MBA 207 – Ethics and Responsible Business Leadership

Instructor: Guo Xu (he/him)

Session 1

Beyond yourself?
Principles of moral architecture

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There's no escaping ethical problems…

Why we are here

- Many business decisions require leaders (you!) to
    1. Identify moral risk
    2. Develop positions on difficult problems

- Ability to make good <u>ethical</u> arguments is a key feature of a competent business leader
    - What is legal can often change dramatically
    - Need decision rules to assess right vs. wrong independently of legal or social norms
    - This course gives you **tools** to develop robust ethical arguments

Expectations

- **<u>Promise of this course:</u>** to give you decision tools to analyze *ethical problems*
  - Apply different ethical rules as "algorithms" to assess options
  - Study archetypes to **abstract** essence, and develop **pattern recognition**

- **Business ethics is hard by design** – often there won't be a single answer
  - Offer structured approach in tackling these hard questions from different perspectives

- Unique venue to discuss critical business-related ethical problems
  - **Inclusive environment:** want all voices and experiences heard
    - <u>Bring your unique experience to the table!</u>
    - <u>4 C's: Curiosity, Candor, Courtesy, Courage</u>

Plan for this session

1. Logistics
   - GSI –Sebastián Arechaga – office hours Thursdays, 4.10-5.10pm F689
   - Lunch **April 10**, **April 17**

2. Some warm-up exercises on optimization
   - Can you optimize?

3. Case discussion
   - Theranos

- <u>Session promise</u>: identify structural and behavioral factors behind unethical behavior – inform moral architecture

Exercise: Economic Agents

- Objective: to earn *points*

- Roles and setting:
  - Two firms in semiconductor industry, must identify and recruit talent
  - **ChipIn**
  - **ConDuct**

Scouts and Poachers

ConDuct's Strategies

	A: Scout	B: Poach
ChipIn's strategies A: Scout	70 \ 70	10 \ 60
B: Poach	60 \ 10	0 \ 0

• Game is symmetric, so you are free to choose whether to look at it as if you are ChipIn, or ConDuct

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Self-interest as a socially constructive force
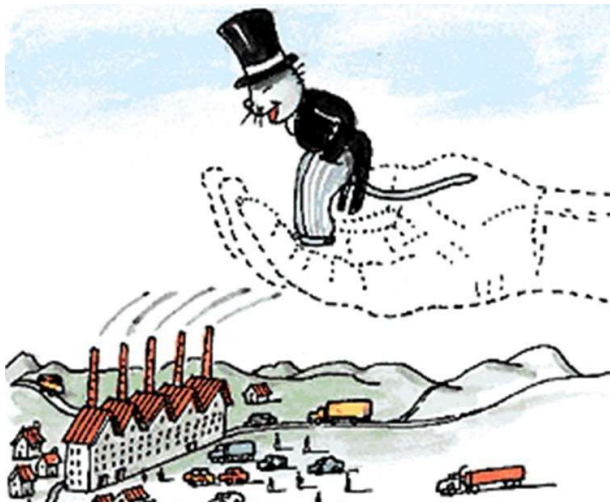
"Every individual necessarily labours to render the annual revenue of the society as great as he can. He generally neither intends to promote the public interest, nor knows how much he is promoting it... He intends only his own gain, and he is in this, as in many other cases, led by an **invisible hand** to promote an end which was no part of his intention."

- Adam Smith

Another go, amass points!

ConDuct's Strategies

		A: Scout	B: Poach
ChipIn's strategies	**A: Scout**	70 \ 70	10 \ 60
	B: Poach	60 \ 10	0 \ 0

• Game is symmetric, so you are free to choose whether to look at it as if you are ChipIn, or ConDuct

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Industry boom: throwing money at the game

Old game

	Scout	Poach
Scout	70 \ 70	10 \ 60
Poach	60 \ 10	0 \ 0

New game

	Scout	Poach
Scout	80 \ 80	20 \ 100
Poach	100 \ 20	40 \ 40

Playing smart: Scout or Poach?

		A: Scout	B: Poach
ChipIn's strategies	**A: Scout**	80 \ 80	20 \ 100
	B: Poach	100 \ 20	40 \ 40

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Found the smart strategy? 2nd chance

ConDuct's Strategies

		A: Scout	B: Poach
ChipIn's strategies	**A: Scout**	80 \ 80	20 \ 100
	B: Poach	100 \ 20	40 \ 40

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3rd chance to hit the smart move

		A: Scout	B: Poach
ChipIn's strategies	**A: Scout**	80 \ 80	20 \ 100
	B: Poach	100 \ 20	40 \ 40

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Debrief

- There are limits to the **invisible hand**

- The new game was *cursed*
  - Some games create a direct tension between <u>individual and collective rationality</u>
    - When each tries to do well, the group does badly
  - Not every Nash equilibrium works to society's advantage

- Old game: the Harmony Game

- New game?
  - Prisoner's Dilemma

The notion of Nash Equilibrium

Harmony game

	Scout	Poach
Scout	70 \ 70	10 \ 60
Poach	60 \ 10	0 \ 0

Nash Eq. is socially optimal

Prisoner's Dilemma

	Scout	Poach
Scout	80 \ 80	20 \ 100
Poach	100 \ 20	40 \ 40

Nash Eq. is socially suboptimal

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Patterns – two friends and drinks

- Two drinks: Champagne (C), Prosecco (P)

- Pleasure points in $: C 180, P 100

- Price: C 140, P 20

- They order separately, but are to *split the bill*

- What would you order?

	P	C
P	**80** \ 80	**20** \ 100
C	**100** \ 20	**40** \ 40

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Patterns – two citizens and a tax

- Each citizen has endowment M=$60
- Can contribute c_i=M or 0 to government
- Public good technology: 1.5 x (c_1+c_2)/2 to each citizen
- Each citizen *i* gets M-c_i+0.75.(c_i+c_j)
- Contribute or Evade?

