



Introduction to Business Ethics: Introduction

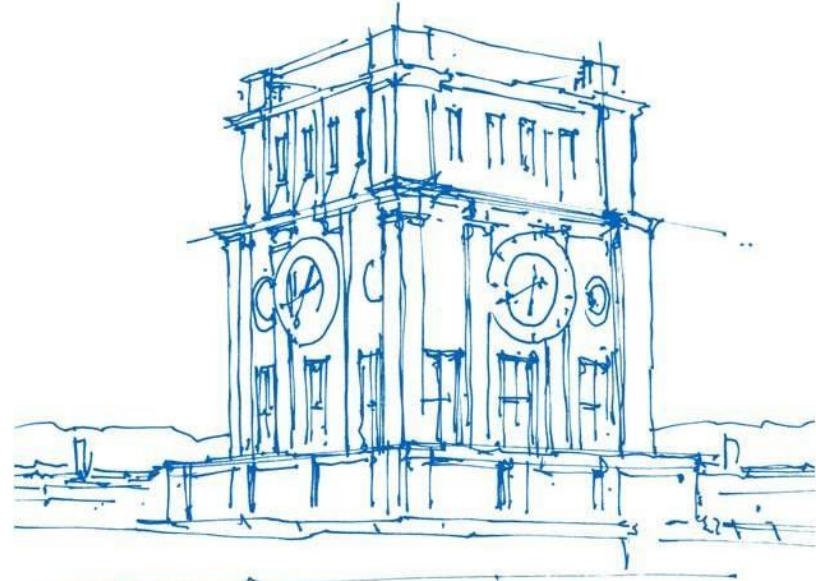
13. December 2022

Prof. Dr. Christoph Lütge

Peter Löscher Chair of Business Ethics

Technische Universität München

Winterterm 2022/23



Uhrenturm der TUM



Personal introduction



Professor Lütge is the Director of the IEAI and has held the Chair of Business Ethics at TUM since 2010.

He has a background in business informatics and philosophy, having received his doctorate in philosophy from TU Braunschweig in 1999 and his habilitation from Ludwig Maximilians University Munich in 2005. In 2020, Lütge was appointed Distinguished Visiting Professor of Tokyo University. He has also held visiting positions at Harvard, Taipei, Kyoto and Venice, and was awarded a Heisenberg Fellowship from the German Research Foundation.

Professor Lütge has been a member of the Ethics Commission on Automated and Connected Driving of the German Federal Ministry of Transport and Digital Infrastructure, as well as of the European AI Ethics initiative, AI4People.



IEAI Launch – 7 October 2019



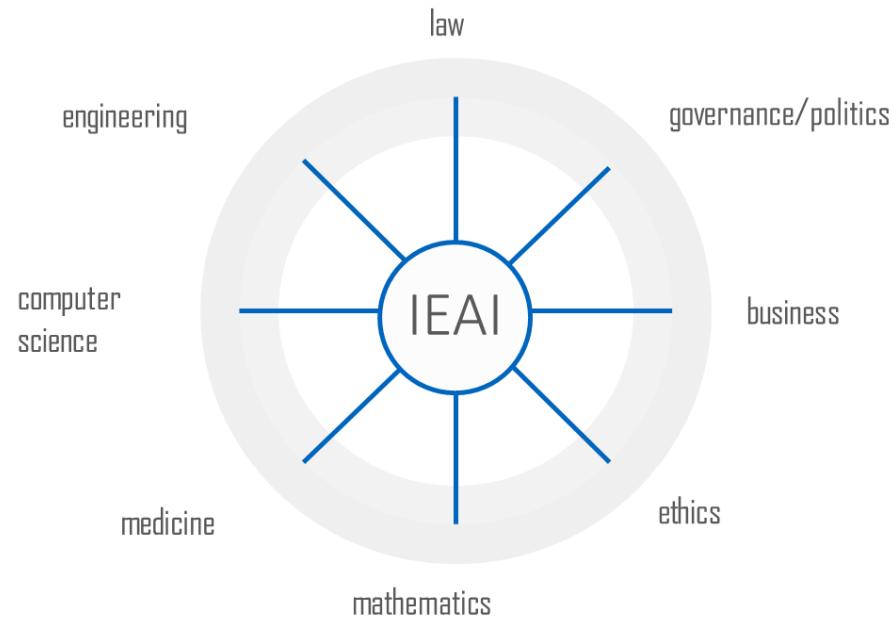
TUM Institute for Ethics in Artificial Intelligence officially opened

