections that follow discuss some of the corporate cultural and governance issues that can impede sound decision making.

Using Facts Selectively—If at All

Top executives sometimes opt to go with their gut instincts, disregarding inconvenient facts. Or they may simply decide to agree with people who provide recommendations that are to their liking.

Information Barriers

In many cases, the relevant facts may never get to decision makers in the first place. For example, EHS professionals may not be allowed enough “face time” to educate executives in ways that would allow them to make truly informed decisions.

In addition, information often gets filtered as it makes its path to top management or across organizations. Perhaps the best example of such a filter is the boss who refuses to convey bad news. But this "failure to communicate" actually tends to be much more pervasive in business organizations.

The Data Hurdle

Whole organizations, not just individuals, may collectively hold certain beliefs or insist on certain processes. For example, some organizations develop a powerful data-driven culture in which everyone has to prove beyond some threshold hurdle (usually in specific financial or statistical terms) that the threat or opportunity they are highlighting is worthy of further consideration.

But, as already noted, intangible or ambiguous threats and opportunities can be phenomenally challenging to quantify. In such cases, documenting a compelling business case that passes muster can be all but impossible, especially since the resources required to research and formulate a truly sound business case can be out of reach for the typical EHS professional. When this happens, environmental managers can find themselves caught in a classic no-win, catch-22 situation.

Groupthink

Organizational conformity and groupthink can stifle unconventional ideas and prevent informed individuals from raising an alarm when they identify an important issue. These individuals may be reluctant to force the issue forward if it might upset their colleagues or create problems with other functional areas. "Going with the flow" may be easier, especially if it seems necessary to preserve the individual's career aspirations. No one likes being viewed as a loose cannon.

Fragmented Information

Sometimes the lack of open communication across functional areas can lead to bad decisions or no action at all. This is particularly true when each group within the organization has only partial information and there is no central mechanism that can pull all the pieces together into a compelling business case. When viewed separately, the individual bits of evidence might look unconvincing. As a result, no one feels compelled to do anything.

Differing Tolerances for Risk

Individuals also have different tolerances for risk. Environmental professionals and attorneys tend to be more risk-averse. By contrast, business executives, and especially sales and marketing staffs, tend to be much more willing to take chances.

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A "can-do" attitude is valued highly in the business world. Confidence (even overconfidence) may be viewed as a positive attribute. It is no wonder that cautious environmental professionals can be seen as "Eco Cops" or "Safety Nazis," and their concerns dismissed out of hand.

Resistance to Change

Individuals within the organization may resist change and stubbornly hold onto their existing beliefs. Even environmental professionals can be blind to emerging issues. Most often, this happens because they are focused totally on the crisis du jour or on maintaining regulatory compliance. Unfortunately, however, a few can be so convinced of their individual prowess that they fail to see the value of an occasional independent assessment.

Reluctance to Identify Issues or Admit Error

Some individuals may fear raising previously undiscovered governance issues, worrying that by doing so they may create problems for themselves. "Why rock any boats?" might be their motto.

In addition, people often do not like to admit errors, either to themselves or to others. Even if emerging facts directly challenge their beliefs, some may persist on the same flawed path. They prefer to selectively choose information that conforms to their own beliefs, going so far as to surround themselves with submissive "yes men" and accommodating consultants.

Hidden Agendas

Hidden agendas can also cause organizations to stubbornly stay the course even in the face of new or different information. This phenomenon can apply to any type of organization—corporate, governmental, and nongovernmental. For example, the 2010 midterm elections were generally interpreted as a repudiation of the policies pursued by the current administration in Washington, including policies directly related to environmental protection. Nonetheless, after the election, US EPA stepped up efforts to implement a range of previously announced regulations, including many that likely would not find support in the new Congress.[7]

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Theories of Decision Making

David Brown, Sc.D., adjunct professor of applied ethics at Fairfield University, states, "There are the three principle theories in decision making, Deontology (duty), Utilitarianism (outcome), and Ontology (virtue)."[8]

Each of these has weaknesses. Brown notes, "The dominant theory in business is Utilitarianism whose weakest points are the need for complete knowledge of the future and assigned dollar values to every outcome. Failure to understand those limitations forms the foundation of much of the environmental and health damage from governmental decision making."[9]

Placing Ethical Boundaries on Business

In a much-cited 1970 *New York Times* essay called "The Social Responsibility of Business Is to Increase Its Profits,"[10] economist Milton Friedman declared that businesses do not have social responsibilities beyond earning a return for their shareholders; only individuals have such responsibilities. One of the more famous quotes from the essay states, "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."

In effect, Friedman places moral and ethical boundaries on executives, arguing that they have no right to spend the monies of the corporation's owners (its shareholders) in seeking to achieve social agendas other than maintaining the vitality of the company—and the inherent benefits the company provides to shareholders, employees, and the community.

This argument has spawned debate between those who take a "free market view" (that creating wealth should be the guiding principle for corporate behavior) and those who adopt a "corporate social responsibility view" (that corporations should broaden their concerns beyond just making money).

Which view is right? Clearly, the world has changed dramatically since Friedman wrote his essay decades ago. Most executives today advocate enlightened self-interest—the view that,

although certain activities may be more costly in the short run, they can further the corporation's best long-term interests. For example, corporate philanthropic activities often are justified as a means of building good, long-term community relationships that may someday pay ample dividends.

Sustainability: Philanthropy or Strategy?