	C	E
C	**90** \ 90	**45** \ 105
E	**105** \ 45	**60** \ 60

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Patterns – two firms advertising

- Each firm has 50% mkt share and $25 budget
- Mkt share for firm i: $50+2.(a_i-a_j)$; spending a_i in advertising increases firm's mkt share
- Payoff for firm i: $25+50+2.(a_i-a_j)-a_i$
- Advertise or not?

	No Ad	Ad
No Ad	**75** \ 75	**25** \ 100
Ad	**100** \ 25	**50** \ 50

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The invisible hand can fail when…

- There are externalities
  - Typical in situations of strategic interaction like Prisoners' Dilemma
  - E.g., contributing to a public good (joint taxes, truthful news, clean environment) vs "free-riding"

- There is asymmetric information

- There is market power

- **Result:** a bad outcome is reached in equilibrium

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The case: Theranos

Theranos' rise - too good to be true?

- 2003: Elizabeth Holmes dropped out of Stanford to start **Real-Time Cures**
  - **Question the status quo:** Medical testing industry dominated by duopoly - scope for disruption - low cost blood-testing with a tiny drop of blood
- 2012/13: Now **Theranos**, partners with Safeway and Walgreens to offer in-store blood tests and open Wellness Centers
- 2014/15: **$9bn valuation.** Breakthrough - news coverage, accolades
  - Holmes among 400 wealthiest Americans (Forbes)
  - Partnership with Cleveland Clinic, Capital BlueCross; Carlos Slim Foundation
  - FDA clearance for HSV-1 test; CLIA waiver from FDA

- All star board members....
  - Henry Kissinger, George P. Shultz, James Mattis, etc...

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Theranos' fall

U.S. SECURITIES AND EXCHANGE COMMISSION

Press Release

Theranos, CEO Holmes, and Former President Balwani Charged With Massive Fraud

- **October 2015:** WSJ article by John Carreyrou
  - **Direct aftermath** FDA: Nanotainer "uncleared medical device" - Theranos halts collecting blood samples from finger pricks

- **2016:** Regulators ban Theranos for running lab and revoke certification
  - Forbes revises estimate of net worth to $0; company valuation from $9bn to $800mn
  - Walgreens pulls out; major investor Partner Fund Management sues company

- **2018:** Theranos ceases operations
  - Holmes and Balwani indicted on wirefraud charges

- **2022:** Holmes and Balwani convicted of fraud

- **What happened?**

THE INVENTOR
OUT FOR BLOOD IN SILICON VALLEY
Watch the Trailer

CAL ALUMNI ASSOCIATION UC Berkeley
"It Kept Failing": Whistleblower Erika Cheung on Working at Theranos
By Alina Tugend

Erika Cheung // Photo by Christine Javier

Ethical concerns aside, Theranos was not a pleasant place to work. Balwani "was a clear dictator and fearmonger, always yelling at people," Cheung said. "Elizabeth was too—we can't let her off the hook. Elizabeth would have big visions—'I want this to process patient samples in 20 minutes'—things that weren't possible. And when people would contest it, she would say 'you're not a team player.'

BAD BLOOD
Secrets and Lies in a Silicon Valley Startup
John Carreyrou
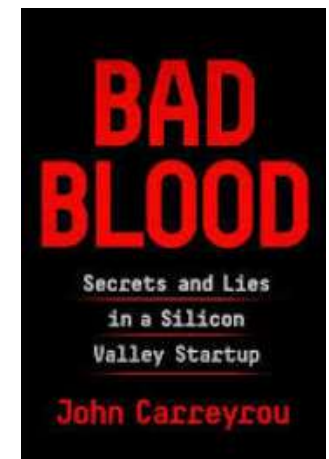
Theranos' fall

Discuss in small groups:

- What/who to blame?

    - The person?
    - The circumstance?
    - The system?