In attendance of Minister of State Dorothee Bär, Federal Government Commissioner for Digital Affairs, the Technical University of Munich (TUM) officially opened the TUM Institute for Ethics in Artificial Intelligence today. At the event the new institute's first research projects at the interface of ethics and artificial intelligence (AI) were presented – in areas ranging from AI in autonomous vehicles to regulatory issues.

TUM has been studying the complex interactions of science, technology and society since 2012 through the work of the Munich Center for Technology in Society (MCTS), which was established under the 2012 Excellence Initiative. As part of the MCTS, the TUM Institute for Ethics in Artificial Intelligence (IEAI) will focus on ethical implications of artificial intelligence. The US company Facebook is supporting this TUM initiative by a 6.5 million euro donation not subject to any conditions or expectations. Read more...

IEAI's mission and approach

Interdisciplinary work to achieve „Human-Centered Engineering“





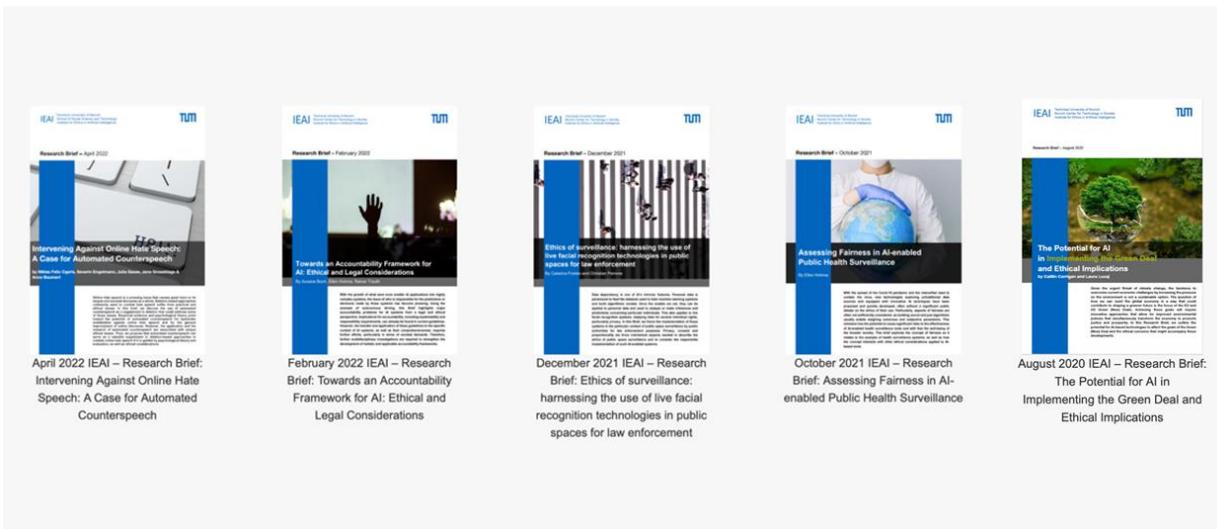
A few research highlights

- **Towards an Accountability Framework for AI Systems** (IEAI/Fujitsu)
- **Ethics for the Smart City: Applied socio-technical frameworks to assess the implementation of AI-related solutions** (Governance/Engineering and Design)
- **MELISSA - mobile artificial intelligence solution for diabetes adaptive care** (EU Horizons Funded Project)
- **ANDRE – AutoNomous DRiving Ethics** (Institute for Automotive Technology/Governance)
- **The Ethics and Practice of AI Localism at a time of COVID-19 and beyond** (TUM School of Governance/NYU Gov Lab/University of Melbourne)
- International Future Labs for Artificial Intelligence - **Artificial Intelligence for Earth Observation: Reasoning, Uncertainties, Ethics and Beyond** (BMBF - Aerospace and Geodesy/Data Science Institute/IEAI/DLR)
- **Online-Offline Spillovers – Potential Real-world Implications of Online Manipulation** (Informatics/Governance)



For the interested listener

The IEAI publishes bi-monthly Research Briefs on different topics related to AI.





