

# Introduction to Business Ethics:

## Corporate Ethics – Use Cases

25. January 2023

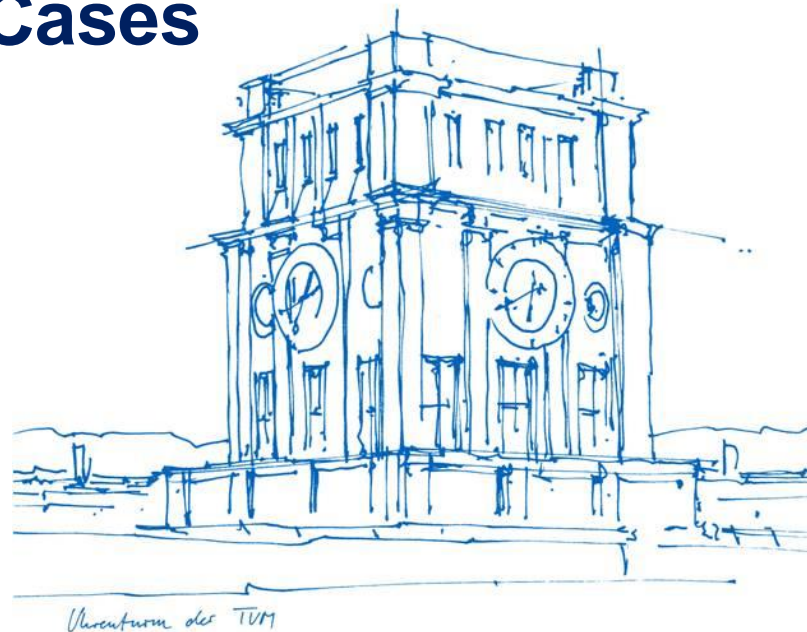
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# Yesterday's lecture

Codes of Corporate Governance

Regulating the relation between owners, supervisory board and management

Mitigating the risk of ...

The grandiose belief, that one can game the system

The risk of the snowball effect: of a small deviation develops into massive fraud

Conflicts of interest

# Principles and recommendations

“The **principles** reflect **material legal requirements** for responsible governance, and are used here to inform investors and other stakeholders.

**Recommendations** of the Code are indicated in the text by using the word “shall”. **Companies may depart from recommendations**, but in this case they are obliged to **disclose and explain any departures each year (“comply or explain”)**”

(German Code p. 2)

# Conflicts of interest

Supervisory board members should be independent of members of management board

They should not be best friends, brothers or the mothers of members of the management board

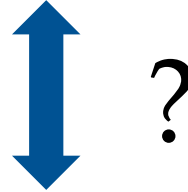
Members of the supervisory board for company X should not have any commercial interests in suppliers or customers Y, i.e., in companies in which the corporation X has an interest

Any management or supervisory board member conflict of interest must be disclosed to the chair of the supervisory board

# Supervisory board – management board relation

## Principle 6

The Supervisory Board appoints and discharges the members of the Management Board; it supervises and advises the Management Board in the management of the enterprise



## Principle 13

The Management Board and the Supervisory Board cooperate on a trust basis to the benefit of the enterprise. Good corporate governance requires an open dialogue between the Management Board and Supervisory Board, as well as between the members of these individual Boards. Comprehensive observance of confidentiality is of paramount importance in this regard