Factors driving ethical failure
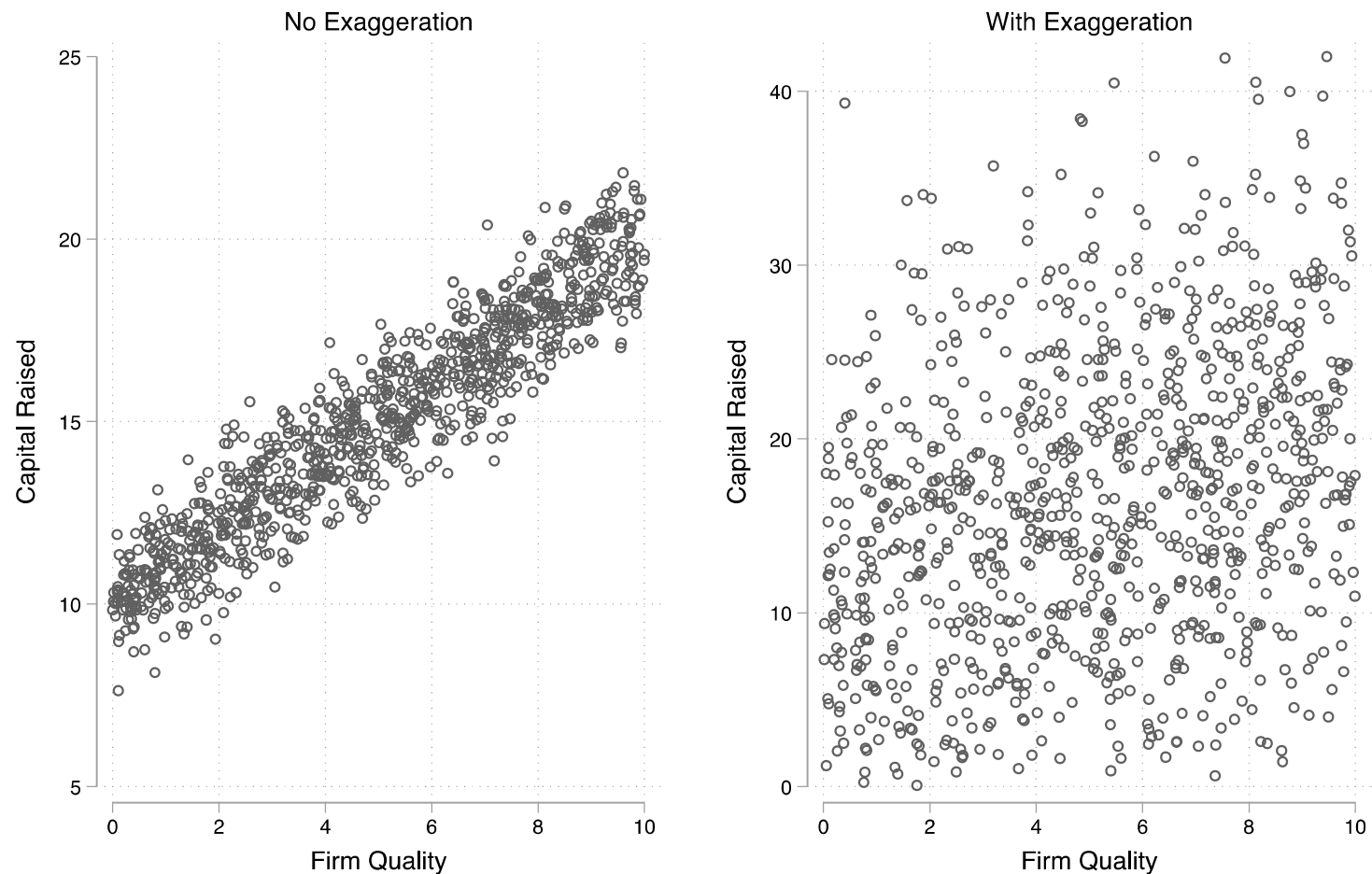
- **Cluster #1: structural elements**

1. Context / external factors

- Competitive pressure – "fake it till you make it"
- Opacity of proprietary tech, privately held firms
- Enabling privileged relationships

- Emerging PDs – Theranos' context
  - VC: exaggeration-friendly market for promises
    - Can always gain by exaggerating some
    - When all entrepreneurs do, VC see noise, everyone worse off

Allocation of capital with exaggeration…

No Exaggeration · With Exaggeration
(Scatter plots: Capital Raised vs Firm Quality)

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Factors driving ethical failure

