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Why Fairness Matters

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‘Make the numbers’ is an over-riding force in many modern companies. But the more managers focus on *what* they achieve – ‘results’ – the less they worry about *how* they achieve it. New research shows how and why attention to fair process is key to performance.

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Which of the following two statements closest describes your organization's management philosophy?

A. Our priority is to achieve results. It is management's job to set stretch targets, to provide our employees with the tools they need to achieve these targets and to incentivize and reward them for meeting and hopefully even exceeding these targets. To make sure that these targets, tools and instruments will be effective we hire outside consultants to advise us in their formulation and implementation.

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B. Our job is to engage people affected by our decisions in an open, honest discussion where alternative ways forward can be suggested and genuinely considered. We work with outsiders for objectivity and for facilitating these discussions. Once we have made a decision, we explain to all concerned why this particular course of action has been chosen. Debate then stops and we all focus on implementing the decision. We always conduct a full evaluation of achieved outcomes, acknowledge mistakes and make the changes necessary in a way that's designed to avoid repeating the same mistakes in the future.

If your answer is 'A', your organization may be surprised to find that things haven't gone to plan. The more one 'manages for results' the more one tells people what to do and what is expected, the more elusive these results may seem to become. Examples abound of companies whose managers manage in this way, thinking that they will be successful, but results are disappointing and the company ends up being acquired. At the same time, managers often appear to have an instinctive dislike for the approach outlined in 'B'. It seems to be vague and a recipe for indecision, and managers adopting it risk appearing not fully in control. Yet, there is growing evidence that the second style of management is both more effective and sustainable. We are also beginning to understand why this is so. This allows us to operationalize these insights for managerial application on a day-to-day basis.

Fairness, Reciprocity, Trust

Students of organizational behaviour have long recognized the power of the emotions aroused by human beings' strong sense of fairness and reciprocity. When somebody gives us a present, we instinctively wish to give something back. Our instinctive response is 'you trust me and I'll trust you' or, somewhat pejoratively, 'you scratch my back, and I'll scratch yours'. At the extreme, if we feel we have been betrayed, our natural response is strong 'revenge' impulses: 'an eye for an eye, a tooth for a tooth'. How fairly we feel we have been treated is the trigger for these two opposite responses.

> Humans are reciprocal beings. They respond to 'fairness' with fairness, and to 'unfairness' with hostility. Fair process improves cooperation, which is critical to economic performance.

Fairness concerns are not simply a matter of socialization – keeping to certain social norms or customs. They appear to be '*hardwired*' into how our brains work. For example, there is an area of the brain called the striatum which is activated when we get a monetary reward. It is also activated when we punish somebody for a previous transgression. When somebody shows trust in us (e.g. through a gift), the levels of oxytocin – a pleasure-inducing polypeptide that's active in mammalian brains – rises. When we repay them, thereby proving ourselves trustworthy, these oxytocin levels rise even higher. Trusting and proving trustworthy literally makes (most of) us feel good. Sociopaths who cannot trust other people and are not trustworthy themselves have abnormally low levels of oxytocin in their brains. On the other hand, when experimental subjects are given extra oxytocin, their propensity to trust doubles.

It is the presence of fairness that generates trust. Reciprocity in trust and fairness leads to team spirit and collective commitment, which are the pillars of high performance teams. These inextricable links between reciprocity, fairness and trust are important economically because they have a strong influence on human cooperation. In trusting relationships we are prepared to risk, commit and invest more, thereby (usually) leading to better and richer outcomes. In un-trusting relationships we tend to withdraw, withhold or perhaps even sabotage.

