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# **<sup>1</sup>Business Ethics and Corporate Governance**

## **Task 1: Ethics Theory and Business Ethics**

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## 1.0 Introduction

This report discusses the corporate application of theories of ethics through the real-world instance of the Volkswagen emissions scandal. The first section presents an overview of the theories of ethics concerning this report's scope and application i.e. utilitarianism and the categorical imperative. Having expanded on these theories, a distinction is summarily drawn between both theoretical approaches. This leads the report to present a real-life instance of the Volkswagen emissions scandal, where the relevance of the theory of ethics is determined in guiding the actions of the company. The report will also consider hypothetical approaches to addressing the ethical dilemma by the implementation of other ethical theories as applied to the scenario.

## 2.0 Overview of Theories of Ethics

### 2.1 Utilitarianism

Utilitarianism is an ethical theory that posits to address the practical question of how a person should conduct themselves in different situations (Harsanyi, 1980). The basic principle of utilitarianism is therefore grounded in focusing on the effects of actions and their outcome in different situations (Harsanyi, 1980). The morally correct approach in utilitarianism is therefore to minimise pain and maximise pleasure; pain in this case may consider the impact of actions on the well-being of an individual, as well as on society as a whole. Therefore, this practice of ethics applies to individuals, organisations and governments, as the cascading effect of decision-making at a progressively macro-scale will affect the well-being of various people across society (Harsanyi, 1980).

Utilitarianism overlaps with the ethical concept of the Golden Rule, which essentially requires an individual to "treat others as you would like to be treated". The principles of utilitarianism such as "greatest happiness for the greatest number" align with this view, and therefore both approaches seek to generalise the decision-makers concern across the interests of others who will be affected by their actions (Fiala, 2009). Another key characteristic of utilitarianism is that it promotes impartiality when considering the idea of the well-being of other people or groups affected by the decision-making. The value of happiness among others is considered the same, and there is no favouritism or partiality considered in determining the importance of one individual's happiness above another's. Similarly, it seeks to maximise the good outcomes of

well-being without prioritising the happiness of any particular individual, ensuring that the net outcomes are generalised across all those who are involved and affected.

The earliest studies into utilitarianism were derived from the theological position of founding thinkers such as Richard Cumberland and John Gay, whose utilitarian philosophy was a consequential derivative of their theological observance of natural consequences and ideals reflective of The Golden Rule (DeTienne et al., 2019). Later contributions to this theoretical field of ethics included the works of prominent personalities like David Hume, whose case for artificial virtues was inspired by the overall quality of virtue found within the study of utilitarianism. Other prominent contributions were done by authors such as <sup>6</sup>Jeremy Bentham and John Stuart Mill, where the practice of utilitarian ethics was able to express itself across macro-environmental concerns such as economy, political and social policy-making.

Utilitarianism presents challenges that result from the perspective of collective well-being taken in the approach of utilitarian ethics (DeTienne et al., 2019). It presents a challenge in considering the values, benefits and costs across different contexts. For instance, by presenting an equal acceptance of value for all forms of art, utilitarianism will disregard the historical works of masters such as Botticelli as having more objective and subjective value than that of a contemporary hobbyist. When considered across the area of corporate governance and behaviour, utilitarianism applied strictly will therefore be ineffective in making calculated decisions of business strategy (DeTienne et al., 2019). Therefore it is best served as a guiding principle in making decisions that are ultimately for the well-being of the company and its stakeholders, such as shareholders, employees and customers.

## **2.2 Categorical Imperative**

The categorical imperative is a study of ethics founded on the works of Emmanuel Kant, who distilled the approach to making moral judgments and evaluating the consequences of actions through his stated approach. Kant held that moral law is universally present in an impartial capacity, while also being rational. The categorical imperative for making ethical decisions must therefore respect the criteria present across universality, impartiality and rationality. From this, it is derived that the categorical imperative assumes universality across people, as they will behave in the same manner through the virtue of rationality (Finlayson, 1998). The quality of impartial behaviour considers that the autonomy and dignity of individuals are respected while making such decisions that can affect their well-being. Consequently, practising the categorical imperative must require respecting the well-being of others without placing personal ambitions on a pedestal that guides the decision-making outcomes (Finlayson, 1998).