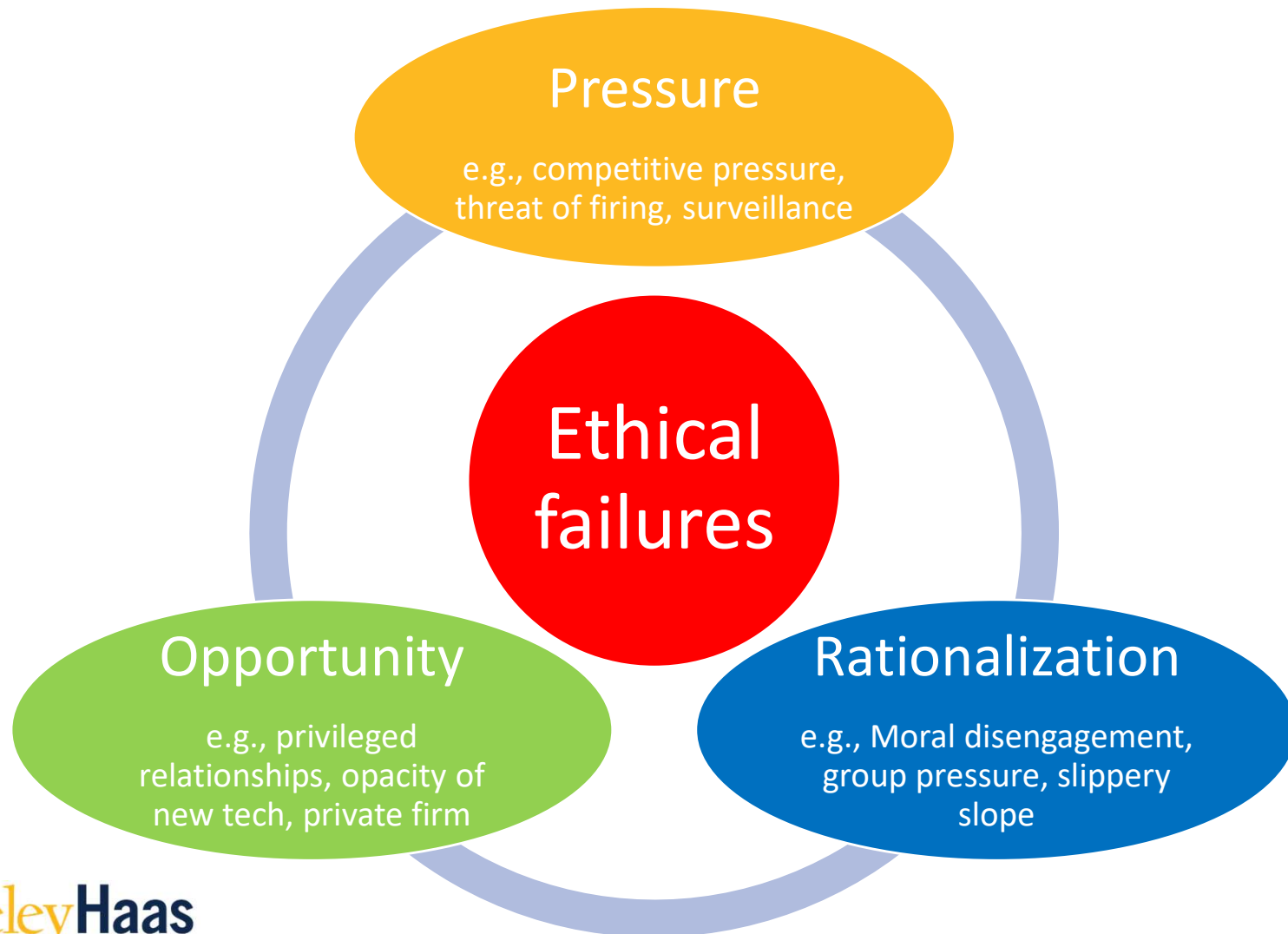- **Cluster #1: structural elements**

<u>**2. Internal factors**</u>

- Compartmentalization
- Legal threats / NDAs
- Surveillance
- Threat of firing / high churn

- Emerging PDs – Theranos' internal rules
  - Dissent is a public good - can save misled organization, but Theranos made it individually costly
  - Dissent suppression creates internal PD

Factors driving ethical failure

- **Cluster #2: behavioral elements**

  - Group pressure
  - Slippery slope dynamics
  - Social modeling
  - Authoritarian directives
  - Fear of missing out

  - Moral disengagement
    - Rationalization

How risk factors interact

Pressure
e.g., competitive pressure, threat of firing, surveillance

Ethical failures

Opportunity
e.g., privileged relationships, opacity of new tech, private firm

Rationalization
e.g., Moral disengagement, group pressure, slippery slope

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Moral disengagement

- A state induced through rationalization

- Absolving narratives
  - *The cause is worthy*
  - *Everyone else is doing it*
  - *It's the nature of the game – I did not make the rules*
  - *If I don't do it, somebody else will*
  - *To maintain resolve, ignore criticism*
  - *It's others' responsibility to do their due diligence*

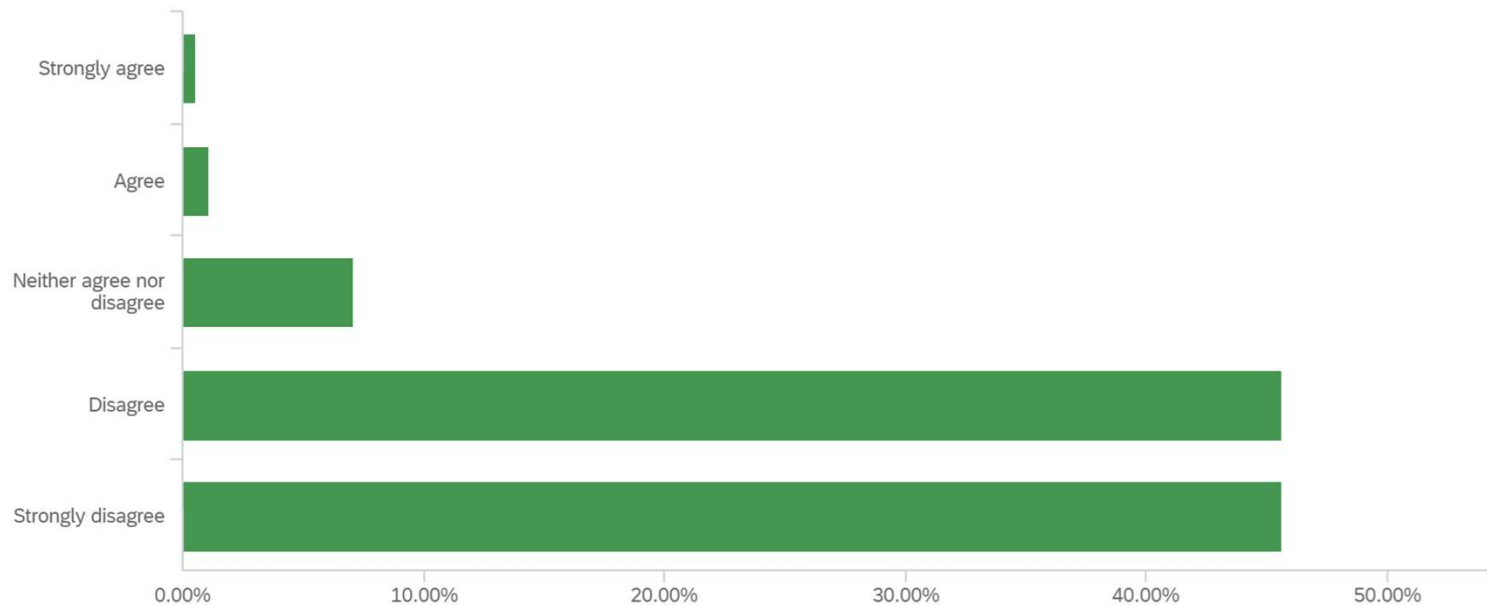# Measuring moral disengagement (Moore et al. 2012)

