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Preface

Better than ever? Employee reactions to ethical failures in organizations, and the ethical recovery paradox

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ABSTRACT

This research examines organizational attempts to recover internally from ethical failures witnessed by employees. Drawing on research on service failure recovery, relationship repair, and behavioral ethics, we investigate how witnessing unethical acts in an organization impacts employees and their relationship with their organization. In two studies—one in the lab and one in the field—we examine the extent to which it is possible for organizations to recover fully from these ethical lapses. Results reveal an ethical recovery paradox, in which exemplary organizational efforts to recover internally from ethical failure may enhance employee perceptions of the organization to a more positive level than if no ethical failure had occurred.

Introduction

The media frequently reveal episodes of unethical activity in organizations of all types, including business, political, athletic, religious, and even charitable organizations. Reports from employees bolster these accounts, with nearly half of U.S. workers personally observing conduct at work that violated company ethical standards, policies, or the law (Ethics Resource Center, 2011a). Research in behavioral ethics has disclosed a great deal about the antecedents of unethical activities like these, but we know much less about what happens—and what should happen—*after* an unethical event takes place.

Organizational ethics is an issue of great importance. Firms invest considerable resources in ethics compliance, education, and training. For example, the cost of compliance with just Section 404 of the Sarbanes–Oxley Act (a portion of the act aimed at accounting fraud) is estimated at $2.3 million *per firm* (Freeman, 2009). Despite investments like this, unethical activity continues to exert a heavy toll on organizations. Workplace fraud alone—be it stealing $20 from a cash register or siphoning millions through sophisticated embezzlement schemes—is estimated to cost organizations nearly five percent of their annual revenues, which translates to more than $760 billion per year in the U.S. (Association of Certified Fraud Examiners. 2012). Finally, the cost of ethical failure is not limited to the failure itself. The ethical lapse of a single individual can result in widespread reputational and financial damage to an entire organization.

The lesson from news accounts is that ethical failures happen, both in good organizations and in bad. Even the most conscientious organizations occasionally find themselves on the wrong side of ethical events. In this research we seek to understand two important but understudied aspects of ethical failures: (1) the internal impact on employees of witnessing ethical lapses in the organization and (2) the effectiveness of organizational attempts to recover from them. In particular, we investigate whether effective recovery efforts on the part of the organization can mitigate or even reverse the negative impact on employees (i.e., their view of the organization and their relationship with it) of witnessing unethical activity.

This research contributes to the behavioral ethics literature in four ways. First, by examining what happens in the aftermath of an unethical event, we explore an overlooked area of ethics research. Most ethics research focuses on the causes of ethical failure, but in this study we investigate consequences: the impact unethical acts have on employees who witness them. This speaks directly to concerns raised in major reviews of the behavioral ethics literature, that more attention needs to be paid to the *consequences* of unethical behavior in organizations (Tenbrunsel & Smith-Crowe, 2008; Treviño, Weaver, & Reynolds, 2006). Second, we examine the extent to which it is possible for organizations

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to recover from such ethical failures. Drawing on research that explores how organizations respond to service delivery failures, we craft a framework for exploring whether ethical recovery efforts can repair the damage caused by ethical failures. Third, building on the relationship repair literature, we extend this framework from individual-level indicators of repair to include relational and systemic (organization-level) aspects as well. Finally, we explore the possibility of an ethical recovery paradox, in which exemplary recovery efforts on the part of the organization may actually enhance the employee-organization relationship, elevating it to a more positive level than if no ethical failure had occurred.

Ethical failure and recovery

Managing organizational failure and recovery has been a topic of interest among organizational scholars and practitioners for decades. Insights on organizational failure have spanned issues ranging from failures in trust (Dirks, Lewicki, & Zaheer, 2009), production (Friel, 2005), safety (Mehri, 2006), leadership (Kroll, Toombs, & Wright, 2000), strategy (Muehlfeld, Rao Sahib, & Van Witteloostuijn, 2012), and justice (Andiappan & Treviño, 2011; Liao, 2007; Reb, Goldman, Kray, & Cropanzano, 2006). One of the most compelling streams of research relating to organizational failure and recovery involves service failures, how organizations respond to such failures, and how individuals react to those responses.