# Corruption, cartels and violation of data privacy legislation

Siemens corruption scandal: Bribery of foreign government officials

European truck cartel: Antitrust legislation

Cambridge Analytica: Abuse of personal data



# SIEMENS

# Background Siemens 1/4

Founded in 1847 by Werner Siemens

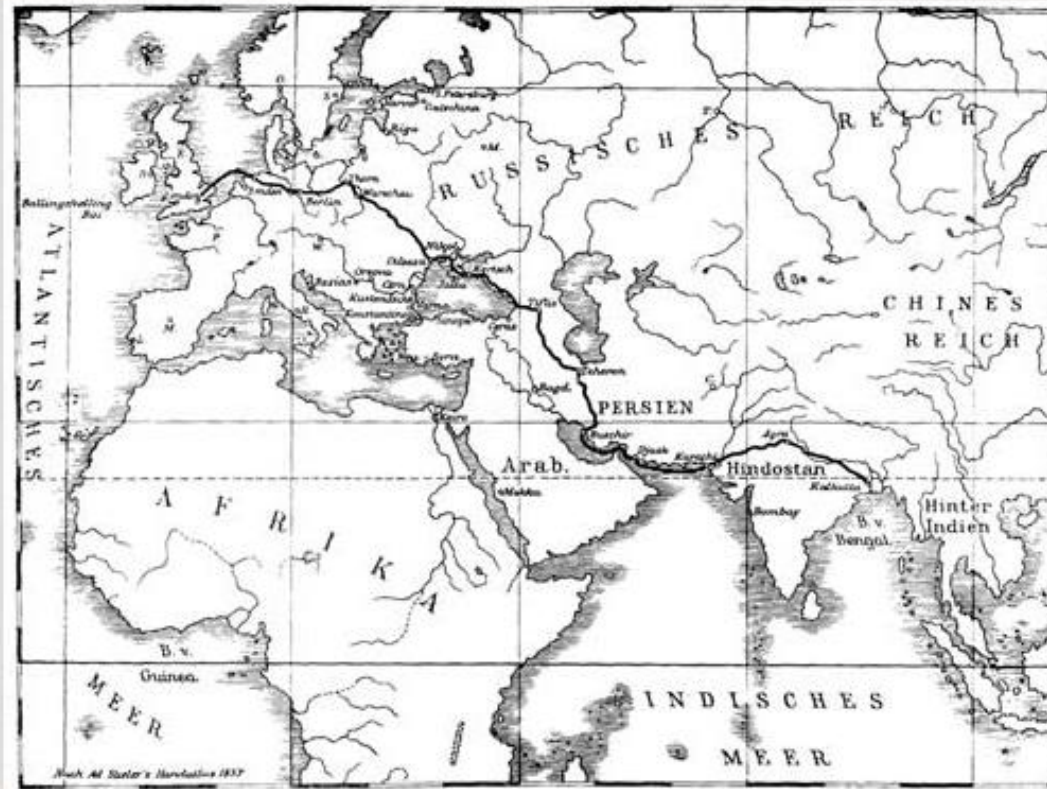
1866: Developed electrical motor on the basis of Faradays invention of the dynamo  
(The connection between movement and electricity)

1870: Build the first telegraph line between London and Calcutta. Reduced communication from 2-3 month (transport by ship) to 30 Minutes

1900: Tramways and telephone networks

1920: Siemens and AEG joins forces with Osram => Production of lightbulbs





## Background Siemens 2/4

1945: Rebuilding the company => Main office in Munich and large production site in Erlangen

1960'ies: Decentralised organisation and production sites India, Africa, South America

From 1975: Microelectronics and development of overseas production facilities

1980s and 1990s: Digital communication systems, microchips, high speed rail and computer technology

## Siemens background 3/4

2008: Siemens divided into sectors

Energy sector: All kinds of energy production, sustainable as well as based on fossil fuel. (2019: Separate company: Siemens energy)

Healthcare: Computed Tomography, imaging for radiotherapy, X-ray systems

Industry Sector: digitalization, electrification, logistics, media, home appliances, lighting, diagnostic imaging, mechanical drivers, and financial solutions.

Sector Infrastructure and Cities: Rail systems, electricity infrastructure, building technology, intelligent energy solutions

# Siemens background 4/4

2020: 311.000 employees

Smart infrastructure

Digital Industries

Digital mobility

Siemens Adventa: Automotive, industrial manufacturing, buildings, oil and gas

Siemens Healthineers



# Siemens scandal 2006

# US Foreign Corrupt Practices Act

US FCPA from 1977 => federal law prohibiting US citizens and US entities from bribing government officials in foreign countries.