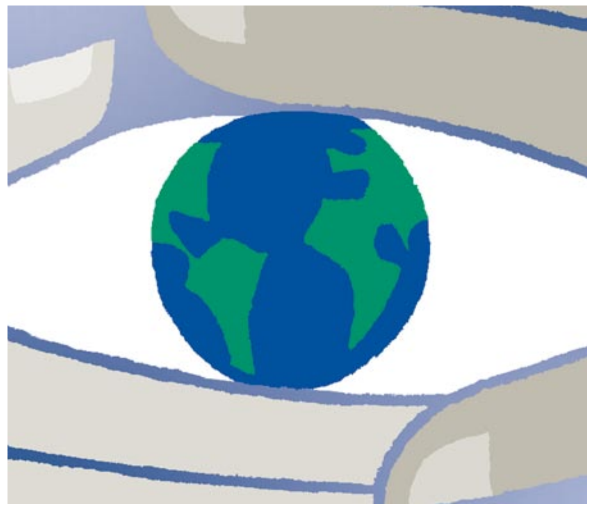
Fair process

Not surprisingly, the issue of fairness has sparked a great deal of interest among organizational researchers. In the early 1970s J. Thibaut and L. Walker showed that the perceived fairness of legal proceedings was key to the acceptance or refusal of legal decisions. G. S. Leventhal (1980) extended this work to organizations, with leading authors such as Chan Kim and Renee Mauborgne (1991) highlighting detailed implications such as the way poisoned relationships between HQ and foreign affiliates in multinational companies lead to performance shortfalls.

One key finding of this research is that fairness has at least two aspects: fairness in *outcomes* and fairness in the *processes* followed to reach these outcomes. Another is that the link between these two aspects of fairness often works in unexpected ways. For example, it's a common finding in the above research that people are much more prepared to accept 'unfair' outcomes if they feel that the process that led to these outcomes was fair. Even more strongly, people are far more likely to reject 'fair' outcomes if they feel that the process that generated these outcomes was unfair. Fair process is therefore very important, and can even supersede the need for fair outcomes. Outcomes are more likely to be seen as fair if they are the result of a process that is perceived as fair.

But what does a fair process look like? What are its key ingredients? Researchers from Leventhal onwards have identified six characteristics that a process must display to be fair. They are:

- *consistency of procedure* (across persons and time, absence of bias),
- *transparency* (full explanation of the decision process and logic),
- *engagement of those affected* (consideration of the views of all parties involved and giving these parties a voice in the process with the possibility of affecting the decision),
- *changeability* (the possibility of 'correction' as a result of new information through, for example, appeal procedures),
- *ethicality* (compatibility of the procedure with moral values).



These findings are interesting but they do not provide a satisfactory answer to the most important question for a manager: what should I do to make sure my day-to-day management work is seen as fair by the people I manage? Can we translate the theoretical insights into something more practical and operational?

These are the questions we addressed in our research. We combined the learnings of the fair process literature with those of the decision making literature (as exposited by Russo and Schoemaker for example) to yield a simple operational framework consisting of key fair process themes. We then did empirical research (in German engineering companies) to test the degree to which adherence to fair process correlated with performance. We report on both here.

First, let's look at our ideal 'fair management process'. It has five main steps.

1. Seeing, engaging and framing.
Management is first about agenda-setting. If every step of a process is followed meticulously but people disagree about its underlying agenda, it's hard to

make progress. Framing is about defining the agenda to which management ought to devote its attention. To frame the debate properly we must learn to see better: people ask from their leaders to see issues and solutions that others do not see. But the best way to do this is by seeing jointly and by engaging people: ask them what they see; what they think should be done; what they think the priorities are. The key question at this stage is: "What would you set as priorities if you were in my place?" Notice that at this stage we have a role reversal: the owner/leader of the issue is offering the opportunity of leadership to those he engages. If they come up with a good answer, their answer will be implemented.

Many top-down command-and-control management decisions – 'my boss did not consult me or anyone affected when deciding about this headcount reduction … and he now obliges me to announce and manage the layoff of 500 people!' – fail at this first, initial stage. Those required to implement the decision may not believe the decision is right and will typically lack the conviction necessary to really follow it through in an effective way.

Engaging stakeholders in framing is not only effective for problem formulation, it is also very useful for implementation. It actively draws change agents in, transforming them from passive recipients of change into active contributors to solutions. When this is done openly, it teaches people that issues might be complex, and starts preparing people for bad outcomes, thus motivating them to search for better outcomes. On the other hand, most people feel abused when their bosses skip this step, or only do it very quickly and formally.