While the Kantian observation of the categorical imperative saw the founding of this approach to ethics, it was also developed further through contributions from other authors. The endorsement of Kantian ethics through the categorical imperative's standards of rationality is upheld by the ethical beliefs of authors such as Thomas Aquinas and John Locke (Hancey, 1976). Aquinas and Locke consider the principles of rationality here in an extended scope where external rational principles are considered identifiable through reasoning. Therefore, a decision-making agent can reason those requirements for rationality are identified through observation of instrumentality present across the decision-making subject. The guiding principle of the categorical imperative, therefore, is found in Kant's requirement that actions and outcomes must treat "humanity, whether in your own person or another, always as an end and never as only a means" (Kant, 1993, pp.1–92).

### **2.3 Distinction between Utilitarianism and Categorical Imperative**

It is essential to distinguish between utilitarianism and the categorical imperative in this report, before an analysis of the real-life instance of the Volkswagen emissions scandal. By determining the ethical positions of convergence and divergence in views, the application of theories of ethics will be more subjective and grounded in practical approaches towards addressing real-life instances.

Firstly, utilitarianism requires that actions must be taken to ensure the net well-being of everyone as it promotes maximising happiness while minimising pain (Brink, 1986). Therefore, utilitarianism does not consider the action itself by which such an outcome is to be achieved. In contrast, the categorical imperative requires adherence to the formulations of universality, impartiality and rationality. An action cannot be made in alignment with Kantian ethics if it does not satisfy this central tenet of the ethical philosophy, and therefore the outcome is not considered a priority, regardless of its positive effect on the well-being of others.

Secondly, Kantian perspectives on the consequences of actions require that actions must be undertaken that are following the maxim of universal law (Misselbrook, 2013). In this context, it requires that an individual can undertake an action if they consider it universally correct, whereas others can also take a similar approach in different contexts. This seeks to determine morality through the action itself and does not regard the consequences of the same. Utilitarianism, by contrast, prioritises the consequences of the actions as it seeks to ensure the outcome of pleasure maximisation, and the action itself is not scrutinised to a similarly ethical extent.

In summary, Kantian ethics or the categorical imperative focuses on the action whereas utilitarianism focuses on its consequences. This points to another ethical dilemma which contests whether the ends or consequences justify the means or the actions undertaken to reach such ends (Finlayson, 1998). This position between consequentialism and deontology will be considered in the analysis of the Volkswagen emissions scandal, where the categorical imperative and utilitarianism can now be applied through this understanding of ethics and how they have their limitations in providing a flawless approach to ethical decision-making.

### **3.0 Overview of real-life instances of Ethical dilemma in professional practice**

#### **3.1 Background to the ethical dilemma**

The report considers it necessary to present a thorough background to the ethical dilemma, as it will provide different areas of consideration that must be evaluated in making ethical decisions. Decision-making as a whole becomes more objective through the analysis of data and awareness of factual information, and applying theories of ethics to the Volkswagen emissions scandal will be inefficient if such details are not provided to their relevant extent. The Volkswagen scandal was identified in 2014 by the independent analysis of Volkswagen's emissions reports <sup>5</sup> by the West Virginia University's Center for Alternative Fuels, Engines, and Emission (Topham et al., 2015). The Center was enlisted for this purpose by the NGO outfit International Council on Clean Transportation (Topham et al., 2015). These researchers were able to alert the Environmental Protection Agency, which conclusively discovered unethical practices at Volkswagen regarding their business practices (Topham et al., 2015).

Volkswagen cars that were sold in the American market were equipped with software in the diesel engines that were able to manipulate the vehicle's emissions performance to abide by testing criteria in the US. This software was installed in over 482,000 cars that were sold by Volkswagen in the US alone, and subsequent revelations by Volkswagen revealed that over 11 million cars were affected by this malpractice on their part (Wendler, 2015). The impact of this unethical practice also affected other automotive industry companies who outsourced engine procurement to Volkswagen, as companies like Audi use diesel engines designed by Volkswagen. These were also affected by the ethical scandal of bypassing emission norms, thereby implicating other stakeholders in the industry through the sole responsibility of Volkswagen.



The scope of the ethical breach, in this case, can be further explored by determining how the software bypassed the emissions criteria during test mode (Topham et al., 2015). As a multinational automotive manufacturer, Volkswagen is required to adhere to emissions laws and other legal compliances present across diverse global markets. Instead of developing its diesel engines to meet such specifications, Volkswagen opted to use software to present the appearance of compliance with emissions laws without making actual changes that were required in the diesel engine (Topham et al., 2015). Therefore, test mode inputs were analysed and determined by Volkswagen, and the software was made capable of bypassing such criteria to present an appearance of total compliance with emissions standards. This ultimately saw cars being capable of emitting over 40 times the federal limit of nitrogen-oxide emissions, as the cars would be operating in a polluting capacity outside of test mode (Atiyeh, 2019).