Officials: civil servants, political parties

Germany: Bribery payments to foreign public officials were legal and could be accounted for in the financial statements as “useful expenditures”.

US Corporations competitive disadvantage (GE General Electric could not compete with Siemens on large infrastructure projects offered to countries with corrupt civil servants)

(Lütge and Uhl p. 214)

# OECD

Organisation for Economic Co-operation and Development

Founded in 1961: Stimulating economic cooperation and trade between countries who see themselves as liberal democracies.

38 Members represent 62% of global GDP

US pressure on OECD to align national legislation on corruption of foreign public officials

1989: Working group preparing the OECD Anti-Bribery Convention signed by Germany in 1999

Ratification process lasted till 1<sup>st</sup> September 2002: Illegal to bribe foreign officials and business partners

# From legal bribery to illegal bribery

Culture where bribery was perceived as a legitimate way of making business

Before 2002: Annual statements: “Nützliche Aufwendungen”, useful expenses

They had no idea how the business could continue without bribery

2002: Managers met up with loyal employee, Reinhard Siekaczek from the accounting department, told him to open accounts in Switzerland. Midlevel executive Siekaczek organised transfer of 40-50 million Euro through secret Swiss bank accounts

Complex constructions of front companies and illegal bank accounts for channelling funds for bribing



# Bribery illegal from September 2002

In Siemens' culture bribery was perceived as a legitimate way of making business

1,3 Billion Euros paid in illegal bribery, for example for

Power plants in Israel

Metro lines in Venezuela

System in Argentina for personal identity cards

Nigeria: € 10 Million for ministers and civil servants for telecommunication systems.

Profit of Project: 600 billion

# Siemens

15<sup>th</sup> November 2006: 200 policemen, public prosecutors and tax officials searched the Siemens headquarters and arrested member of management board Thomas Ganswindt

March 2007. Extra scandal: Manager arrested for supporting trade union alternative to IG Metall

April 2007: Head of the supervisory board Heinrich von Pierer and head of the management board, Klaus Kleinfeld resign

May 2007: Peter Löscher new head of supervisory board

Fines, lawyers and investigations: € 2,5 billion

# Interview with Reinhard Siekaczek

[Frontline Interview of Reinhard Siekaczek - YouTube](#)



# Consequences

Centralisation of bank accounts => easier to control the cash flows

Compliance system: Prevent - Detect – Respond. Incompliance => immediate dismissal

Independent monitoring of compliance behaviour (US), who participated in meetings and tested the whistle blower system => reports to the Securities and Exchange Commission (SEC).

In Germany 2009 the former finance minister Theo Waigel was appointed as compliance monitor

Implementation of compliance processes Compliance training for employees

# Siemens Compliance System (internal)

Zero tolerance: Prevent, detect, respond

Preventive measures: Training of Employees => information on legal requirements (bribery, antitrust, money laundering etc.), identifications of high risk areas and guidelines for handling situations (e.g. where bribes are requested)

Shared compliance policies with business partners based on contractual agreements

Communication channels: Whistle blower system and ombudsperson => high ranking professional independent of management to whom complaints can be addressed.

