

# Supply Management & Ethical Decision Making: A Behavioral Experiment

KOUFTEROS

Supply managers and executives are under direct pressure to perform. Top management and external constituents expect supply management to reduce spend in order to bolster profitability. Thus, they may institute a compensation structure that motivates supply managers and executives to contain spend. To exacerbate the situation, supply managers and executives may get tempted to stray from ethical behavior due to the large amount of money they handle and due to lucrative but often unethical actions by sales personnel. This research uses a lab experiment approach to examine whether the reward structure (i.e., beneficiary - Mazar et al. 2008; Umphress et al. 2010; Gino et al. 2013, and timing – O’Donoghue & Rabin 2000; Strathman et al., 1994; Loewenstein & Prelec, 1992) and other salient factors (such as context, motivation, and personal characteristics) have an effect on ethical behavior. Specifically, we posit that the beneficiary of a bonus (the individual who undertakes the decision, or the group/organization), the timing (in the near future - next paycheck, or in about a year – at the anniversary of contract), and the safety of the product (low, or high probability of failure that can result in injury or even death) may impact ethical behavior. The participants included 457 subjects that completed the assignment over two different administrations, spread one week apart.

During the first administration, the subjects assumed the role of a Director of Supply Management of a supplier of the automotive industry who issued a *Request for Quotations* (RFQs) to purchase transmission cases. One of the bidding suppliers attempted to gain advantage by soliciting information about the competitor bids from the director. Prior to the presentation of the scenario, the subjects read the ethical standards issued by the *Institute for Supply Management* and were administered a quiz in order to assure that they fully understood that sharing bid information would be an unethical choice. During the second administration, the subjects had to respond to the solicitation; they could simply reply that they cannot share the information, they could share the information and note the lowest bid, or they could relate any reasonable price below the actual lowest bid. Before the subjects considered their choice, they became aware that there is a new reward structure; if a target price per unit was met, cash bonuses would be distributed (to only the director, or to be shared by all organizational members and either on the next pay check, or in a year). Furthermore, the safety of the product was manipulated; the transmission cases offered by the unscrupulous supplier could have the same failure rate as industry standards or double the industry failure rate. The experiment was thus conceived as a 2 X 2 X 2 design resulting in eight blocks, where each subject was assigned only to one block. Furthermore, subjects were asked to report on their motivation (Umphress & Bingham, 2011) for their specific behavioral choice. Subjects received a cash award which was correlated with the price they reported to the supplier (if they acted unethically).

Results suggest that 47% of the subjects acted ethically and did not share the lowest bid information with the supplier. About 19% of the subjects shared the correct lowest bid information while almost 34% of the subjects reported bid information which was below the lowest bid. The proportion of individuals that opted for a “middle of the road” yet unethical

choice (i.e., they correctly reported the lowest bid price) is statistically significant at the 0.0001 level across a variety of environments and demonstrates that some individuals may act unethically but not so much, in order to maintain their self-concept (Mazar et al., 2008). Detailed analyses across three motivational environments suggest main effects as well as two-way and three-way interactions. The findings can potentially help construct compensation structures that motivate employees but curtail unethical behavior.

Our two-stage procedure may hold promise as a way to measure risk preferences for the purpose of setting optimal defaults or giving advice about portfolio allocation.