- Moral justification

Q1 - It is okay to spread rumors to defend those you care about.
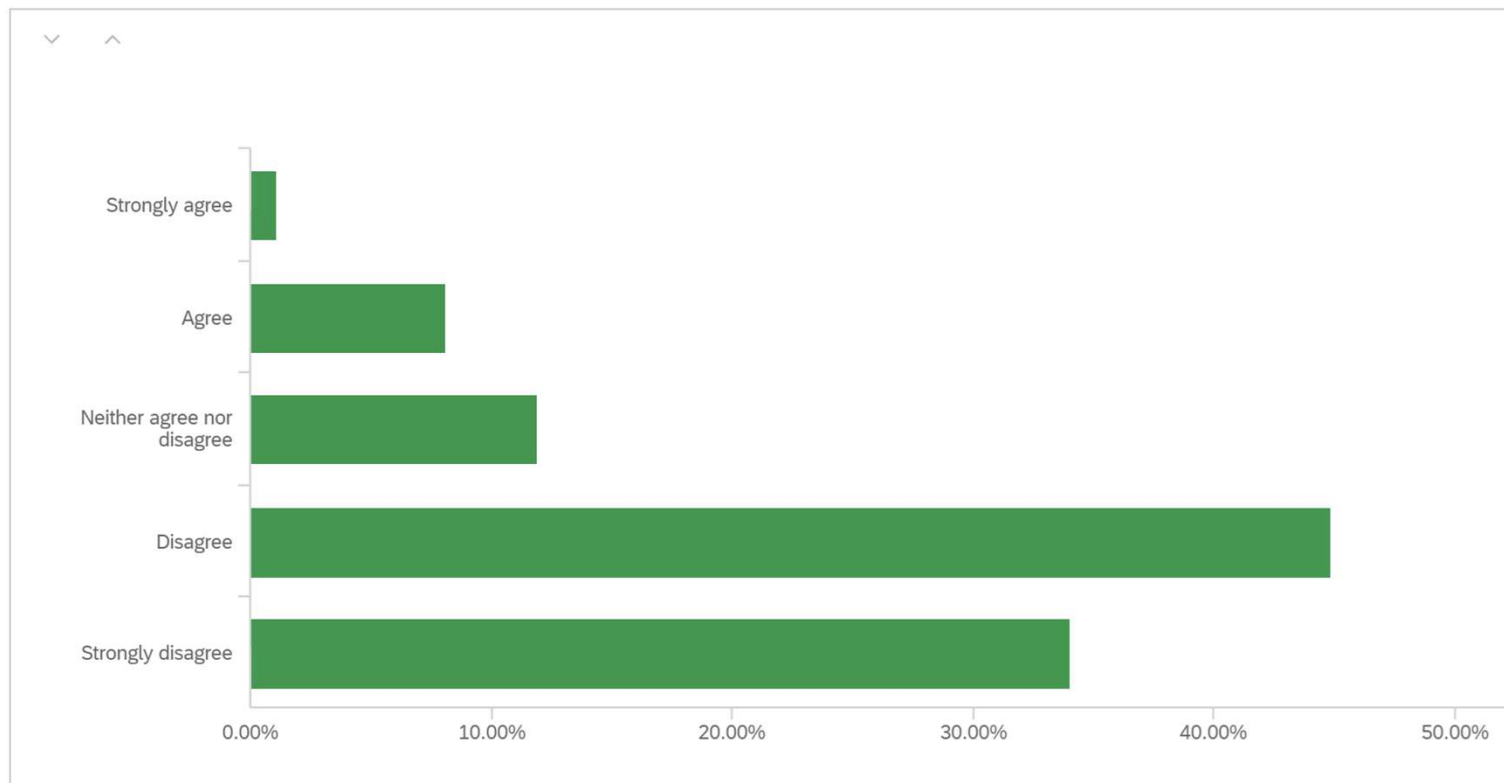
Measuring moral disengagement (Moore et al. 2012)
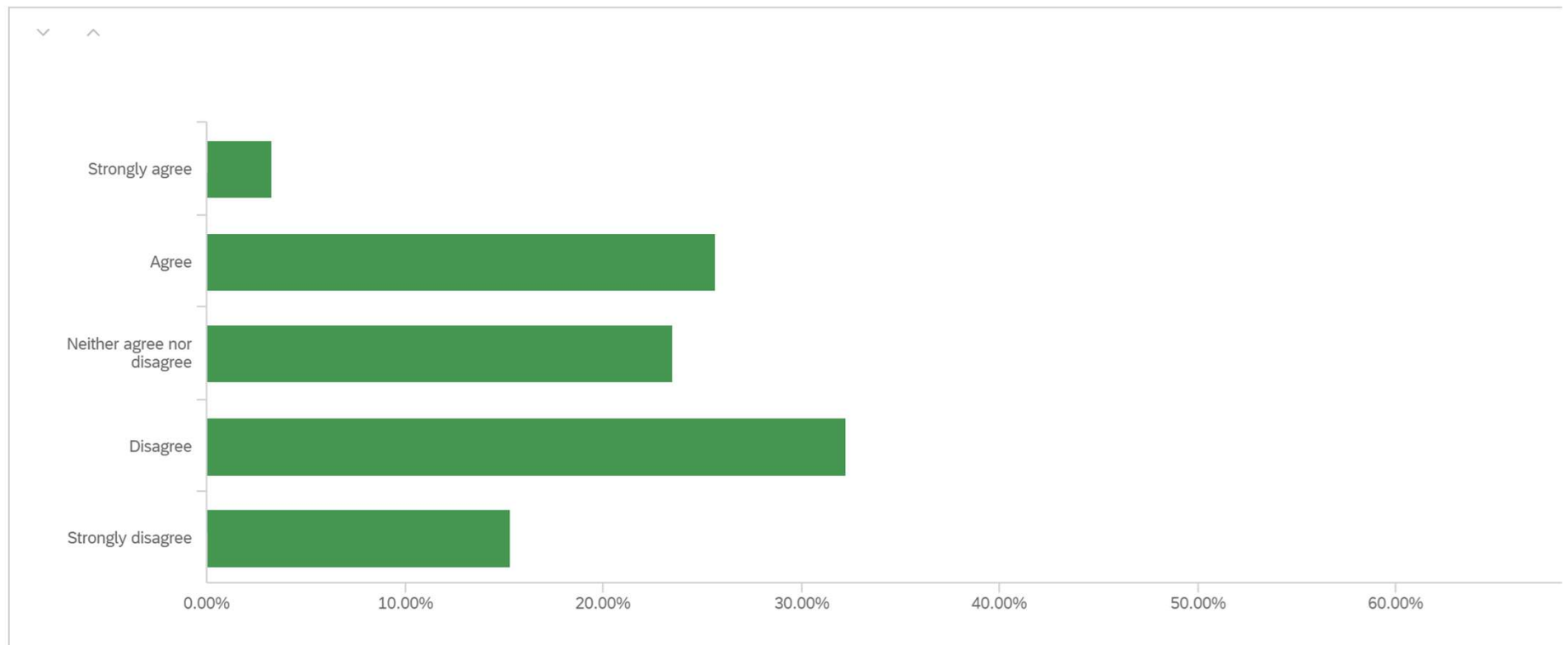
- Euphemistic labeling

Q2 - Taking something without the owner's permission is okay as long as you're just borrowing it.