THE _____ Singapore – September TBD

RESPONSIBLE AI FORUM 2023



ISBEE
International Society
of Business,
Economics and Ethics

IEAI





....but let's get to
Business (ethics)



Important Information about the Lecture

The lecture will take place from 13th of December to 8th of February:

Tuesday **11.30 a.m. – 01.00 p.m.**

Wednesday **01.15 p.m. – 02.45 p.m.**

Location: [0980, Audimax \(0509.EG.980\)](#)

The lectures will be recorded and uploaded to Lecturio.

All relevant information about this lecture is stated on TUM Moodle.



Information on the Exam

- Module “Foundations of Entrepreneurial & Ethical Business”: **Exam date: February 17th, 16.30-18.30** (120 minutes)
- You need to register for the exam (in addition to the lecture)!
- **Written exam with physical presence** (exact room: tbd.)
- 100 % multiple choice questions (1 out of 4 answers is right – see quizzes!)
- 100 single-choice questions in total; 50 questions from the Business Ethics part

What is relevant?

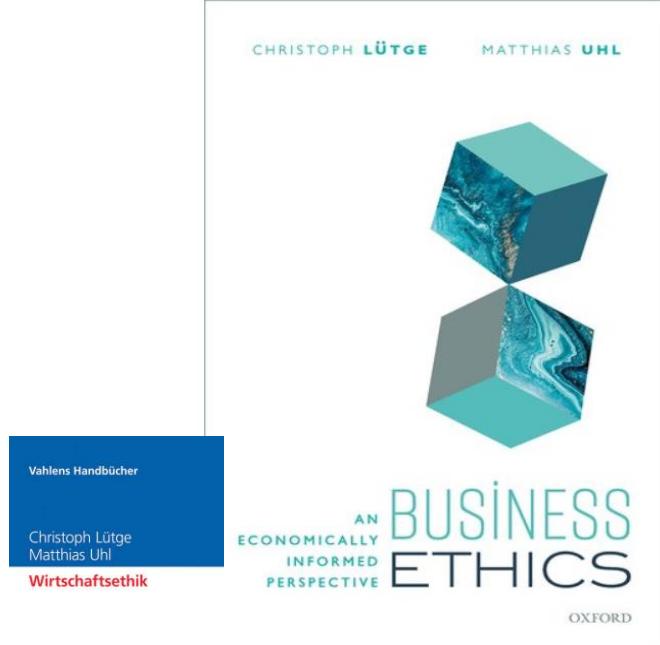
- **All content provided:** Live sessions, audio slides with exercises, guest lectures, video links on moodle (unless indicated otherwise)!
- No exact numbers and statistics



Recommended Literature

Christoph Lütge & Matthias Uhl
Business Ethics: An Economically Informed Perspective

Munich: Oxford 2021





Why have an economically informed perspective?

„[T]he **economic component** is not merely an adjunct, but of **great relevance for business ethics**. In this book, not only are classical economic methods and results called upon in many places, but also experimental studies, their findings, and approaches. We believe that this results, in many ways, in a **new conception of the phenomena of business ethics.**“



Overview of the Lecture:

Introduction

Chapter 1: Business Ethics in the Age of Globalization

Chapter 2: Basic Concepts

Chapter 3: Historical-economic Background: Premodernity and Modernity

Chapter 4: Foundations and Tools of Business Ethics

Chapter 5: Problem Areas of Business Ethics

Chapter 6: Corporate Ethics*

*we will also invite guest speakers, which we will announce soon



Focus of today

Introduction

Chapter 1: Business Ethics in the Age of Globalization

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Introduction

Why Business Ethics? (1/4)

- In 2018, up to 1.1 m people died from AIDS-related diseases
- 70% of them are from countries of sub-Saharan Africa
- Worldwide HIV could be confined through antiretroviral medication

What obligations do Western pharmaceutical companies have to supply Africa with antiretroviral medications?