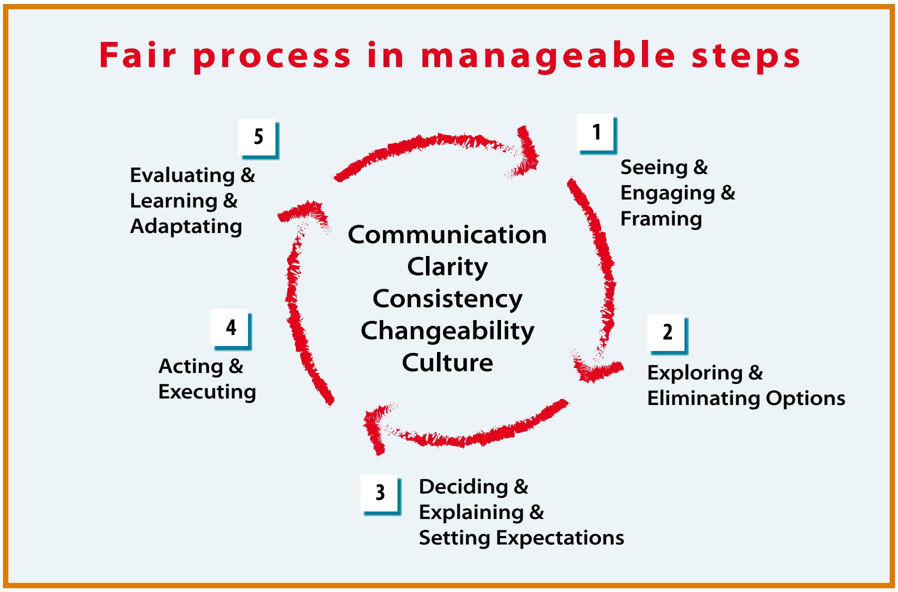


Figure 1: Operationalizing fair process

2. Exploring and eliminating options

Once the main issues have been identified, there are usually differing views as to how best tackle them. Organizational problems tend to be multifaceted and complex. So it is good for multiple viewpoints to emerge: now it is time to see 'what solutions the team can come up with'. This is difficult for many experienced managers who have strong self-belief and just 'know' they are right. To them, spending time exploring alternative options is a frustrating waste of time; to the team, this is the creative and fun part. Again, if the team comes up with a solution, implementation is greatly facilitated, for the team will always be more committed to its own solution than one imposed from outside. If this stage of the process is short-cut, implementers are likely to see the outcome as a product of political manipulation, or raw exercise of power, and not because 'it is right'.

This is also the stage where arguments opposing the solution are formulated, which is very useful when it comes to explaining the decision. The job of the manager at this stage is not to be a strong advocate of his own opinions, because that will restrict the decision. His role here is to be an impartial judge, choosing the best decision out of the many different options discussed. If consensus arises, he does not even need to argue, he only needs to agree.

3. Deciding, explaining and setting expectations

People are curious creatures and want to know 'why' (meaning and understanding) as well as 'what' (objectives and 'how to'). The reason why this matters so much (far more than many managers suspect) is because it sends potentially make-or-break signals about reciprocal intentions. People who feel their intelligence is not being respected tend to respond reciprocally: "If you are not going to treat me seriously, I am not going to treat you, or what you say, seriously".

But expectation setting brings with it another, crucial, dimension. It is where fair *process* expands to generate fair *outcomes*. By clarifying expectations up-front – about what we are going to do, how we are going to do it, and who will get what benefits from doing it – the expectation setting process not only gives all concerned their due respect, it pre-empts the often bitter recriminations that tend to break out when people start arguing about 'fair shares' of the cake. This is also an opportunity to convince those whose executional burden is the highest that they will not be let down by others. As Nelson said: "Let every man do his duty!"

In all of these three steps, reliance on outside consultants to advise managers 'behind the backs of' staff is an almost sure-fire way of making the process seem unfair from the staff point of view.

