



ETHICAL BUSINESS LEADERSHIP IN THE GLOBAL ECONOMY

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Toolkit Introduction

Why are business people talking about ethics and what do they mean?

- **Contract ethics – perform what you promised to do – ethical obligations are defined within the four corners of the business agreement**

“My word is my bond”, Shylock

- **Some additional requirement – not mandated by law or contract**

“Obedience to the Unenforceable”, John Moulton



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Why is the second view now prevalent?

- **Business people are now viewed as professionals to be judged by conduct as well as performance**

“A profession has established criteria for admission and legitimate practice”, Abraham Flexner

- **Privatization of norm making – in a growing number of instances governments have shifted significant enforcement burdens to employers (Sexual Harassment, Sentencing Guidelines (2004), FCPA (1977), 1997 OECD Anti-Corruption Convention**



Market Failure and Rights Violations

- An **efficient economy** has: (1) perfect competition; (2) no externalities; (3) no public goods; (4) perfect information. They are self-regulating because no one party can acquire the **power** to infringe upon the **rights** of another
- When **market failures** occur, one party can **violate** another's rights. Further, when markets fail, prices are not set efficiently. The four common market failures interfere with the market efficiency that can maximize the welfare of all participants. In so doing, they can give rise to **rights violations**



The Four Market Failures and their Rights Violations

Market Failures:

- Monopoly/Monopsony
- Externalities
- Public Goods
- Asymmetric Information

Rights Violations:

- Price Gouging
- Pollution
- Free Riding
- Fraudulent Selling



Ethics / Prudence Decision Types

Bad Decision: The decision violates a party's rights (eg fraud) and the firm is found out and punished (eg Prudential Securities \$1.6b settlement). Everyone loses.

Good Ethics is Good Business: Honoring rights serves to maximize shareholder value (eg building reputation and loyalty). Such decisions are also termed "enlightened self-interest."

Exploit Market Values: The decision violates a party's rights, but there is little risk of retaliation (eg aggressing billing hours, churning accounts, covert pollution, or workplace safety), so on a risk-adjusted basis shareholders' interests are served, but at the expense of someone's rights.

Exercise Moral Restraint: The market fails, but instead of exploiting it, which on a risk-adjusted basis would be prudent, the decision respects the rights of affected parties, thereby lowering returns to shareholders (eg scrupulously honest billing, more-than-prudently-mandated worker safety or pollution control.)



Business Prudence and Business Ethics

The **prudent manager** seeks to maximize the long-run risk-adjusted value of the firm. The **ethical manager** avoids violating the rights of other parties in the economy. Any decision will be prudent, ethical, both, or neither, as follows:

Ethical?	Prudent?	
	NO	YES
NO	Bad decision; lose / lose	Exploit market failure
YES	Exercise moral restraint	Good ethics is good business



Norm, Decision & Market Failure

When markets fail, the manager must **decide** either to exploit the market failure or exercise moral restraint. **Neutral Omnipartial Rule Making** (by Ronald M. Green) is *one* proposed method for making this decision. In question form, it can be applied as follows:

Step 1. State conduct (exploit market failure)

Step 2. Ask screener questions:

- a) Are you willing for this conduct to be fully reported and known by everyone?
- b) Are you willing for this conduct to be an option for all others in similar circumstances?
- c) Would a fully informed, objective person (ie an omnipartial judge) also allow this conduct?

Step 3. If the proposed conduct passes all screeners, then do it. If not, don't (ie exercise moral restraint). Or modify it so that it does pass.



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Can we find the ethics space – two views:

- No – business ethics as such does not exist. Prudence – all that is needed is a standard of care or due diligence above and beyond legal and contractual requirements – “Building Fences Around the Law”
- Yes – There are ethical principles for business practice and methods for deriving them
- We will proceed on the second assumption



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If we talk about ethics what do we mean?