Standardised investigation and resolution procedures

# Siemens Integrity Initiative (external)

\$120 m. initiative covering 85 projects in 50 countries

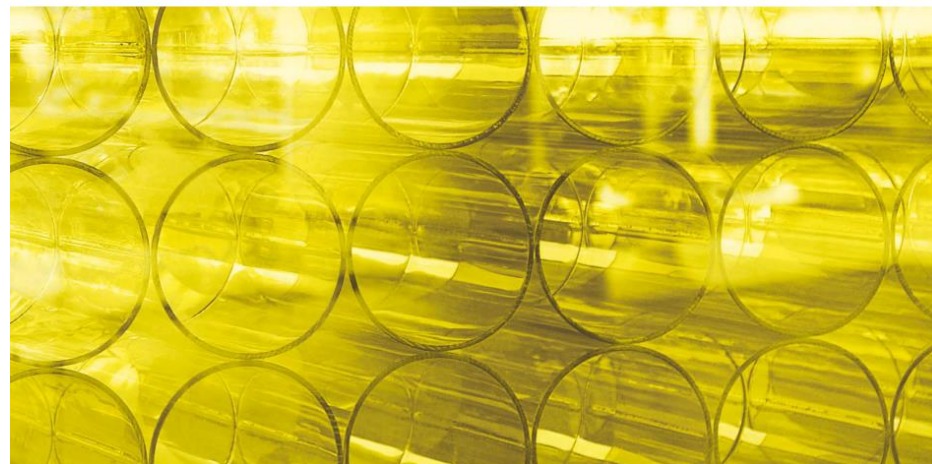
Purpose: To contribute to reducing corruption world wide

Contribute to creating a corruption free environment => level the playing field for competitive market economy

SIEMENS

Siemens  
Integrity Initiative  
**Annual Report 2021**

[siemens.com/integrity-initiative](https://siemens.com/integrity-initiative)



# Collective Action

Cultural problem in countries with high risk of corruption

Companies faced with choice between paying bribes to win business or withdrawing from market

Combatting corruption requires cooperation of various interest groups: Companies, governmental organisation, NGOs, politicians etc.

Creating fair marketing conditions for all participants => weakening corrupt cultures => no opportunities for other (competing) firm to take advantage of opportunities of bribe public officials

Integrity pacts between private and public sector: Contractual agreement on public procurement processes monitored by neutral agent (could be Transparency International)



# Example from Indonesia

Cooperation with Indonesian government and local organisation: Indonesian Institute for Independent Judiciary

Assisting regional anti-corruption courts: Strengthening their ability to pursue cases of corruption (gathering evidence, establishing and following procedures)

Assisting the creation of a coherent legal framework => alignment of processes and protection of whistle blowers

200 page report identifying the development of the judicial system: Challenges of workload and procedures, lack of qualified judges etc.

Report used by policy makers and NGOs



# Theory of corruption in organisations

# How do organisations become corrupt?

Three processes: Socialisation: Newcomers are introduced to the practices of bribery

Institutionalisation: Corruption is rewarded, participation in corruption as criteria for promotions.

“Rope Teams”: Professional networks of executives loyally supporting each other

Rationalisation: Justifying corruption => “we do it for the sake of the company”, “other firms bribe as well”

Sieckaczek (Siemens) in Interview: “We all knew it was illegal, but from the ethical standpoint, we did it for the company. It was about keeping the business unit alive.”

Managers to Sieckaczek: “If you do not participate, you will be endangering jobs”.

Sieckaczek was later told from a loyal manager, that he would serve as scape goat in case the bribery was discovered.

(Ashforth and Anand: “The Normalization of Corruption in Organizations” 2003)

Emotional  
Blackmail

# Challenge to newcomers

Evaluating the risk of working for a corporation where you are suspicious of foul play

The lack of authority due to beginners' standing in hierarchy

Lack of alternative jobs and fear of losing job and prestige of working for large, successful corporations

Working in corrupt culture challenges newcomers' norms

Confrontation with corrupt corporate culture challenges the moral integrity of employees



# The Lorry Cartel

# Trust as social capital

Trust as social capital – societies with high level of trust tend to be more prosperous

Trust benefitting society: Increasing willingness to interact professionally with people outside sphere of close relations and reducing transaction costs in business

Reliability that business partners will comply with contractual agreements

Trust increases predictability and reduces risks of investing time and capital in business

Fewer cases of costly and time consuming litigation (court cases)

Promotion based on merits and not on pre-established social relations (family ties and social network)

Higher quality of workers at managerial levels

Higher willingness to enter into professional relations characterised by incomplete contracts