This real-world instance is a unique case for analysing through the theory of ethics, as the above facts show that it was neither a state issue in the US nor a safety issue inherent to the cars themselves. The ethical breach of Volkswagen is found in the violation of federal emissions laws, and it resulted in Volkswagen and other manufacturers being prohibited from selling new diesel model cars, which also covers the prohibition of resale of used or pre-owned types of diesel (Atiyeh, 2019).

Volkswagen responded to the findings by being upfront about its unethical practices, which was stated by the then President of the Volkswagen Group of America as breaking the "trust of our customers and the public" (Hotten, 2015). Volkswagen also launched an internal inquiry into the matter which ultimately resulted in car recalls from global markets including 8.5 million recalls in European markets and over 500,000 recalls in the US market (Hotten, 2015). Before the report analyses the instance through theories of ethics, it must be noted that Volkswagen was made aware of this issue before the scandal. Regulators in the US raised the issue of emissions levels in 2014, which were summarily dismissed by Volkswagen as "technical issues" that are created by unexpected real-world conditions which differ from test mode scenarios (Hotten, 2015). Therefore, there is a case of wilful misleading of the stakeholders and the public Volkswagen, which deepens the case of ethical violation.

### **3.2 Relevance of the theory of ethics in guiding the company in the situation**

#### **Utilitarianism**

Utilitarianism is presented as a consequentialist theory, as determined in the report. Therefore the moral consequences of the actions are considered in this approach towards determining the ethical value of a decision. Volkswagen engineers deliberately participated in the corporate



decision-making that saw software being installed in Volkswagen diesel engines, where tests could be bypassed while allowing forty times the legal emissions to be released during standard operations. This presents a breach of utilitarianism ethics, as this theory of ethics considers the well-being of all those involved, associated with and influenced by the outcomes. For this case in particular, the scope of negative impact on well-being is expansive, as higher emissions contribute to environmental pollution. This in turn affects the health and well-being of different stakeholders at once, such as managers, employees, customers and society itself.

As an ethical dilemma, the Volkswagen scandal is more closely associated with determining a right or wrong choice as opposed to a moral temptation which would require more than one solution. In this case, the right choice would have been to maintain compliance with global emissions standards such as in the US and to design new diesel engines that offer the required level of low emissions performance. This was disregarded in favour of the personal benefits of the organisation, as Volkswagen favoured the prospects of short-term profits and higher stock prices from sales over the moral considerations involved. Falsifying the test-mode results ultimately created a detrimental relationship between the firm with its stakeholders. Apart from the environmental pollution affecting the different stakeholders in unison, stakeholders were also affected individually in the Volkswagen scandal (Jacobs and Singhal, 2020). From the position of utilitarian ethics, this can be elaborated through a brief classification of the firm's stakeholders who were negatively affected by the outcome of this ethics issue. This will be shown through Freeman's Stakeholder Theory which classifies stakeholders as primary or secondary to the organisation (Freeman, Harrison and Zyglidopoulos, 2018). In this instance, the internal stakeholders comprise the employees, customers, shareholders and suppliers of Volkswagen. The external stakeholders are found in the US government officials and regulators as well as NGOs.

Employees were affected by this ethics breach directly as Volkswagen was forced to lay off over 30,000 employees after the scandal occurred (NBC News, 2016). A settlement on the case saw Volkswagen being required to pay \$15 billion to US authorities and the owners of Volkswagen diesel cars (NBC News, 2016). Therefore, this large and sudden cost needed to be accommodated through cost-cutting measures, the biggest of which was this layoff decision. The layoffs would save the company \$4 billion over time on an annual basis commencing from 2020 (NBC News, 2016), and Volkswagen thereby violated the well-being of its employees by protecting its interests through the layoff measure affecting its employees. Customers of Volkswagen were also affected by the product recalls, as their ownership of the car was rescinded even as they were compensated for their suffering during this period (Schwartz,

2018). Volkswagen's shares declined by over 37% per cent within a month of the scandal due to such unethical business practices (Snyder and Jones, 2015). A lawsuit was undertaken against Volkswagen for its failure to notify shareholders of such practices, as the financial impact of the scandal was a moral responsibility Volkswagen owed to its shareholders (Schwartz, 2018). Losses on their shares could have been avoided through prior admission of their behaviour, and suppliers were also affected as car orders declined after the scandal occurred (Schwartz, 2018). The aforementioned \$15 billion settlement saw Volkswagen become penalised by the US government and authorities associated with the scandal such as regulators. Therefore, this summary shows that utilitarianism was entirely violated by Volkswagen's decision-making as it affected all the major stakeholders of the company in ways detrimental to their well-being.