4. Acting and executing

Once expectations have been set any failure to actually commit to, and carry out the decision, risks being seen as some sort of betrayal: you have broken your promises. This is why, contrary to how many managers see it, fair process actually *requires* and depends on resolute, disciplined action (which will greatly be helped by the first three steps above). One particularly insidious (and common) practice here is the attempt to go behind peoples' backs to overturn decisions before or while they are being implemented. This often happens when individuals or groups are committed to their own hidden agendas which are not compatible to fair processes (see below). The fair process approach to such manoeuvres is "No time for re-discussion here. You should have raised this before. If you are still worried about it when we have finished, you can raise it again at the review stage".

5. Evaluating, learning and adapting

There is nothing more likely to inflame peoples' sense of unfairness than if a mistake has clearly been made yet the 'powers that be' (for reasons of their own which they never seem to explain and are then interpreted as mere face saving), refuse to recognize this fact or do anything to rectify the situation. 'Results' may have been achieved this time round, but peoples' willingness to commit to achieving future results may be severely undermined. If mistakes have been committed by the management, then continued collaboration with employees requires that these mistakes are admitted.

By clarifying expectations up-front – who is going to do what, who is going to get what benefits – fair processes also help to ensure fair outcomes. This helps avoid disputes over who gets how much of the cake.

Also, an integral part of fair process is a continued desire to make sure that the process itself is fair. Budgeting is a classic example here. People who know the classic budgeting game tend to inflate their budget requests, knowing that each such request is likely to be reduced by a random, across-the-board percentage figure. People who have been honest and played the game 'fairly', and who have not inflated their figures, are then effectively punished for their honesty. Uncorrected, these unfair process effects (which often seem just a natural part of corporate life) quickly accumulate, spread and deepen, so that soon a large proportion of the organization's time and energy is spent on in-fighting, internal politics and blaming: the opposite of fair process in other words. Thorough evaluations at this stage are the best way to stop the cancer of cynicism from spreading.

But the most important aspect of Step Five is this: Implemented in a disciplined manner, evaluating, learning and adapting is the secret of continuous improvement. If the organization can surface, publicly recognize and address problems as they arise, and if it can involve everyone affected in finding a solution to these problems, then it has hitched itself to the escalator of continuous improvement *and therefore* continually improving 'results'. Most failures are unfair not because they occurred but because they occurred and were left uncorrected.

market average, percentage of new technology content in new products, number of derivative products using the same platform provided an innovation and technology perspective. Finally, we also examined knowledge transfer and integration into the strategic product planning process (SPP).

Testing the hypothesis

The five steps outlined above sum up much of 'what we know so far' about fairness in the context of organizational behaviour. But do they work? To test this out, we studied how 15 German engineering companies actually made and implemented serial development (SD) and strategic product planning (SPP) decisions.

Participants – usually lower or middle level managers who are actually involved in the process – were asked to fill in a questionnaire which was designed to tease out the degree to which 'fair process' was adhered to, at each of the five crucial steps. Degree of compliance was ranked according to a straightforward 1–5 scale. The questions were self-evident given the above description: Were multiple options examined? At the end of the exploration stage, was the decision clearly explained and were expectations fully spelled out? How good was execution? And did a thorough evaluation take place at the end of the process?

We also needed to measure the quality of outcomes or results. We did this by looking at outcomes from both objective and subjective angles. Revenue generated by new products provided a financial measure; timeliness of market introduction, product performance as assessed by end-users provided useful customer measures; proportion of products first to market, number of new products compared to

Correlating fair process to planning performance

Source: Limberg 2007

Figure 2: The link between Fair Process and Performance in the Strategic Product Planning process (SPP) of 15 German engineering companies

The correlations we obtained through this empirical analysis were remarkably strong. As Figures 2 and 3 clearly indicate, the verdict from the data was clear: the fairer the process, the better its results.

To check and obtain further insight into these results, we looked in more detail at what actually happened in specific companies.

Example 1: electronics firm, internal process

We interviewed 31 people involved in the serial development (SD) process of a global, specialist high-class electronic-devices producer. They were drawn from all ranks (managing director, department heads, team leaders, operatives) and from all departments (R&D, product management, production management, production, marketing & sales, purchasing, and quality management.