Lütge and Uhl p. 205 and 248

# Slide from former lecture

Consider for example: **Theory of Incomplete Contracts**

## Starting point

Assumes that human interactions are governed by contracts, formal (e.g. codified laws) and informal (e.g. promises)

## Problem

These contracts are incomplete in number of ways (for example: performance and consideration are not precisely defined)  
Incomplete contracts thus increase uncertainty

➤ Goal of Corporate Ethics:  
Recommendations for actions in face of incomplete contracts



*Oliver Hart (\*1948) and Bengt Holmström (\*1949):  
Nobel Memorial Prize in Economic Sciences in 2016*

## Trust as necessary cultural component in civilized societies

Incomplete contracts => not every move of citizens can be regulated

British businessman Sanjay Shah involved in cum-ex => scheme for fraudulent claims for tax returns  
...beyond the imagination of tax authorities and legislators

Trust requires trustworthy citizens who are willing to comply with legislation and ethics of society

Trustworthy managers and employees as basis for compliant corporations



# Prisoner's Dilemma: Normal Form

Trust is good  
for criminals  
and bad for  
police

		Player 2	
		cooperate	defect
Player 1	cooperate	I 2, 2	II 0, 3
	defect	III 3, 0	IV 1, 1

# Unwanted relations of trust

Competition as productive criteria

Market economy: Competition encourages discipline to produce good quality at a fair price

From lecture 20<sup>th</sup> December

**“Competition enables growth and growth** increases the size of the cake

Market economy and competition explain the economic growth after the industrial revolution”

Trust between competing corporations => undermines competition => cartel => inefficiency and exploitation of consumers

# Antitrust regulation and competition law

Prohibits cartels: Cooperation between competing parties agreeing not to underbid each other

=> Control prices and increase profits

Most famous cartel world wide: The international organisation of OPEC => Organisation of the Petroleum Exporting (Countries => Acting above national legislation)



Enabled petroleum importing countries to play petroleum exporting countries against each other

Purpose of antitrust legislation to ensure: “pluralism, decentralisation of economic decision-making, preventing abuses of economic power, promoting small business, fairness and equity and other socio-political values.”

(<https://www.oecd.org/competition/the-goals-of-competition-policy.htm>)

# Antitrust regulation: Historical facts from the US

1890: First US Anti trust regulation in order to avoid monopolies and cartels which undermine free market economy and the advantages of competition. Specifically an attempt to undermine the market dominance of R.D. Rockefeller's Standard Oil

Up till 1970s: Strong antitrust regulation is key to competition between firms  
Competition => efficiency and profitability => economic growth

Beginning debate concerning pros and cons of cartels

1980s (President Ronald Reagan): Trimming of antitrust law: Policy of only pursuing clear cut cases of antitrust violations

=> Easier for corporations to merge => larger corporations => internationally more competitive which makes sense in times of globalisation

# European Antitrust Policy: Example of current antitrust issue

Idea of the European Union: To create a single market with fair competition, increasing efficiency and encouraging entrepreneurship

European Commissioner for Competition  
Margrethe Vestager

EU challenged by monopolies of US Big Tech firms

Example: Google as search engine  
Amazon as internet trading platform

Digital Market Act from October 2022



# EU Digital Market Act

Antitrust law facing new challenges through the rise of Big Tech

Principle: If you are successful, you grow in market power => grow in responsibility

Once you reach a certain size (45 Million monthly active users and more than 10.000 businesses), you will qualify as gate keeper => to do list and not-to-do list, duties and prohibitions

List of companies which qualify as “gate keepers”.

“Online search engines, social networking services, certain messaging services, video sharing platform services, virtual assistants, web browsers, cloud computing services, operating systems, online marketplaces, and advertising services.”

