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What is the role of business ethics in a competitive economy? ❖

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There has recently been a surge of publication on business ethics. This reflects growing academic interest in the subject, spurred on by the development of business ethics teaching in university Business Schools in Britain and North America. Teaching development has occurred at both undergraduate and MBA level, as both an elective and, less frequently, a core subject of the curriculum. This in turn reflects a rising concern for "corporate responsibility" in the boardrooms of major companies, and a growing interest among company management to be seen to be taking ethical concerns seriously. External pressure has been growing on companies in a number of areas through, what might be loosely termed, the "political process". One area is reflected in the burgeoning subject of corporate governance, entailing concerns about the determination of boardroom pay (adverse press coverage of "fat-cat" salaries seemingly unrelated to individual performance), the monitoring of executive directors and mechanisms for ensuring adequate accountability to shareholders. This has provoked over the last decade a number of official or semi-official reports; Cadbury (1992) on financial aspects of corporate board structure and governance, Greenbury (1995) on company directors' remuneration and Hampel (1997) on standards in corporate governance.

A further aspect of this process is reflected in growing consumer and shareholder activism, particularly over the issue of environmental concern. This has obliged many companies to begin to address questions of their responsibility towards the planet and in some cases to provoke embarrassing U-turn's in policy (such as Shell's Brent Spar debacle). A still further aspect of this is the rapid growth of "ethical" investment, albeit from a very low base, over the last 15 years or so in the UK (but longer in the US) (Sparkes 1995). This movement has begun to force companies into an appraisal of the social acceptability of their activities. Almost as a reaction to the "greedy eighties", business ethics[1] has become good business practice in the "caring nineties". It is tempting to conclude that, for the typical large multinational, wearing your business ethics "on your sleeve" is as much about enlightened self-interest as about moral crusade, at least for British public relations. The cynic might even add that the growing plethora of corporate codes of ethics, corporate responsibility reports and environmental audits is really a "smoke and mirrors" act. By this I mean one in which companies think that they ought to be seen to be thinking about their ethics even if in practice they only behave ethically if they can afford to.

Business ethics has rapidly been gaining favour as a subject in Business Schools. In the UK the Institute for Business Ethics recently undertook a survey of 79 of the UK's Business Schools (Cummins 1999) and found that 57 percent of undergraduates and 43 per cent of postgraduates were given some exposure to the subject in their courses. Despite this the subject often has low status and may often be viewed as, at best, tangential to the question of what makes for corporate prosperity and economic growth.

Published academic work on business ethics falls into a number of categories, reflecting the diverse academic and professional backgrounds of its authors. At one extreme business ethics has been seen as an opportunity for applied philosophy, an avenue for diversification for underemployed university philosophy teachers. Unsurprisingly the main thrust of this literature is to illustrate how theories of ethics might provide a basis for prescribing virtuous behaviour in business.[2] In itself this is a worthy exercise; however it makes for glazed eyes among a typical undergraduate audience of economics and business students. At the other extreme, at the risk of unfair caricature, is the "teach yourself business ethics"–type publication aimed at the harried executive or MBA student. Typically this sort of book is highly applied, full of case study material, often inviting useful reader introspection and sometimes geared towards the "code of ethics" or "code of practice" model or corporate integrity.[3] A further, rather smaller category is work in reaction to the business ethics movement, defending an older tradition that morality is for individuals not corporations; corporations exist to make as much profit as possible and any failure to do so is to the detriment of overall social well-being.[4] These authors find much to frustrate them in the allegedly social-liberal agenda of the business ethics movement, and often castigate the perceived certainties of its "moral rearmament in the boardroom" stance. They are critical of a prevailing attitude in society that they feel is about "politicizing" the firm by imposing obligations of corporate responsibility (beyond those to uphold the law and maximize profit). Finally there has also been a growth in edited collections or "readers" aimed at the student, bringing together the ethical teachings of philosophers, religious scripture writers and theologians down the ages, alongside more modern commentary and case study on corporate ethics.[5] These are often very comprehensive, but tend to contain much more than an average undergraduate will get through in a short module or course on the subject.

It is sometimes quite difficult when reading on business ethics to see "where the writer is

[1] Throughout I shall adopt the popular shorthand of using the terms "business ethics" and "ethical behaviour" to mean "good business ethics" and "good ethical behaviour".