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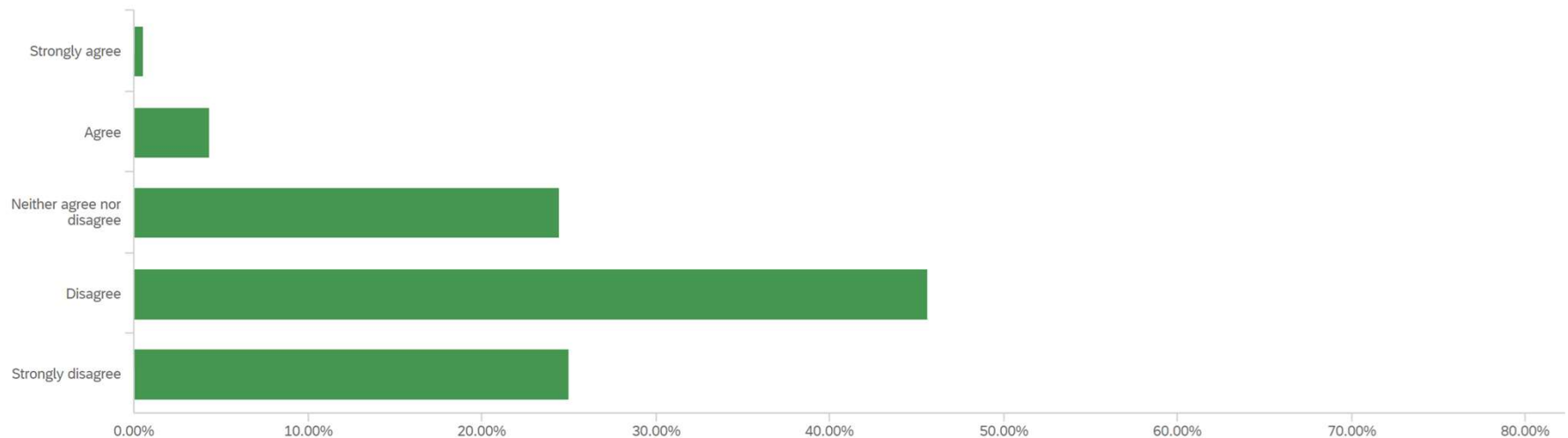# Measuring moral disengagement (Moore et al. 2012)

- Advantageous comparison

Q3 - Considering the ways people grossly misrepresent themselves, it's hardly a sin to inflate your own credentials a bit.

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Measuring moral disengagement (Moore et al. 2012)

- Displacement of responsibility

Q4 - People shouldn't be held accountable for doing questionable things when they were just doing what an authority figure told them to do.

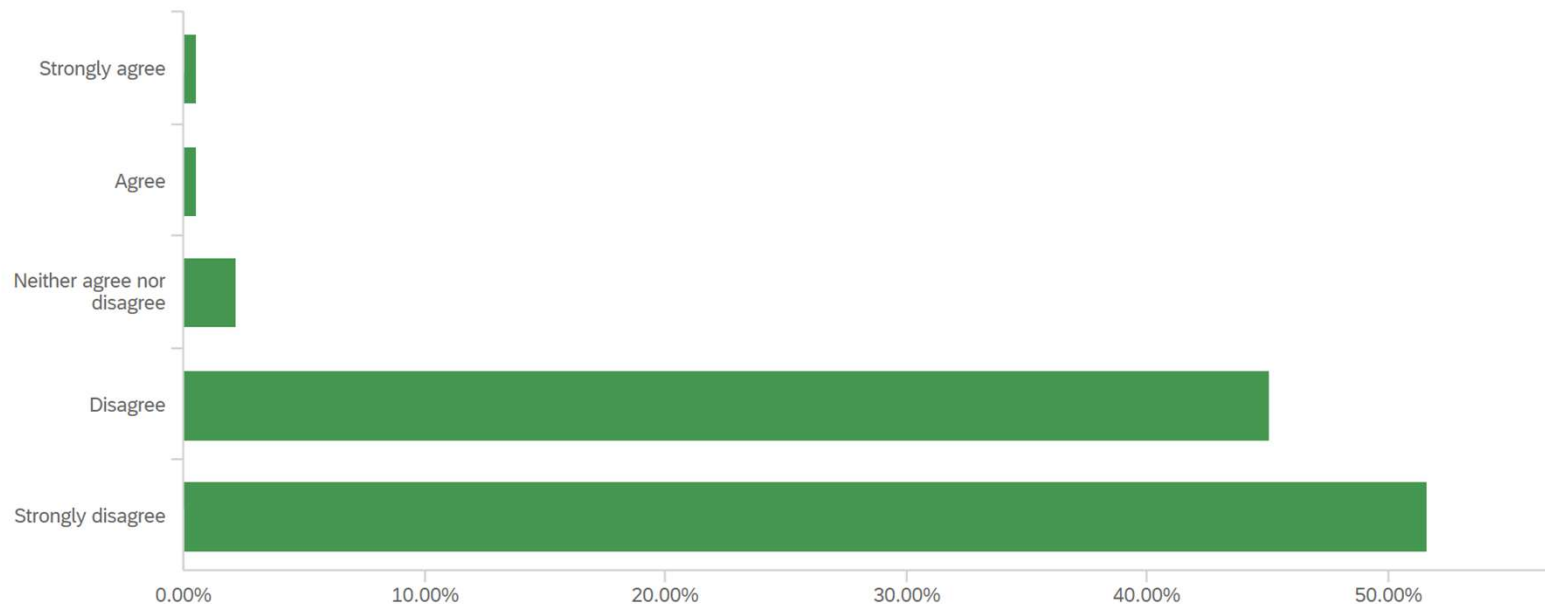# Measuring moral disengagement (Moore et al. 2012)