Source: wikipedia.org

Why Business Ethics? (2/4)

- In 1981, American Express developed a campaign according to which the company gave 2 cent to charity for each credit card transaction.
- Credit card returns increased by 28 percent.

Can Corporate Social Responsibility become a business case?



Source: wikipedia.org



Why Business Ethics? (3/4)

- **The Millennial Factor:** „86 percent of millennials consider it a main priority to work for a business that conducts itself ethically and responsibly. In fact, most millennials would be willing to take a considerable pay cut to work for such a business.”

Is Corporate Social Responsibility key to attract and retain top talent?

How Much Do A Company's Ethics Matter In The Modern Professional Climate?

Larry Alton Former Contributor @
I cover changes to the American workplace.

Sep 12, 2017, 01:30pm EDT

⌚ This article is more than 5 years old.



How Much Do A Company's Ethics Matter In The Modern Professional Climate? PEXELS.COM

More than ever, a company's success depends on the talent it's able to attract, but attracting the best talent is about more than just offering the best salary—or even the best benefits. Companies may have a lucrative

Source: Forbes, 2017



Why Business Ethics? (4/4)

The collage consists of three overlapping screenshots:

- Top-left screenshot:** A news article from **TECH MONITOR** titled "Digital power: How Big Tech draws its influence". The text discusses how society needs new approaches to govern Big Tech because it is powerful in ways we haven't encountered before.
- Middle screenshot:** A research article from **frontiers in Research Metrics and Analytics** titled "Artificial Intelligence and Blockchain: How Should Emerging Technologies Be Governed?". It features a circular graphic with segments labeled "Research Policy and Strategy" and "Management".
- Bottom-right screenshot:** An article from **pwc** titled "Tech's wake up call: with great power comes great responsibility". The text by Dr. Celine Herweijer and Benjamin Combes discusses the responsibility of tech giants. A quote at the bottom states: "With great power comes great responsibility. This aptly describes where today's tech giants find themselves."

Does the fast technological progress & increasing power of companies demand more responsible self-regulation?

...but do companies have the power to shape technology?

Traditional views of technology

Technologies' meaning, influence and direction is **solely constructed by society** and society's desires.

→ technology can be considered as a '**blank slate**' or **neutral object** waiting to gain meaning and values through human interaction (e.g., Drake et al., 2000; Herschel & Andrews, 1997).

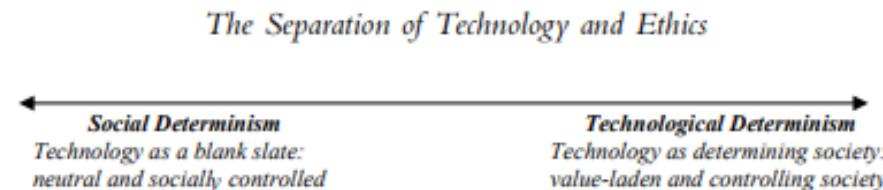


Figure 1. Traditional views of technology.

"**Technology** develops as the sole result of an **internal dynamic** and then, unmediated by any other influence, **molds society to fit its patterns**" (Winner, 1986).

→ individuals are turned into 'cogs in the machine' (Allinson, 1998) or 'slaves to artefacts' (Ellul, 1962); technomoral artefacts (Vallor, 2015)

Yes, companies do have the power to shape technology.