### **Categorical Imperative**

By choosing to overlook this in favour of the manipulation of real-time tests, Volkswagen presents a case where business decision-making stands separated from the field of morality and ethics. Business practices are often amoral in such a way, as a cost-benefit analysis ultimately determines the extent to which right or wrong decisions are made when profits are involved (Audi, 2005). The chances of the emissions manipulation being wrongful were therefore weighed against the benefits in the short-term such as higher profits through increased sales, and rising stock prices. A further understanding of the scope of Kantian ethical relevance here can be by briefly assessing corporate decision-making through the criteria of James Rest's four-component model (Rest, 1984). Making moral decisions requires an understanding of moral awareness, judgement, motivation and courage. As Kantian ethics is concerned with the means rather than the end, an intersectional ethics analysis through Rest's model is chosen as being contextually relevant in this case (Rest, 1984). It can be concluded that the moral awareness of Volkswagen engineers enlisted for developing this software were informed of the immoral application of it bypassing real-world emissions standards. Therefore, moral awareness was present in making this decision and any subsequent moral judgments were disregarded in favour of the cost-benefit analysis indicated above. Morality was further constricted due to the company culture at Volkswagen during the time of this scandal, and therefore the scope for dissent or internal whistleblowing was constricted by the corporate structure.

Therefore, Kantian ethics are more contextually appropriate in determining the semblance of ethical behaviour that was followed in this instance. While the decision-makers were morally aware of their decisions being immoral, their motivation was driven by the cost-benefit analysis that assumed this emissions scandal would not occur in the first place (Audi, 2005). This shows

that theories of ethics are not always capable of addressing the scope and context of ethical violations in the business environment, as a different moral consciousness is followed in corporations where short-term growth and profits are prioritised to maintain competitive performance in today's interconnected and globalised world. However, from a strictly theoretical position, the decision-making also violates Kantian ethics of the categorical imperative as Volkswagen violated the Kantian principle of impartial behaviour by infringing on the autonomy and dignity of stakeholders who were affected by the scandal.

### **3.3 Hypothetical approach to the ethical dilemma using other ethics theories**

#### **Virtue Ethics**

A hypothetical approach to the aforementioned issue can be considered through Aristotle's virtue ethics, which considers ethics through agents and not means or their ends. This takes a preventive approach to mitigating unethical outcomes by requiring decision-making agents to have virtuous characteristics, such as justice and empathy (Papouli, 2018). This would see the decision-making at Volkswagen separate from its ethical concerns, as the corporate leadership and engineers would develop new engines that would meet the emissions laws in the US. Ethical challenges are therefore addressed by having virtuous people make the decisions in such matters. However, in real-world circumstances, virtue ethics is not a common observation across corporate leadership. In real-world firms, the leadership role of a CEO is driven by individuals with decidedly unethical values that correspond with Machiavellianism, narcissism and psychopathy (Palmer, Holmes and Perrewé, 2020). A 15-year study determined conclusively that individuals with such Dark Triad characteristics "tended towards higher hierarchical and financial attainment" (Wille, De Fruyt and De Clercq, 2012). Another study links the particular traits of narcissism and Machiavellianism with a higher salary and leadership levels respectively (Spurk, Keller and Hirschi, 2015). Therefore, virtue ethics is not a practical consideration when assessing ethical breaches of decision-making in such multinational firms.

### **4.0 Conclusion**

The report has discussed the theories of ethics through the case of Volkswagen's emissions scandal. The discussion considered the different ways in which consequentialism through utilitarian ethics can be applied, as well as deontological perspectives through Kantian ethics presented in the categorical imperative. The discussion ultimately showed the discrepancy between ethics and moral practices in the business environment, where firms need to consider

the cost-benefit analysis outcomes against any moral judgments. This ultimately presents ethics as something that must be implemented through corporate governance bodies, where independent appointees can hold decision-makers to account for their ethical practices. As corporate governance continues to evolve across organisations, such ethical issues will be mitigated in future cases across different firms.

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