- Diffusion of responsibility

  Q5 - People can't be blamed for doing things that are technically wrong when all their friends are doing it too.

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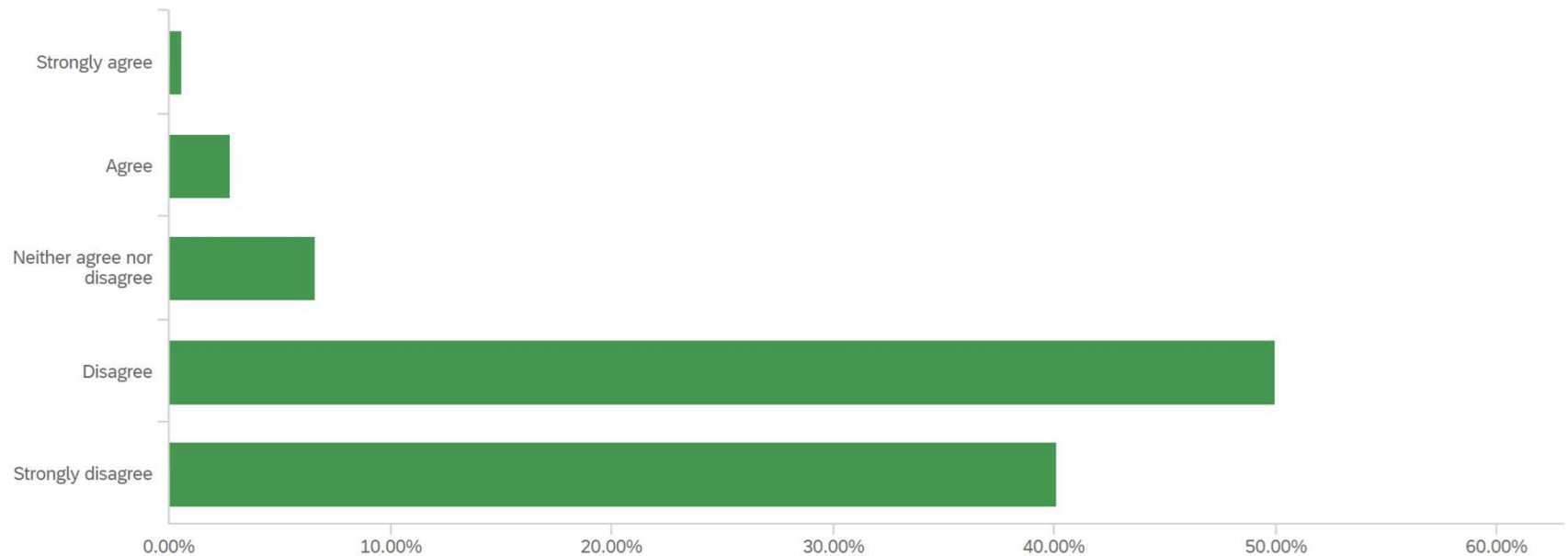
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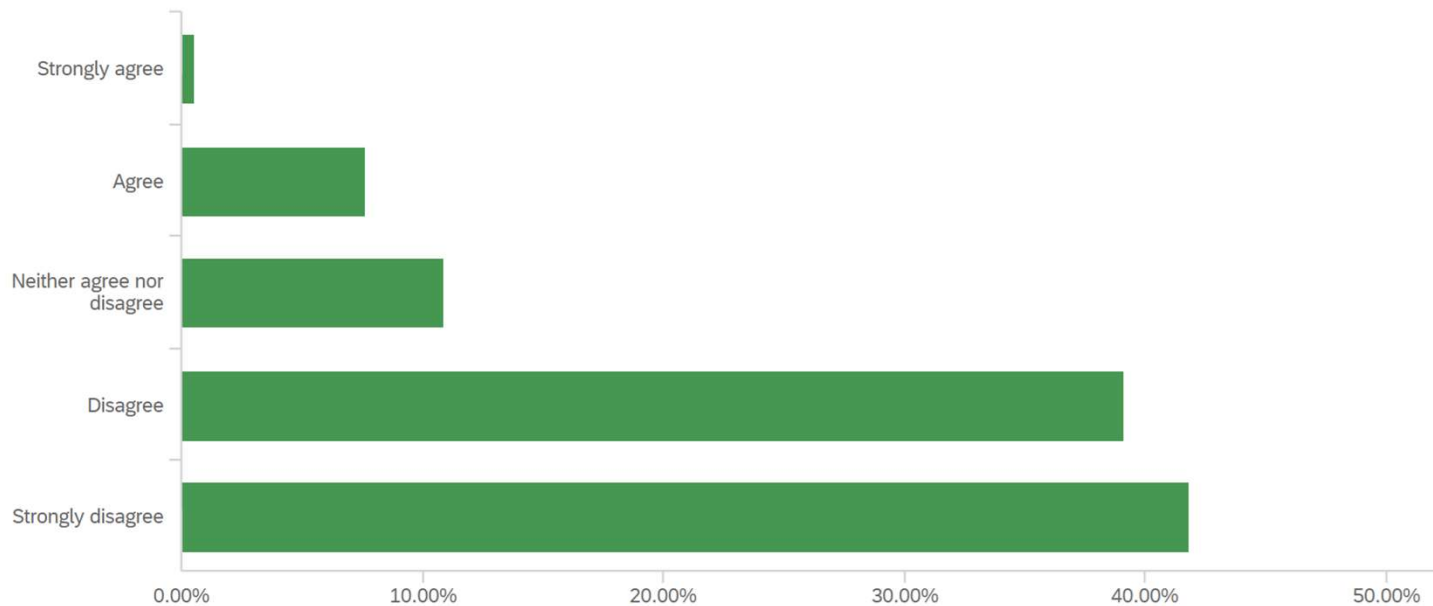
- Distorting consequences