([https://ec.europa.eu/commission/presscorner/detail/en/IP\\_22\\_6423](https://ec.europa.eu/commission/presscorner/detail/en/IP_22_6423))

# Amazon 2020 case

Amazon is a platform for other firms and a retailer of products on its own platform

Amazon also allows third party sellers to offer products to Amazon consumers

Amazon collected sensitive data from other retailers using their platform in order to strengthen their own market position

EU analysed 80 million transactions and 100 million products and the time of their launch

Amazon has collected data on the transactions of third party sellers

Insight into which products are successful and which were less successful as basis for decisions on which products to launch as a retailer

# The lorry cartel case

1997 - 2010: DAF, Daimler, Iveco, MAN, Scania and Volvo

Exchanged information on prices for medium and heavy trucks in order to coordinate these prices

Enabled them to coordinate gross list prices to avoid underbidding each other

Coordination of pricing and timing of new technologies

The EU truck market => “Oligopoly” => 90% of market dominated by few large players

Few companies made it easy to organise price coordination

Rationalisation: “Crippling competition” between European lorry manufacturers



In 2010 MAN turned themselves in and applied for leniency

“Kronzeugenregelung”

European Competition Network Leniency Program

Competition authorities (CA) will grant firms immunity from fines if the firm  
“is **the first to submit evidence** which in the CA’s view, at the time it evaluates the application, will enable the CA to carry out targeted inspections in connection with an alleged cartel”

([https://ec.europa.eu/competition/ecn/mlp\\_revised\\_2012\\_en.pdf](https://ec.europa.eu/competition/ecn/mlp_revised_2012_en.pdf))

# Fines

2017: Lorry producers (apart from MAN) were fined almost €3 billion. Scania was fined € 880 million

Statement by commissioner Vestager:

“... the truck producers discussed the "gross price list" increases they were planning for medium and heavy trucks and coordinated these with each other.”

[https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT\\_17\\_3509](https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_17_3509)

2022 Customers who had paid too much for the around 100.000 Trucks are suing MAN, Daimler, DAF, Iveco und Volvo/Renault for 590 Million Euro

# Lorry cartel from the perspective of MAN

Siemens corruption scandal => MAN became aware that disproportionate consulting fees had been paid to business partners in Kazakhstan.

They contacted to compliance team from Siemens, and the team helped them build a compliance system in MAN

The focus on compliance made it clear that the close relation to the competitors was not acceptable on a long term basis

=> Decision to inform authorities and cooperate with the authorities

# Example from MAN Code of Conduct

## DEALINGS WITH PUBLIC OFFICIALS AND HOLDERS OF POLITICAL OFFICE

Deals with public officials or holders of political office, governments, authorities and other public institutions often involve special statutory rules, any individual breach of which may have serious consequences and could permanently bar MAN Truck & Bus from public contract awards.

### EXAMPLE



You know that an authority is planning a call for tender for a major contract. You consider asking the authority's employee responsible for the tender, who you know from a previous project, to design the tender in such a way that MAN Truck & Bus wins the contract.

**Do not under any circumstances take any such action. Exerting this kind of influence would be illegal.**

# Example from MAN Code of Conduct

## FAIR AND FREE COMPETITION

Fair and free competition is protected by the applicable competition and antitrust legislation. Complying with this legislation ensures that market competition is not distorted – which is to the benefit and in the interest of all market players. In particular, agreements and concerted practices between competitors intended to achieve or effect the prevention or restriction of free competition are prohibited. Abusing a dominant market position is also inadmissible. Such abuse can, for example, take the form of treating customers differently for no objective reason (discrimination), refusal to supply, imposing unreasonable purchase/selling prices and conditions, or unjustified tie-in arrangements for the requested additional service. Anti-competitive conduct has the potential not only to significantly damage MAN Truck & Bus' good reputation, but also to incur severe fines and penalties.

### EXAMPLE



You talk to a competitor's employee at a trade fair. After a while, you notice you are being sounded out for information about MAN Truck & Bus' future business planning. In return, the employee offers to divulge the same information about his company.