- Universal Principles
- “Moral Legislation” arising from individual transactions (Private Ordering)

“The Life of the Law is not Logic it is Experience”, Oliver Wendell Holmes



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How do we derive ethical principles?

- **History – The Usable Past – Both Macro and Micro**
- **Corporate Constitutionalism**
 - “A Constitution is made for people of fundamentally different views”, Oliver Wendell Holmes
- **Ideal Community – Emerging From A “Veil of Ignorance” (John Rawls) What rules would you make?**



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Can ethics be taught?

- **Moral reasoning can be taught. Can we teach the character traits that moral reasoning requires?**
- **To do so requires establishing connections between the empirical – what we see and know from experience and the normative – rules that are derived from analytic methods**

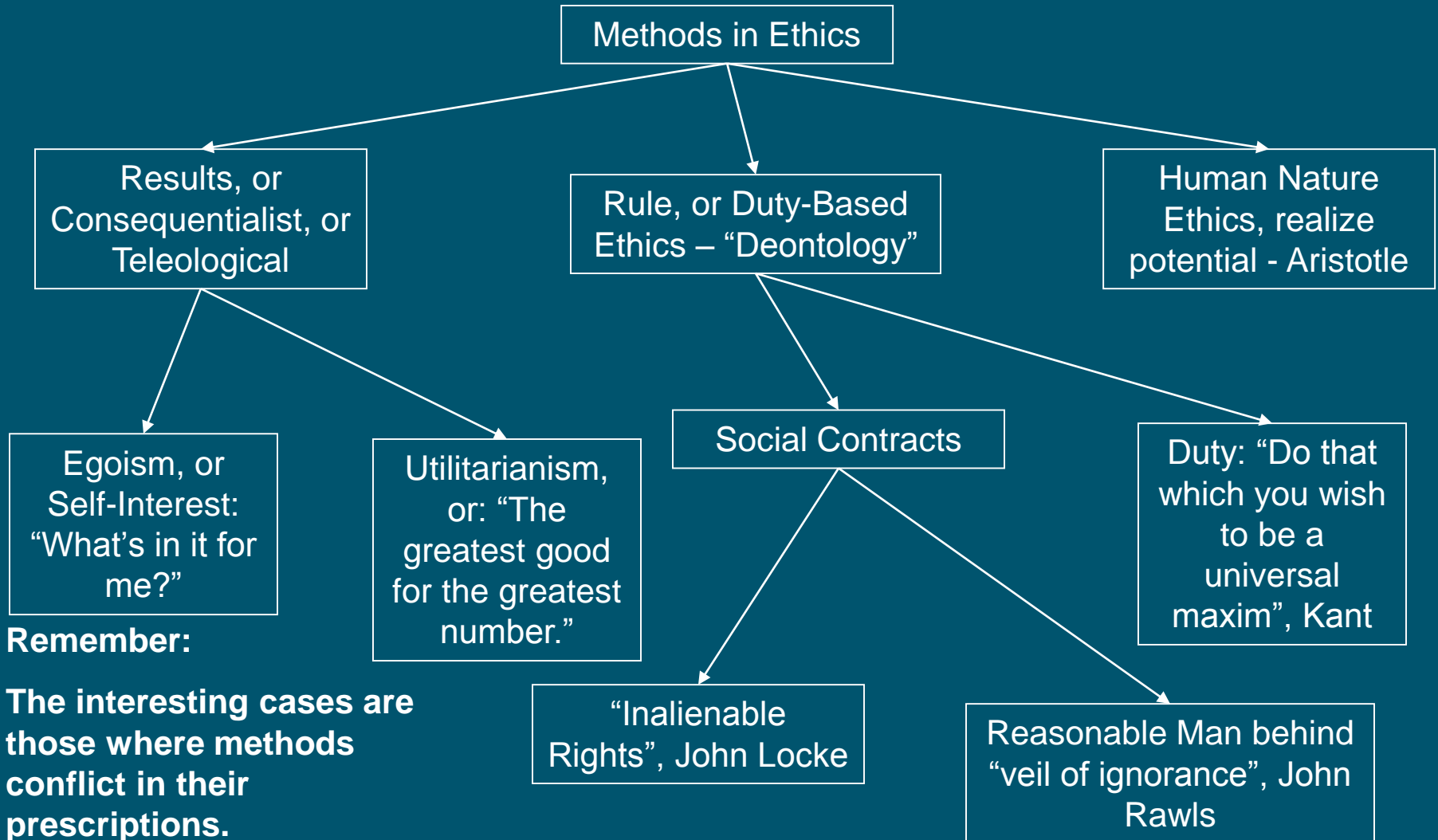