Q6 - Taking personal credit for ideas that were not your own is no big deal.

Measuring moral disengagement (Moore et al. 2012)
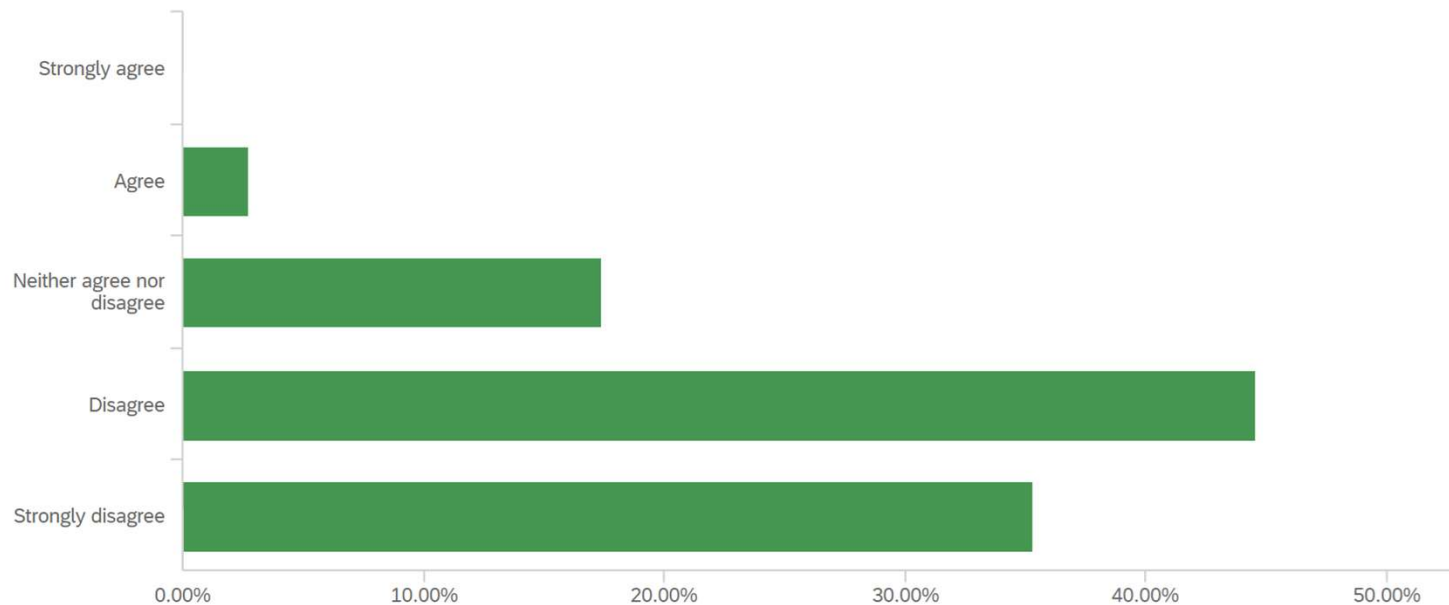
- Dehumanization

Q7 - Some people have to be treated roughly because they lack feelings that can be hurt.

Measuring moral disengagement (Moore et al. 2012)

- Attribution of blame

Q8 - People who get mistreated have usually done something to bring it on themselves.

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Sound familiar? Pattern recognition

Embattled Crypto Exchange FTX Files for Bankruptcy

The announcement capped a stunning week that has shocked the crypto industry.

Give this article

HOME > TECH

Sam Bankman-Fried was the poster boy for 'effective altruism.' Now its followers are heartbroken, and critics are questioning its 'weird' funding setup.

Crypto S of the Ur

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Comparing Theranos and FTX

	Theranos	FTX
Structural factors:		
- External: Industry	Emerging new technology, private firm → difficult to regulate	
- Internal: Firm	Hierarchical, siloed, secretive, intimidation	Flat, disorganized, chaotic management
Behavioral factors:		
- Social	Founder myth, FOMO	
- Individual	Slippery slope, ends justify the means	
....	....	

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Takeaways for moral architects

What do good leaders do?

1. As **game designers:** set the incentive structure
   - Some "games" lead to good social outcomes (e.g., HG, when invisible hand works), some do not (e.g., PD) – two important *archetypes*

2. As **game players:** ward off moral disengagement
   - Be aware of psychological biases we may face – moral disengagement (diffusion of responsibility, slippery slope) – "evil traps for good people"

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Takeaways for moral architects (ii)

- Many think big fraud driven by greed and blatant dishonesty; easy problem to solve – just don't be evil!
  - But situational and systemic factors interact with individual decision making
  - Even large transgressions start small, hard to detect, seemingly innocuous, part of optimistic, mission-driven business drive

- How to avoid "evil traps for good people"?
  - Where to draw the line?

- **Ethics**

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Next steps

- Conversation

- Value systems other than self-interest can
  - Provide a moral compass
  - Help counter psychological biases

- What are *your* non-negotiables?

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