Updated view of technology

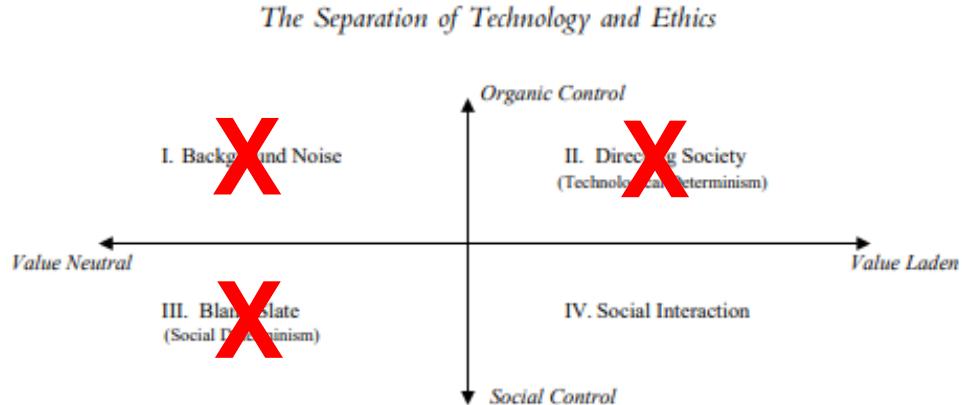


Figure 2. Technology as...

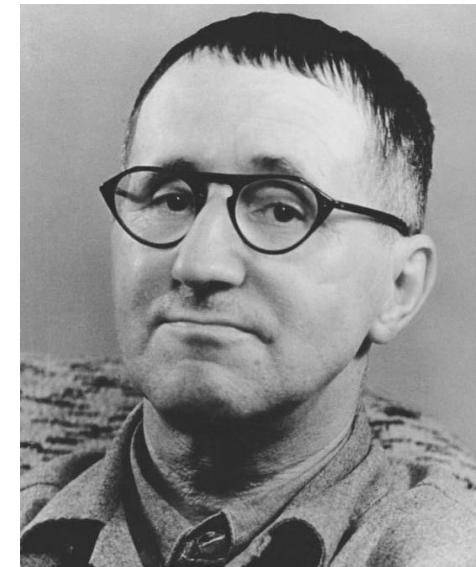
- Technology does hold inherent values but these can be controlled by society.
 - Neither technology nor society possess sole dominance over the other, rather they co-shape each other.
- Companies' responsibility increases: "[T]he controlled development and design of technology becomes paramount within a corporation".

Source: Martin & Freeman, 2004

General Perception (1/3)

Public perception is coined by virtue ethics:

- "Greed": Main cause of economic misconduct
- Distrust of certain population groups such as bankers, speculators, "grasshoppers", etc.
- Bertolt Brecht: "Bankrobbery: An initiative by the unprofessional. A true professional founds a bank."