[2] Examples include Donaldson (1989) and Jackson (1996).

[3] A highly readable example is Murray (1997).

[4] A recent example here might be Barry (1998). This style of approach harks back to a rather longer established literature, see for example Friedman and Friedman (1962).

[5] Two examples might be Hoffman and Frederick (1995) and Stackhouse *et al*. (1995).

coming from" in terms of their personal understanding of moral imperatives. This is a challenging problem in the "post-modern" world in which we are continually being told we inhabit. The line goes that my "meta-narrative" is as equally valid or invalid as anyone else's, and so where I get my business ethics from is as valid or as invalid as where you get yours from. In fact for many writers on business ethics, the source of those ethics is likely to be highly self-referential. The modern corporation responds to the contemporary (and therefore continually changing) preferences of the society in which it does business, but in turn it shapes those preferences and attitudes through the marketing and public relations process.

The task for those interested in the role of business ethics in the economy may therefore be translated into one of highlighting the importance for the business executive (or social science student aspiring to become a business executive) in sorting out where he or she stands on important ethical issues. In other words the important message is that there can be no such thing as an economic agent with no business ethics, or perhaps more accurately that no business executive operates in a moral vacuum. This task was revealed to me rather starkly after delivering the first lecture on business ethics on a new undergraduate course on corporate governance and business ethics in 1997. It became glaringly apparent over the space of 50 minutes that, for the 60 final year undergraduates present, it had never crossed their minds that they would face ethical dilemmas in a career in business. I think they had signed up expecting to be told what was right and wrong, not to be given a long list of questions to go away and think about. Their confusion about the nature of the subject was further reinforced when in the second lecture I abandoned my prepared notes and had them complete a questionnaire designed to reveal their attitudes to such issues as office pilfering, petty insurance fraud, corporate whistle-blowing, and insider-trading. The results were surprising. For example, very few even knew that if one was a company director and knew that a take-over announcement was imminent, then it would be illegal to tip off one's husband or wife to buy some shares in advance. Interestingly, and with offers of explanation invited, the ethical confusion was significantly greater (in a statistical sense) amongst men than women and amongst economists than other business students. Added to this confusion was the impression that business ethics had really little or nothing to do with corporate performance and economic prosperity. It was more in line with the school Friday afternoon "personal and moral development" class – a bit of light relief from the rigours of neoclassical analysis of rational economic behaviour.

The proposition that business ethics and economic performance go hand in hand is an important one – it strikes a chord at the heart of many of the world's belief systems that ethical economic behaviour leads to prosperity at the personal and societal level. This aside, from where does the modern secular "demand" for business ethics come? Most authors see it as arising through the mechanism of consumer activism, particularly in the areas of environmentalism and "ethical" investment. So, is the growing influence of ethical concerns on decisions about production technology and investment activity simply an economically rational self-interested response to a change in consumer tastes? The answer to this question is very probably yes, but not exclusively so. We cannot rule out the existence of genuinely altruistic motives on the part of businessmen, no least because the last two hundred years of economic and business history is littered with examples of companies run along "socially responsible" lines. Many of these companies established themselves as household brand names – Lever Brothers, Rowntree's and Cadbury's, for example – although ownership is generally in very different hands nowadays compared to the Victorian philanthropic families of the late nineteenth.

So, will the economy be more competitive if businesses behave ethically? One type of answer to this question starts from the premise that "ethics" impose a fixed cost of production, which a non-ethical firm will not incur. Consequently any firm which voluntarily burdens itself with this cost will, in the long run, become un-competitive and therefore either close down or be taken over by other investors who do not wish to incur the costs of behaving ethically. This is the line often taken by critics of the business ethics movement. The problem with this response is that it seems to brush aside the question of where the demand for ethical behaviour is coming from. If consumer tastes are shifting towards a consideration of ethical questions then careful market positioning of a company's brand image in the same direction can have a bigger effect on marginal revenue than it has on marginal cost. Consequently it is just as likely that ethical producers will drive unethical ones out of the market. In the UK we have recently seen much the same processes in operation in the switch towards organic production in agriculture.