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- Use case method because it teaches people to be “Morally Articulate” (“Think as men of action – act as men of thought”, Pascal) What are the threshold requirements before using analytic methods to decide an individual case?
- Truth – Insistence on truthfulness and accuracy of facts on which decision is based (Facts are invariably incomplete or in dispute)
- Justice (“The tribute that power pays to reason”, Robert Jackson) Is the scope of reason limited by cultural differences (Amartya Sen)? Fairness of decision-making process, good faith, and results that are solicitous of rights and rigorous in their imposition of duties



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IS THE SCOPE OF REASON LIMITED BY CULTURAL DIFFERENCES?

Moral Minimums for Multinationals - Donaldson

Basic Concept: Rights imply Responsibilities or Duties, by Correlation

Three levels of correlative responsibility:

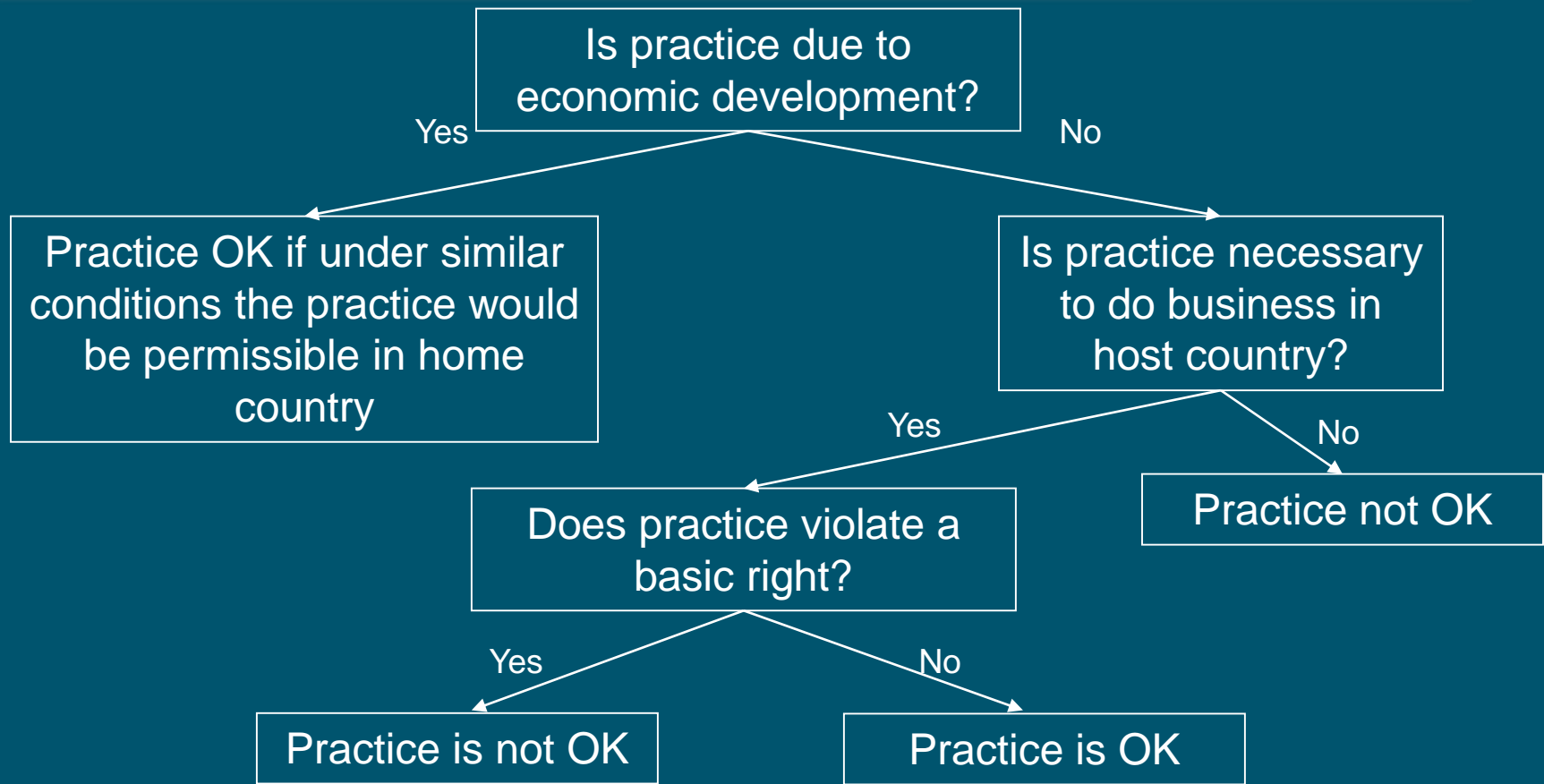
1. To avoid depriving
2. To help protect from deprivation
3. To aid the deprived