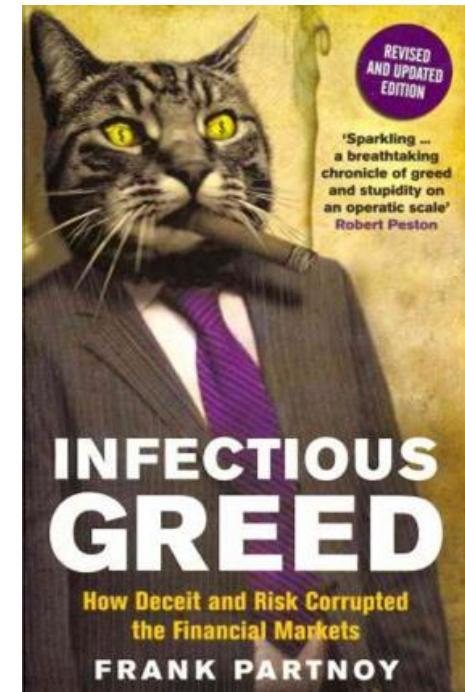
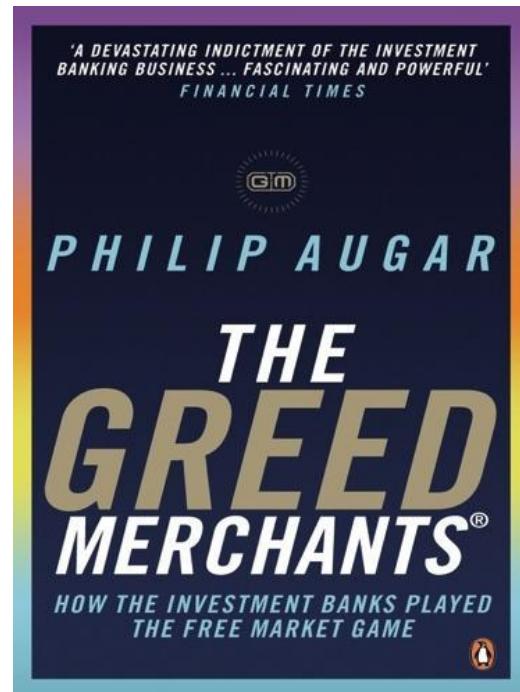
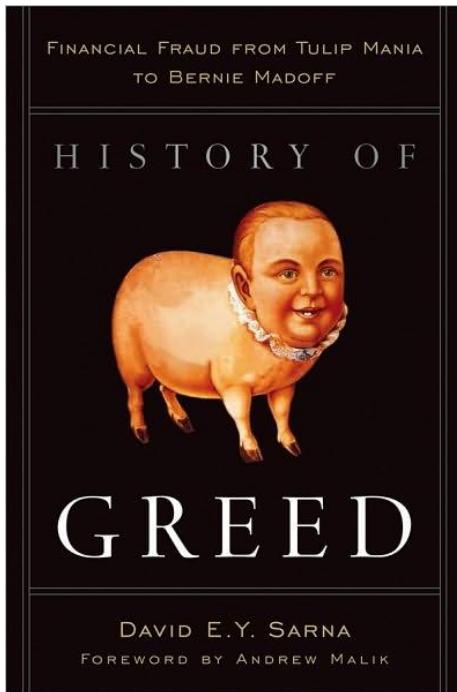


➤ Criticism targets involved actors and not structures

Source: wikipedia.org



General Perception (2/3)





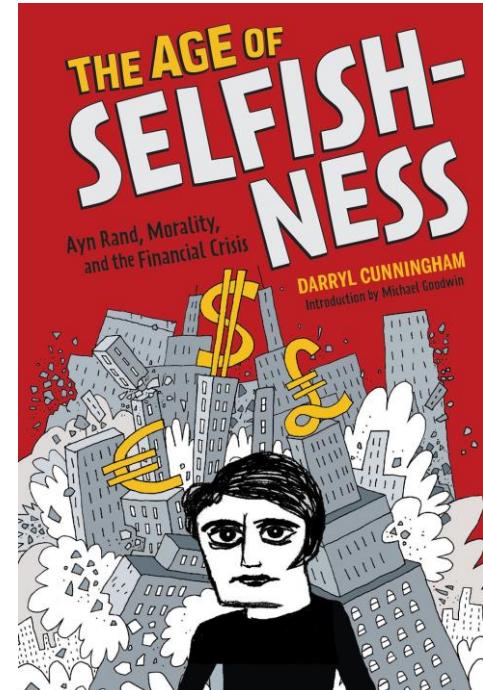
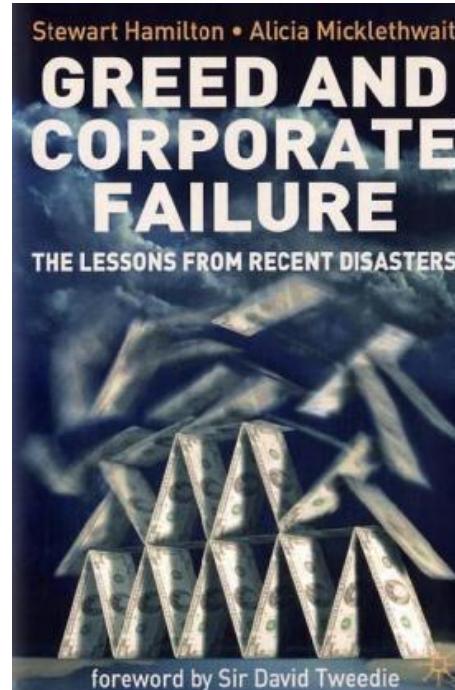
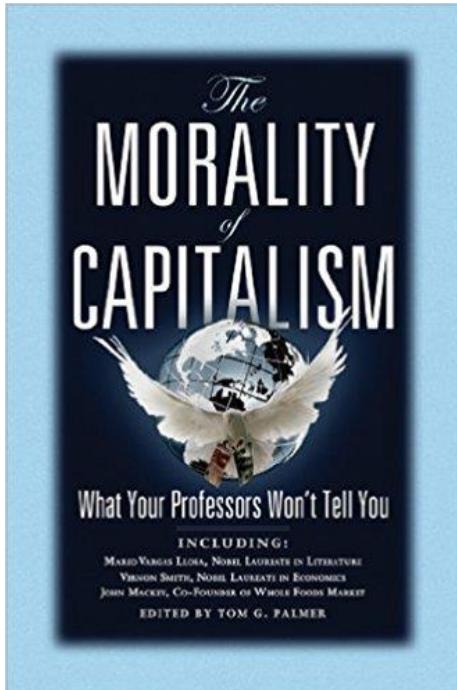
Peter Löscher Chair of Business Ethics