An alternative approach is to argue that the motivation to avoid anti-competitive behaviour, for those who run companies, has at its roots an ethical stance. For someone such as myself, who was schooled as a student into the opinion that market imperfection and abuse of market power is the principle failing of market economies, this is an important motivation. Firms and those who run them should seek to avoid exploiting monopolistic power, not just because of the threat of legal sanction, but as a point of ethical principle. So, for example, in the field of advertising, claims that are truthful are more likely to be informative and improve rather than undermine freedom of entry and exit into markets. In the field of pricing strategy ethical firms ought to be concerned that they avoid any form of restrictive practice or predatory behaviour. Predation is undesirable in terms of economic outcomes, as well as being inherently unethical. The problem is that economists have found it extremely difficult to establish a workable, policy-implementable definition of predation. The problems that the British Office of Fair Trading encountered with the famous Times Newspaper price cut of 1993-94 illustrates this well, and accords with academic economic research on the subject.

In the field of economics and ethics reputational effects are very important. Trust appears to be very important in the real world of business, where agents value the stability of long-term networking arrangements. Trust allows the establishment and repetition of co-operative outcomes, and allows one agent to rule out the possibility that another will act against their mutual best interest. Ethical lapses can have very adverse and long-lasting consequences for a company – the impact of the Exxon Valdez disaster on the reputation of the Exxon Company is one example. A reputation for (say) environmental responsibility may take many years to establish but can be destroyed very quickly. But economists (particularly English-speaking ones) are instinctively wary of anything which smacks of collusion – are words like "trust" and "networking" just a polite description of the institutions of collusion? There is a challenge here for economists to unravel – can trusting economic relationships be compatible with competitiveness? Is there a synergy or a trade-off between the two?

So, will good corporate ethics compromise (short-run) corporate profitability? For the economist there ought to be no compromise – business must be ethical, competitive and profitable. As we have discussed failure to be profitable, or to sacrifice profitability to pursue other objectives, will, assuming a competitive market structure, result in long-run exit. The key question that arises is what happens if some companies in a competitive industry are engaged in "ethical dumping", in the sense that unethical behaviour allows them to enjoy lower costs of production than ethical firms. Economic theory would tell us that a Gresham's Law or adverse selection effect might be at work, to the detriment of ethical standards in business. But casual empiricism would suggest that in practice ethical firms survive because consumers, suppliers and investors prefer to do business with them (trust relationships again), so in economic terms they perhaps benefit from stronger demand and lower factor prices. You could conclude from this that ethical firms are well-managed ones, and well-managed ones are more successful.

Ethical concerns are often complex and rarely straightforward – they often leave firms with difficult dilemmas to resolve. The key questions for economists who place importance on ethical concerns are to do with the transmission mechanisms from business ethics to corporate and economic performance (see Jones and Pollitt 1998). Critics of the business ethics approach, such as Brittan (1998), see a grand conspiracy at work, one which aims to overturn the Anglo-American model of capitalism with a continental European social market economy overburdened with regulation. But such writers seem unwilling or unable to distinguish between a process that encourages the voluntary adoption of high ethical standards, and the compulsory imposition of regulation. It is a mystery why the former must inevitably lead to the latter.
In reality there are likely to be a number of mutually inclusive routes through which ethical companies and ethical managers perform better than others. It may well be that, put simply, people are better motivated and more productive in such organisations. This is a line of reasoning akin to the "efficiency wage" hypothesis in labour economics, that the costs of being "ethical" are outweighed by productivity improvements. It might also be the case that for many companies a move towards a more "ethical" product orientation has allowed the exploitation of a first mover advantage – the taking advantage of a previously unoccupied area of product characteristic space. A similar argument might apply to ethical investment funds. These sorts of arguments all point in favour of the enlightened self-interest explanation – good business ethics is good for business. This is of some reassurance but is at the same time disquieting in that it points heavily towards the relativist view that firms behave in a way that reflects what is expected of them by society. Introduce market power and an element of persuasive advertising and the whole process becomes an endogenous one in which firms behave ethically because consumers and investors demand it. Firms in turn manipulate that demand through their marketing and public relations strategies. It would be more reassuring if we were certain that business is interested in business ethics for its own sake – a deontogical explanation in which ethical business is promoted and developed by strictly exogenous moral imperatives.