Donaldson's List of Rights

1. Freedom of movement
2. Ownership
3. Freedom from torture
4. Fair trial
5. Non-discrimination
6. Physical security
7. Speech and association
8. Minimal education
9. Political participation
10. Subsistence



Donaldson's Algorithm For Resolving Home/Host Country Conflicts



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SUSTAINABILITY

ROOTS IN GAME THEORY ECONOMICS – ENTERPRISES WILL PROSPER MORE IF:

- **THEY DO NOT ABUSE TRUST TO MAKE A KILLING IN INITIAL TRANSACTION**
- **ELECT INSTEAD TO CULTIVATE LONG-TERM RELATIONSHIPS OF TRUST**

“MEETING THE NEEDS OF THE PRESENT WITHOUT COMPROMISING THE ABILITY OF FUTURE GENERATIONS TO MEET THEIR OWN NEEDS”, GRO HARLEM BRUNDTLAND



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EXAMPLES:

- **AESOP – PARABLE OF THE GOOSE THAT LAID THE GOLDEN EGG**
- **MR. FORD, “WHY DO YOU PAY YOUR WORKERS \$5 A DAY?” ANSWER: “SO THAT THEY CAN AFFORD TO BUY MY CARS.”**



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SUSTAINABILITY INDICES



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FTSE4GOOD INDEX CRITERIA FOR INCLUSION:

- ENVIRONMENTAL
- HUMAN RIGHTS
- SUPPLY CHAIN LABOR STANDARDS
- COUNTERING BRIBERY REQUIREMENTS
- CLIMATE CHANGE MITIGATION AND ADAPTATION



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In line with mainstream global responsible investment thinking, a small number of sector exclusions have been applied:

- Tobacco Producers
- Companies manufacturing either whole, strategic parts, or platforms for nuclear weapon systems
- Companies manufacturing whole weapons systems



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TO DATE:

- **OVER 200 COMPANIES HAVE RESPONDED TO MORE STRINGENT ENVIRONMENTAL CRITERIA. 85 HAVE BEEN DELETED FOR NOT DOING ENOUGH TO MEET THE CHALLENGE**
- **58 COMPANIES MEET THE HUMAN RIGHTS CRITERIA, 20 HAVE BEEN DELETED**
- **20 COMPANIES HAVE IMPROVED POLICIES, MANAGEMENT AND REPORTING ON SUPPLY CHAIN LABOR, 8 HAVE BEEN DELETED**
- **ANTI-BRIBERY CRITERIA ARE RECENT AND NO INFORMATION AS YET**