Some executives place sustainable development in the category of "good deeds." But companies that see sustainability as a philanthropic activity are missing the greatest benefits it has to offer. Decisions based on this myopic viewpoint fail to see the risk-reduction possibilities and the potential brand-position and marketing opportunities afforded by sustainable development.

Sustainability can be integral to the success of many companies today. Organizations that reduce environmental, health, and safety risks for their employees, consumers, and host communities can benefit by avoiding legal problems, bad press, and broken consumer relations down the road. This more strategic approach identifies the adverse effects business operations may have on people or the environment, seeks to mitigate or lessen the probability of these effects, and positions the business to act responsibly vis-à-vis society and the environment.

In branding, using sustainability as a lens can remind businesses to be *responsive* to consumers, in addition to being *responsible*. Nowadays, more consumers (as many as nine out of ten) report that their values influence their spending.[11] By integrating consumer values with core business practices, companies can capitalize on this. Businesses can also construct a strategy around sustainability trends in consumer preferences, continually enhancing brand appeal and consumers' bond with the brand.

The benefits to integrating sustainability with core strategy are virtually endless. Payoffs for developing sustainable operations can be immediate and enduring, and sustainability need not be reduced to only a peripheral component of a successful organization.

Ethical Decision Making and Sustainable Development

Considering the preceding points raised, what should a business executive do to ensure that he or she is making ethical trade-offs when considering issues involving sustainable development? Here is our list of the top ten key elements:

1. Determine whether your staff is competent in these areas. Since most executives do not have direct experience with running sustainable development and EHS groups, an external review may be in order. We have seen far too many individuals assigned to head up these functional areas even though they lack the requisite expertise. On-the-job training is not acceptable if the stakes are potentially high.

Payoffs for developing sustainable operations can be immediate and enduring, and sustainability need not be reduced to only a peripheral component of a successful organization.

2. Review your company's vision, mission, and policy statements relating to sustainability and EHS concerns. You may find that they sound more like value statements than any real reflection of how the company operates. If so, create a new set based on thoughtful review of what your company is really trying to accomplish. Ask yourself the question, "Are these clear and actionable statements, or do they merely sound politically correct?"
3. Do not interpret a record of excellence in EHS compliance as an indicator of superior performance. Sometimes, a spotless record simply reflects lax regulatory oversight. Regu-

lators may have failed to identify compliance issues because their priorities happen to lie elsewhere or they are short on staff. Moreover, lack of compliance problems in the past cannot serve as a forward-looking indicator of emerging issues.

4. If someone within the company appears to be a gadfly, listen: That person may have a valid point of view. Ensure that there are processes in place to bring in outside expertise to offer second opinions.
5. Establish processes that help guarantee internal communication and transparency on crucial issues, such as an ombudsman and a toll-free employee hotline. Establish an executive advisory committee in which several top executives meet directly with sustainable development and EHS staff on a quarterly basis.

Establish a strong governance system and a set of sustainability metrics that reflect where you are headed, not where you have been.

6. Evaluate the substance behind your company's public relations statements relating to sustainability and EHS. Are you being fooled by your own PR? Are you mistaking external awards and placement on lists of "best" companies as markers of actual performance?
7. Create networks of opportunity for stakeholder involvement in sustainability and EHS issues at the local, regional, and corporate levels.
8. Get involved. Some CEOs just show up at the annual EHS awards banquet and deliver a speech others have written. Make your involvement in this area substantive, just as you would be directly involved in any other important business issue.
9. Establish a strong governance system and a set of sustainability metrics that reflect where you are headed, not where you have been. Implement sustainability sign-off procedures for all new business ventures, raw materials, and products. Establish a sustainability assurance-letter process in which each business unit officer reviews and signs off on his or her area.[12]
10. Check for overall system effectiveness and internal coherence. Do the outcomes of your trade-offs (and the related documents, efforts, and governance mechanisms) genuinely promote social and/or environmental well-being?

The Ultimate Tests for Trade-off Decisions

Trade-offs that stand the test of time are those that can pass a couple of simple tests, as discussed below.

The "Front Page" Test

This test forces executives to ask, "How would I feel if everything that goes on in my company's decision-making processes were to appear on the front page of the newspaper?" Business executives and sustainable development professionals must assume that, sooner or later, everything they do will be disclosed to the public.

Supreme Court Justice Louis D. Brandeis once said, "Sunshine is the best disinfectant." When it comes to ethical decisions, his statement is absolutely true.

The "What If It Were Me?" Test

The second test directs executives to place themselves in the position of other parties who may be affected by their decisions. They should ask themselves, "Would I want to live next to this factory/operation?" and "Would I want my family to be subjected to the consequences of this decision?"

Don't forget about the flora and fauna that have no voice at all. Professor Brown states, "Sustainability forces extension of commonly held ethical theory beyond humans who can reason to include ecosystems that cannot. That extension

can be supported by either Anthropocentric or Biocentric principles, both of which are difficult to include in business decision making."[13]

Concluding Thoughts

When companies have the proper decision-making processes in place, the span of factors they consider is broad. In the realm of sustainability and EHS, their questions go beyond regulatory compliance and impacts on short-term profits.

A sound decision-making process requires questioning and skepticism on the part of staff members. It also requires longer-term, more holistic consideration of the impacts that company decisions may have and how business operations may factor into the company's sustainability goals. Staff should be ontological reasoners who evaluate not only the business dynamics of any decision, but also the humanistic dimensions.

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