**Immediately make it absolutely clear to the competitor's employee that you will not talk to him about such issues. This type of conversation – apart from the unauthorized disclosure of business secrets – is also a breach of prevailing competition and antitrust legislation and could have drastic consequences for you personally, MAN Truck & Bus, and both the competitor's employee and his company. Inform your responsible compliance contact listed in chapter 4 immediately and discuss the further approach with him.**

# Dilemma of Competition in Digital Market Economy

Traditional pre-digitisation market economy: Competition in slow motion gives companies time to adjust to requirements. This enables the coexistence of several competitors

Digitisation => market transparency where the client can instantly identify the cheapest supplier  
(For consumers: Idealo.de)

Websites for comparing prices creates instant price competition

Choice between underbidding your competitors to the point of making no profits or being excluded from market

Large size corporations can temporarily underbid competitors order to exclude them from market

# Lessons learned

Corruption, cartels etc are untenable for two reasons

- 1) Reputational risks
- 1) Risks of litigation. FCPA can be seen as a world wide standard in so far as every business which has anything to do with the United States can be prosecuted by the US. This includes cooperating with US corporation, using Dollars and using a US based communication system: Teams, Zoom, Whatsapp, etc.
- 2) Costs of a compliance system in large corporations: € 10-20 million.

# Cambridge Analytica I

## What is the scandal about?

- Cambridge Analytica assisted election campaigns with micro targeting and psychographic messaging based on information of over 80 million Facebook users.
- Information bought from researcher from Cambridge University
- Suspicion of influence on the 2016 U.S. presidential election and the Brexit vote.

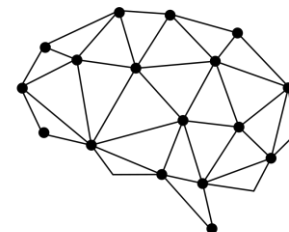




# Cambridge Analytica

## Who is Cambridge Analytica?

- Founded as a subsidiary of Strategic Communication Laboratories (SCL), a UK company based in the US
- Co-founded with Steve Banon and Robert Mercer (Right wing republicans)
- CEO: Alexander Nix.
- British political consulting named “global election management agency”.
- Specialised in collecting data on voters => Micro targeting and psychographic messaging



Cambridge  
Analytica

# Cambridge Analytica

## The Case Timeline:

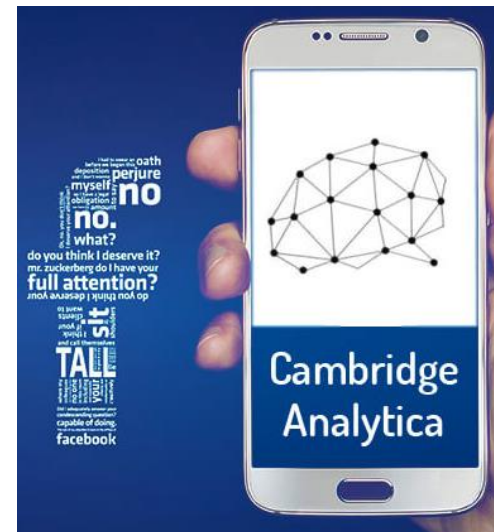
- April 2010: Facebook launched Open Graph allowing external developers to reach out to users and request permission to access a large chunk of their personal data, and the one of their friends.
- 2013: “This is your digital life” app by academic researcher and founder of Global Science Research (GSR) Aleksandr Kogan is launched.
- Combines personality test, facebook profiles and voter records.



# Cambridge Analytica & the Facebook Scandal

## This Is Your Digital Life & Aleksandr Kogan:

- Kogan develops an app for Cambridge Analytica which, in turn, arranges an informed consent process for academic survey research for Facebook users.
- The app is allowed by Facebook's design to collect personal information of consenting participants AND of all people in the FB user's social network.