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BOOK REVIEW:

Ishikawa, Kaoru. Nation Building and Development Assistance in Africa: Different but Equal. Published by St. Martin's Press, 1999. PP xiv+167. ISBN 0 312 21667 X.

This monograph by a senior Japanese diplomat draws attention to the plight of the African (especially sub-Saharan) nations in the post Cold War era. With the demise of the Cold War, the foreign aid regime that accompanied it disappeared as well. Prior to 1990 many Western donors, especially the United States, used foreign aid to secure the loyalty of a "client" against the Soviet Union. How effectively aid funds were used for development purposes seemed a lesser concern. Since then, poorer countries have had to meet various criteria to be eligible for aid. They must present themselves as market reformers, advocating liberalization and stabilization policies. In short, poorer countries qualify for aid not just on the basis of poverty, but also degree of democracy and respect for human rights, as well as sound economic management.

The monograph opens by providing background to national economies in sub-Saharan Africa. It discusses the countries' products and industries, and how fundamental commodity agreements (for example, the International Coffee Agreement) are for the people of Africa. Chapter 2 deals with general aspects of development assistance and with "aid fatigue" which has had an impact on the level of aid donors supply African nations. It is also well-known that re-channeling of aid by Western donors to the countries of East Europe and the Newly Independent States of the former Soviet Union has had a deleterious impact on aid to African countries. This is followed in Chapter 3 by identification of education, health, and women as three key sectors needing support if the people of sub-Saharan Africa are to achieve a better life. (Japan's recent focus on women in development can perhaps be explained as an attempt to deflect criticism on its poor international reputation in this area). This chapter also reviews the challenges these sectors face and how aid may be used more effectively to meet them.

The ending of apartheid in and joining of South Africa as a member of the African community has raised the potential for it to act as a locomotive to pull other nations in this region out of poverty and repression. This possibility is taken up in chapter 4 with a special focus on Japanese aid to South Africa. (Japan had no diplomatic relations with South Africa until January 1992). The Japanese (general) approach to aid to help African development in the twenty-first century also receives attention in this part of the book.

Three appendices, one summarizing the Tokyo Declaration on African Development, one presenting abstracts from summit meetings in Halifax, Lyon and Denver, and one outlining decisions made at relevant Organization of African Unity meetings complete the monograph.

This is a valuable book on the record of aid to Africa. Assistance has become so important in Africa that it doubtless has a profound impact not only on the lives of the citizens of this region, but also on the style of their governments. However, there are limitations to the analysis of this monograph. First, the author does not tackle the issue of conditionality of aid (linking the availability of aid to policy reforms in recipient countries) and whether conditionality has been successful. Another drawback is that non-governmental flows of aid to this region do not receive the attention they deserve. These flows are significant and affect the well-being of many Africans. In addition, the human impact on debt in Africa and initiatives to co-ordinate aid with debt relief ought to have been discussed. Finally, since the focus of much of this book is on Japanese aid to Africa, I would have preferred more information on the details of such aid (for example, longer description of some of the projects mentioned and more systematic information on allocation). Nonetheless, this book is a useful addition to the growing literature on aid to Africa.

Mak Arvin

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June 28-July 1, 2000: 8th annual conference of the International Joseph A Schumpeter Society. Theme: innovation within the context of economic and social dynamics. Contact: Sharon Hammond at the University of Manchester in the UK. e-mail: sharon.hammond@man.ac.uk

July 10-13, 2000: Annual conference of the *Royal Economic Society*. All areas of economics covered. Further information from Manfredi La Manna, Department of Economics, University of St. Andrews. e-mail: mlm@st-and.ac.uk

August 21-25, 2000: 13th annual conference on Input-Output Techniques. Theme: recent developments in the area of input-output analysis. Contact: Michael L. Lahr, Centre for Urban Policy Research, Rutgers University, 33 Livingston Avenue, Suite 400, New Brunswick, NJ 08901-1982, USA. Internet details on http://www.unimc.it/ioconf/

USEFUL WEB-SITES:

International Atlantic Economic Society may be accessed via: http://www.iaes.org Eldis (Electronic Development and Environmental Information System) is available at: http://www.ids.ac.uk/eldis The *British Treasury's* home-page is located at: http://hm-treasury.gov.uk

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