TUM School of Social Sciences and Technology

Technical University of Munich



General Perception (3/3)





Some statistics

Costumers' demand: More ethical practices by companies

- Barclays' study on "Reshaping retail – How ethics and sustainability are changing retail's ecosystems":
- Around 63% of customers surveyed in the study said they want to see the industry make further sustainable and ethical changes.
- 52% of consumers said the ethical and sustainable credentials of a business will be an essential factor for them when choosing what to purchase.

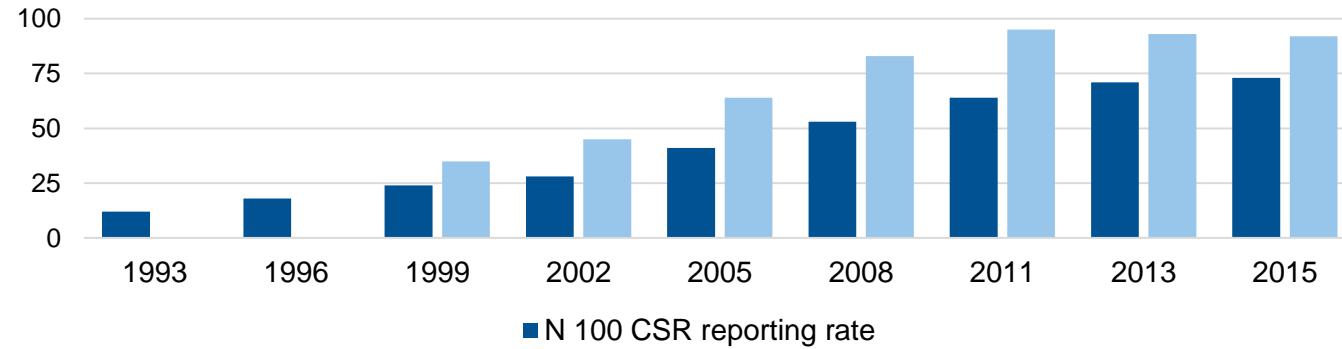


Source: Barclays, 2022; Soocial.com

CSR Reporting Development

CSR reporting rate of the 250 biggest companies worldwide:

Increase from 35% in 1999 to 95% in 2011



Source: KPMG Survey of Corporate Responsibility Reporting 2015



On an individual level (misconduct) reporting rises, too.

- Ethics.org report on ethics and compliance (2020): Around **8 in 10 employees** worldwide **report misconduct** nowadays
- Examples of the most common forms of observed misconduct included **lying** and **favoritism**
- BUT simultaneously, “there seems to be a growing issue with retaliation in response to employees reporting misconduct”: Around 61% of global employees report that they have experienced retaliation as a result.