These interviews revealed a very poor performance. Financial targets were never met, project spending was consistently above plan. Project progress was out of control, milestones were rarely reached on time. The resulting lead times and times to market were far slower than market averages. The number of patents generated by the firm fell below competitive benchmarks. Morale was low. Those involved rated knowledge transfer from R&D to the downstream units as weak; knowledge sharing between different product development projects was seen as very weak. In other words, performance was poor.

Fair process is rooted in good communication. But in this company, communication was poor or non-existent at every step, in every project and every department. Its big problem was far too much concern with status and hierarchy and a consequent downgrading of employee skills, commitment or contribution. Thus, for example, project leaders were not allowed to present progress reports to project steering committees. Instead, these presentations were made by the head of R&D: the meeting consisted only of people at the same organizational level. There was more concern for the defence and protection of positions than for learning.

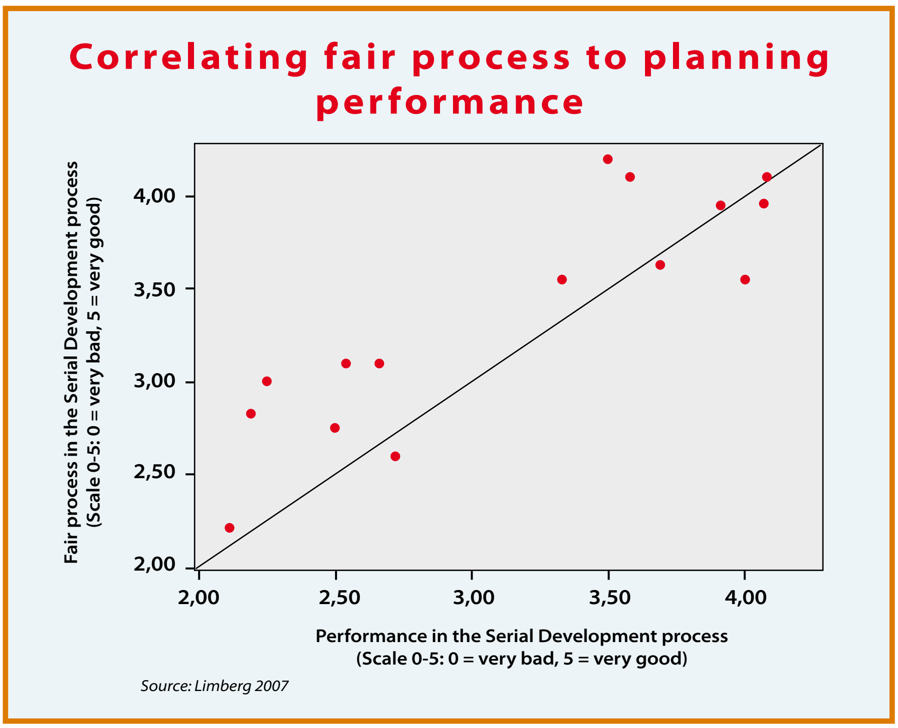


Figure 3: The link between Fair Process and Performance in the Serial Development process (SD) of 15 German engineering companies

Detailed questioning was limited and very little information flowed across departments or even within the same department (there was even poor communication inside R&D between the technology and innovation sub-unit and the design and construction unit). Decisions made by one sub-unit were rarely explained to other sub-units, even when the other sub-unit was affected by these decisions.

The result was that departments retreated into their shells and tried to focus on departmental goals in isolation to their peers – paying attention to other departments only in a reactive way. Cross-unit responsibilities were difficult to exercise effectively and with authority. Execution was seriously harmed, with many compromises and adjustments being made just to bring products to market. Missing deadlines further worsened the situation, with departments blaming each other for the problems.

Example 2: electronics firm, internal process

This was another electronics firm of similar size. The contrasts could hardly have been starker. Once again, we interviewed all those involved in the strategic product planning process (SPP), across all relevant departments R&D, technology & innovation management, production & logistics, marketing & sales.