The service recovery paradox

McCollough and Bharadwaj (1992) coined the term "service recovery paradox" to describe what happens when an organization fails in its attempt to provide quality service, but recovers from that failure in a highly effective way. They found that a well-executed service recovery may actually result in *higher* customer satisfaction than if no failure had occurred in the first place. In describing the phenomenon, Hart, Heskett, and Sasser (1990) noted, "a good recovery can turn angry, frustrated customers into loyal ones. It can, in fact, create more goodwill than if things had gone smoothly in the first place" (p. 148). Meta-analytic research has corroborated the existence of this service recovery paradox with respect to customer satisfaction with the organization (Matos, Henrique, & Rossi, 2007). Thus, service failures—and efforts to recover from those failures—have come to be viewed as opportunities for organizations to enhance customer satisfaction (Magnini, Ford, Markowski, & Honeycutt, 2007), although research does not suggest ineffective service followed by outstanding recovery as a viable long term strategy (Michel & Meuter, 2008).

The service recovery literature provides a conceptual foundation for understanding organizational recovery efforts more generally. The expectancy disconfirmation paradigm (Oliver, 1980, 1993, 1997) is the most widely utilized framework in the consumer satisfaction literature, and service recovery researchers have adopted it to explain consumer satisfaction with organizational recovery attempts in general (Oliver, 1980; Singh & Widing, 1991) and the service recovery paradox in particular (Matos et al., 2007; McCollough, Berry, & Yadav, 2000).

The expectancy disconfirmation paradigm proposes that individuals do not evaluate product or service performance on an absolute scale. Rather, they compare actual performance with their a priori expectations of performance. If performance meets or exceeds expectations, confirmation happens, and the result is satisfaction. If performance falls short of expectations, disconfirmation happens, resulting in dissatisfaction.

In recovery situations, a related but more complicated series of events occurs. Individuals possess multiple expectations regarding service deliveries, including service expectations, failure expectations, and recovery expectations. *Service expectations* reflect an individual's standard of adequate levels of delivered service quality. *Failure expectations* reflect an individual's understanding that a service failure might happen, even when dealing with reliable service providers (Fisk, Brown, & Bitner, 1993). For example, failure expectations are evidenced by an individual's interest in items like warranties and refund policies, even when dealing with reliable firms. *Recovery expectations* reflect an individual's beliefs about how the organization is likely to respond to a failure, should one happen (McCollough et al., 2000).

In a failure recovery situation, overall satisfaction therefore involves two disconfirmation events rather than one: initial disconfirmation and recovery disconfirmation. *Initial disconfirmation* reflects the difference between failure expectations and service expectations. *Recovery disconfirmation* reflects the difference between recovery expectations and actual recovery performance. When a failure happens, a negative initial disconfirmation may occur, but if the failure was anticipated as a possibility, individuals may withhold final judgment on the overall event until recovery is complete. Research suggests that once in a recovery situation, it is recovery expectations—rather than initial service or failure expectations—against which the final efforts are judged (Kelly & Davis, 1994; Oliver, 1980; Singh & Widing, 1991).

The expectancy disconfirmation paradigm provides a general framework for understanding the impact of organizational failure and subsequent recovery efforts. We suggest it is therefore relevant to ethical failure and recovery, and for understanding the emergence of an ethical failure recovery paradox. Specifically, an employee who has witnessed an ethical failure in the organization, followed by an effective internal recovery effort by the organization, may view the organization *more* positively than if he or she had not witnessed an ethical lapse at all.

Organizational ethical failures

Ethical failures in organizations may take many forms. They may be minor or severe, may reflect individual or collective actions (e.g., board or committee decisions), and may affect internal or external targets. In this study we focus on organizational ethical failures through the eyes of employees. We examine the impact on workers of personally observing conduct at work that violates company standards, policies, or the law, and efforts on the part of the organization to recover from those failures.

Employees, scholars, and the public often anthropromorphize organizations, as illustrated in statements like, "General Motors laid off 1200 workers this week." However, organizations do not act; only individuals act. So in one sense, there is no such thing as an *organizational* ethical failure, but only the ethical failure of specific individuals (or groups of individuals) within organizations.

Nonetheless, employees often view the actions of organizational members as representing the organization, and they therefore form attitudes and beliefs about their organization based on the behavior of the people in it (Dean, Brandes, & Dharwadkar, 1998). The literature refers to the individuals who shape employee perceptions of the organization as "relational others" (Sluss & Thompson, 2012). These relational others include both supervisors and coworkers, and the actions of each are commonly viewed as representing actions of the organization itself.

For example, from the employee's perspective, supervisors are traditionally assumed to personify or embody the organization and to represent a credible and appropriate agent of the organization (Sluss, Ployhart, Cobb, & Ashforth, 2012). Supervisory actions are therefore viewed as being carried out on behalf of the organization (Eisenberger et al., 2010; Neves, 2012). As Treviño and Nelson (2011) note, "managers are the lens through which employees