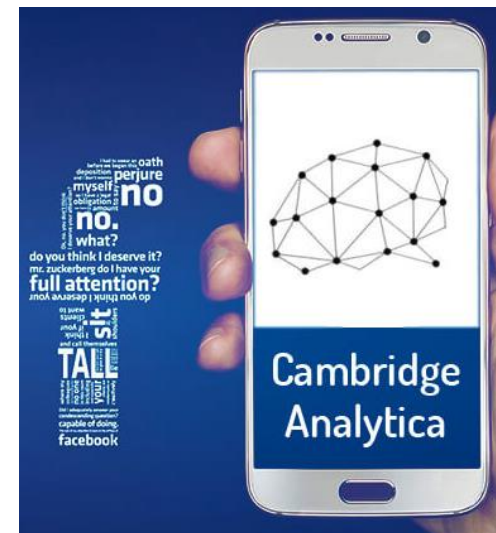


# Cambridge Analytica & the Facebook Scandal

## This Is Your Digital Life & Aleksandr Kogan:

In total, it is **87 million individuals' personal data**  
that were harvested from **320 000** initial users.

→ Interestingly, SCL (subsidiary of CA) used a million dollar to pay 3-4 \$ for each person who would participate in the survey on Kogan's app asking questions about personality.



# Cambridge Analytica

## Behind the Scene (2014):

- Cambridge Analytica contacted researcher Alexandr Kogan, psychologist from Cambridge, and creator of "This is your digital life".
- Kogan set up Global Science Research (GSR) (which has nothing to do with Cambridge Analytica).
- Cambridge Analytica **buys a dataset** from Kogan's Company / Global Science Research (GLS) – psycho-demographics + personality from the app Kogan set up on Facebook.

# Cambridge Analytica & the Facebook Scandal

## The Case Timeline:

- 2014: Change of rules limiting developer's access to user data. This change is not retroactive, thus Kogan did not have to delete the data previously acquired.
- 2016: Trump's campaign team begins investing heavily in Facebook ads, with the service of Cambridge Analytica.
- Alexander Nix (CA CEO) works on the campaign.



# Cambridge Analytica & the Facebook Scandal

## The Case Timeline:

- 2013: “This is your Digital Life” by Kogan
- 2014: Creation of Global Science Research (GSR) by Kogan
- 2014: SCL (subsidiary of CA) pays over a million dollar to pay participants to “This is your Digital Life” Survey
- 2014: CA buys a data set from GSR
- 2016: CA is involved in Trump’s campaign that uses psychographics to target communication.

# Cambridge Analytica & the Facebook Scandal

## The Case Timeline:

→ March 2017: Whistle-blower and co-founder Christopher Wylie exposes CA and the harvesting of **over 50m Facebook profile data** (later estimated at 87m) in the Guardian and the New York Times.

Wylie explains the data were used to develop **psychographic** profiles and deliver pro-Trump material to them online.





# Cambridge Analytica & the Facebook Scandal

## The Case Timeline:

→ March 2017: Zuckerberg reacts a few days later on the social media.

“We have a responsibility to protect your data, and if we can’t then we don’t deserve to serve you. I’ve been working to understand exactly what happened and how to make sure this doesn’t happen again.”



# Cambridge Analytica & the Facebook Scandal

## Consequences of a Scandal:

- 2018: the Cambridge Analytica operation is closed due to the scandal.
- Awareness in regards to data privacy.
- Standards and regulations being enforced such as the GDPR  
(European General Data Protection Regulation).



# Cambridge Analytica & the Facebook Scandal

## GDPR:

→ At the heart is Personal Data. Broadly this is information that allows a living person to be directly, or indirectly, identified from available data.

→ Obvious: Person's name, location data, or a clear online username.

→ Less apparent: IP addresses and cookie identifiers.



# Cambridge Analytica & the Facebook Scandal

## GDPR's Seven Principles:

- Lawfulness,
- Fairness and Transparency;
- Purpose limitation;
- Data minimisation;
- Accuracy;
- Storage limitation;
- Integrity and confidentiality (security);
- Accountability.