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FTSE4GOOD Performance (Aug '09 – Aug '14)



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DOW JONES SUSTAINABILITY WORLD INDEX (DJSI WORLD)

TOP TEN PERCENT BASED ON LONG-TERM ECONOMIC CRITERIA OUT OF THE BIGGEST 2500 COMPANIES WORLDWIDE (LEADERS IN EACH OF 57 INDUSTRY GROUPS). CRITERIA INCLUDE:

- **CLIMATE CHANGE STRATEGIES**
- **ENERGY CONSUMPTION**
- **HUMAN RESOURCES DEVELOPMENT**
- **KNOWLEDGE MANAGEMENT**
- **STAKEHOLDER RELATIONS**
- **CORPORATE GOVERNANCE**



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DJSI vs MSCI Performance (Oct '99 – Oct '13)



This chart compares the Dow Jones Sustainability World Index, which includes companies who scored in the top 10% for environmental, social and governance (ESG) criteria, to the MSCI World Index, a broad global index that doesn't take into account ESG criteria.* The annualized 10-year return through 09/30/13 of the Dow Jones Sustainability World Index was 7.2%, versus the 7.58% return of the MSCI World Index.



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Four Hypothetical Cases

They have happened, just not to you



Case One

The foreign assignment:

- **Natasha Gopal is the project leader for a mission to Windenao. In Windenao men will not engage in business negotiation with women**
- **The Bank's policy in these situations is to respect local cultures. Under such circumstances, senior women executives are installed in a local hotel and they communicate with male members of the team via cell phone. No decision can be made without their approval and they get full credit for successful project completion. In fact, within the last two years three women have received promotions for work done under identical circumstances.**



Should Natasha Gopal agree to these conditions for the mission?

Should The Bank change its policy?



Case Two

What to do about machine tool theft

- You are the factory manager of ABC Corp's facility in Fredonia – a country that is moving aggressively to interest US, European and Japanese companies in establishing factories in Fredonia.
- ABC is French company with a no-tolerance machine tool theft policy. A sign prominently posted at all factory gates says: “Anyone caught stealing machine tools will be fired immediately. The theft will be reported. ABC will fully cooperate with the authorities in prosecuting the individual to the full extent of the law.”
- A factory worker is caught stealing a machine tool. He is immediately discharged and local law enforcement is notified. He is picked up within an hour and taken to the factory entrance. As people are leaving, the alleged perpetrator is summarily executed.



Should ABC change its machine tool theft policy?

What should it do the next time someone is caught stealing machine tools?



Case Three

Accepting an honorarium

- For the last ten years, Soon Park has been invited to speak at the Galactic Economic Seminar- a meeting of leading business, political, and entertainment personalities that is held annually in the last week of July in St. Paul De Vence. It is pleasant duty and Park also receives a \$20,000 honorarium.
- The meeting is financed entirely by Eugene Warbucks a publicity shy wealthy industrialist who believes that this kind of forum serves an important purpose.
- The SEC has just announced that Warbucks is the target of an insider trading investigation. Other than the announcement, no further information is available. The meeting will be held in two months.



Should Soon Park accept the honorarium?



Case Four

Surfing the web

- Jason Integer is the most promising young economist on your staff. Your organization provides all professional staff members with lap or desk top computers for home business use.
- A routine scan of computer website connections traces repeated pornographic visits to Integer's computer. Such unauthorized usage is grounds for dismissal and three employees have been terminated for that reason within the last two years.
- Integer denies knowledge and says that his two teenage sons (aged 15 and 17) may be the culprits.



What should you do about Integer?