In this firm there were specific cross-functional SPP groups for each product group, with responsibility for the governance of the products in their portfolio. These committees were composed of specialists from each of the four core departments; they had an explicit, active voice in debates concerning product strategies and their implementation. They were also responsible for keeping their own departments informed. Departmental members had the right to question their SPP representatives. Department members frequently asked their reps for more information and questioned them about the rationale for their decisions. The reps, in turn, did not view these questions as challenges or criticisms. They saw the process as helpful: this way they were constantly kept informed of departmental concerns and potential bottlenecks. Besides, SPP members work performance was partly judged in terms of their contribution to the SPP committees' work.

> While factories make products, fair processes 'make' trust. 'Fair process' therefore lies at the heart of effective collaboration. So why are so many managers so resistant to fair processes?

Two times a year, the SPP committees had formal meetings when SPP matters had top priority over their other responsibilities. During that time, strategic options were explored, and external specialists and research institutes were called in for additional input. These meetings ended with clear decisions, including about the investments needed to deploy the new product ranges and enter new markets. Finally, the committees regularly held evaluation and learning reviews about their decisions and the ways these were communicated and deployed across the firm.

Not surprisingly, the performance of this company was very good. It is experiencing consistent, rapid sales and profit growth on the back of its rapid rollout of innovative new products and its eager exploration of new markets and new product ranges.

Example 3: financial services firms, internal process

In one firm, the auditing department relied critically on the collaboration of the audited department for effectiveness. Speed, quality, and implementation of recommendations were all greatly enhanced when the audited department felt that the auditors acted fairly. However, in another firm the auditors found it extremely difficult to get access to the data they needed. The audit took much longer, and the auditors' recommendations were not really addressed. Confronted with the fair process framework, this company changed its audit process to ensure that fair process was consistently adhered to. Even though some of the recommendations were quite tough, audited departments became much more willing to implement recommended changes.

Example 4: supplier relationship process

This supplier had successfully survived its automotive manufacturing customer's move from buying components to buying 'systems'. It was now one of a smaller number of suppliers, and therefore (ostensibly) had a more important relationship with the customer. That was the good news. The bad news was that it was a very one-sided relationship.

While the car assembler talked in terms of 'partnership' the supplier did not feel it was in a partnership at all. Its bigger, more powerful customer was uncompromising in its demands, imposing constant audits, and complaining volubly about quality defects even when measured in terms of a few parts per million. The customer also expected constantly reducing prices and constantly improving quality: the supplier knew that just to stay still next year it would have to cut costs, improve processes and so on.

You might think this sounds like a perfect, disciplined win-win: constant customer pressure for increased value forces the supplier to continuously improve performance. The result was actually the opposite. Because of its skill and technology expertise, the supplier was actually making improvements *faster* than those dictated by its customer, and it was *holding these improvements back* from its customer as an insurance policy for the future. Without a fair process leading to fair outcomes (mutually acceptable risk and benefit sharing) the potential fruits of collaboration were actually being undermined, not maximized. The problem was not the goal, nor the capacity to reach these goals but the process of formulating and obtaining these goals.

Implications

The examples and research above show why a commitment to fair process is *a pre-requisite* for effective collaboration both inside companies (e. g. between

departments) and between companies (e. g. retailers and their suppliers, or corporations and their service providers). Human beings are instinctively reciprocal creatures. If they are not responding to the other party's actions with one side of the reciprocal coin ('you gave to me, so I'll give to you in return') they are probably responding with the other side ('an eye for an eye'). This is true even when the response is hidden and 'kept secret', as in the automotive example.

Decisions to invest in, and commit to, relationships do not revolve around likely outcomes alone; they depend on judgements as to the other party's *intentions*. Fair process demonstrates 'good intentions': while factories make products, it is fair process that 'makes' trust. And as we all know, without trust effective collaboration is impossible. One interesting domain in this regard is brand building. The temptation to "extend and leverage brands" is great. This article reminds brand managers that it is key to build brands on transparency and truth; when brands are extended in a way that leads customers to feel cheated on the core brand values, or when they simply feel taken advantage of, the brand value diminishes and loyalty greatly reduced.

Nevertheless, there is still considerable management resistance to fair processes. Why is this?

One major obstacle is private and hidden agendas. The process of implementing fair processes exposes people's intentions and goals. By definition, any attempt to keep these intentions and goals hidden undermines the attempt to make the process fair. Why should anyone want to keep to a hidden, private agenda? Usually it is because they hope or plan to benefit at someone else's expense. In other words, they do not *want* to play fair. They are in 'win-lose' mode, not 'win-win' mode. Any attempt to introduce fair processes in this context is therefore likely to meet with resistance. This will be examined in a forthcoming paper by Wu, Loch and Van der Heyden (2007).

The transparency of fair processes also creates a second major obstacle. Fair processes surface mistakes, misconceptions, errors and problems. They expose peoples' weaknesses, potentially making them 'look stupid'. Mishandled, this provides a cue for blaming and defensiveness. The real aim of fair process is precisely the opposite: to surface and solve any potential problem – and to solve it 'better' precisely because everyone who needs to be involved is involved. This open discussion requires a good deal of emotional intelligence, but probably even more important is a respect for people and truth (See Brockel (2006)).

An interesting corollary of our research is that it has explained the importance and power of Toyota's concept of *kaizen* (or continuous improvement) and its relentless focus on the PDCA cycle: Plan, Do, Check, Act. This concept contributed greatly to the definition of the fair process cycle, and we now understand that *kaizen* is actually a fair way for plant and line mangers to interact with the line operators. So fair process is not only how organizations build trust. It is also a big part of how they learn – it lies at the heart of organizational learning. These two themes of trust and learning are intimately connected.

But the biggest obstacle to implementing fair processes is this: When asked to choose between philosophy A and philosophy B as outlined at the beginning of this article, many managers baulk at having to make a choice in the first place. They want *both* the results *and* the fair processes. But the lessons from a growing body of research, including our own, is that *this is not possible*. You can't fudge this one. The choice is real. It is either A or B.

Why is this? First, because outcomes are the results of processes and continually improving results can only be achieved by sustainable, continuous improvements to underlying processes. You can fix your results by fixing your processes. But you cannot fix your processes by 'fixing' your results. If you try to 'fix' results without fixing underlying processes, chances are, you are only building up trouble for the future.

> Managers cannot 'manage by results' and manage fairly at the same time. A determination to 'deliver the numbers no matter what' is a determination not to be fair.

Second, if you are genuinely committed to fair processes you cannot commit yourself in advance to any particular outcome. The whole point of fair processes is that they allow other people and other considerations to influence outcomes. During the process the outcome is not yet determined. So managers cannot 'manage by results' and manage fairly at the same time. A determination to 'deliver the numbers no matter what' is actually a determination *not* to let process improvement 'get in the way' of delivering these results.

Conclusion

In this article we have focused on collaboration inside an organization, suggesting that a fair process framework goes a long way to answering the operational question 'how to interact effectively?'. But the principles of fair process apply both to intra-company processes such as new product development and strategic planning, and to inter-party relationships such as those occurring between retailers and manufacturers, retailers and consumers, and manufacturers and their suppliers. If collaboration is to work, fair processes will most likely lie at the heart of it.

At first sight, fair process issues often appear to be of marginal importance to managers. When first presented with the above five step framework, many managers react by saying something like: "Oh. You mean good communication is very important. Yes. I understand that. So I will communicate more in the future. Now, what's next?"

But 'better communication' is just a first step in engaging others. Fair process management leads to a radically new view of leadership that goes way beyond communication. It starts from the principle that leadership itself must continuously be tested and that fair process is a structured way of doing so. The result of fair process management is that leadership becomes more widely shared throughout the organization. Fair process then generates a deep and new level of effective collaboration that answers critical questions facing all organizations such as 'how can we build trust?' and 'how can we learn, adapt and continuously improve?'.

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Further Reading

A good place to start is to review the classic article by Kim & Mauborgne (1997). This is the article that inspired our work, which aims to provide a normative answer to the question "what do I need to do to work fairly?" A recent article by Brockel (2006) reviews the many reasons why fair process is not a natural practice. Finally, a superb must read for every manager is the book by Cialdini (2001). The author explores behavioural and emotional aspects of social relationships, such as altruism and reciprocity, which fair process addresses very effectively.