Source: Ethics.org, 2020; Soocial.com



The Ford Pinto Case

Ford Pinto (1/7)

- Car of the **lower compact class**, developed by Ford in the 1960s as a reaction to the first Japanese compact car and the popular German Volkswagen "Käfer"
- Introduction in 1970
- Price 2,000 USD
≈ 11.400 EUR in 2018



Source: wikipedia.org

Ford Pinto (2/7)

Problem

- Fuel tank behind the rear-wheel
 - Thus damage caused by rear-end collisions at low speed
 - Possibility of leaking fuel, danger of explosion
- Engineers hinted to the problem
- Managers reasoned about the costs

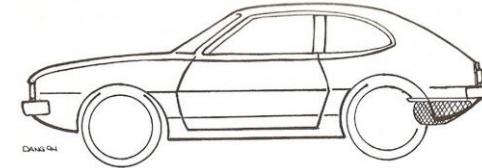
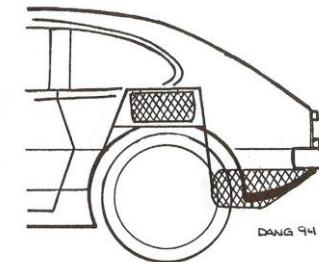


FIGURE 1
This diagram shows the placement of the fuel tank in the Ford Pinto.



Source: automotopad.com



Ford Pinto (3/7)



Source: youtube.com

Ford Pinto (4/7)

Question to Ford: Protecting rubber shell for the fuel tank?

Cost calculation:

- Fitting costs: 11 USD/vehicle for 12.5 m scheduled cars
⇒ **137.5 m USD**
- Costs, if not attached (Calculation of the Ford-statisticians):
 - 2,100 burning vehicles (average time value 700 USD)
 - 180 dead (official „indication of value“ by the US Government at that time: 200,000 USD)
 - 180 heavily injured (insurance claimed „value“ 67,000 USD)⇒ **49.5 m USD**



Source: barfblog.com

Ford Pinto (5/7)

Decision: No rubber shell

In the following years after the decision

- ca. 60 lethal accidents
- ca. 120 heavily burn injured people
- 117 lawsuits were brought against Ford
- Pinto was withdrawn from the market 1980



Source: cjsmith96.wordpress.com



Ford Pinto (6/7)

Decision: No rubber shell

Ethical evaluation?

- No contravention (prevailing rule, tank has to remain intact at the speed of 20 mph was implemented)
- Pinto was "statistically" as secure as every other compact vehicle (according to Ford)
- Human life is constantly evaluated
- Increased safety measures in traffic, e.g. backfitting of older cars with airbags?
- 11 USD per vehicle are still 0.5 percent of the sales



Ford Pinto (7/7)

Problems for Ford

- Loss of reputation, especially when the calculation was discovered
- Trial against Ford
 - First US Corporation accused of manslaughter
 - No conviction
 - However: five months after the case, the Pinto production was stopped for good.
- Starting point for Corporate Social Responsibility (CSR)
- Long-term ethics and commercial success compatible



Article recommendation

The Ford Pinto case & missing moral awareness

Pinto Fires and Personal Ethics: A Script Analysis of Missed Opportunities

Dennis A. Gioia

ABSTRACT. This article details the personal involvement of the author in the early stages of the infamous Pinto fire case. The paper first presents an insider account of the context and decision environment within which he failed to initiate an early recall of defective vehicles. A cognitive script analysis of the personal experience is then offered as an explanation of factors that led to a decision that now is commonly seen as a definitive study in unethical corporate behavior. The main analytical thesis is that script schemas that were guiding cognition and action at the time precluded consideration of issues in ethical terms because the scripts did not include ethical dimensions.

difference. My initial job title was “Problem Analyst” — a catchall label that superficially described what I would be thinking about and doing in the coming years. On some deeper level, however, the title paradoxically came to connote the many critical things that I would *not* be thinking about and acting upon.

By that summer of 1972 I was very full of myself. I had met my life’s goals to that point with some notable success. I had virtually everything I wanted, including a strongly-held value system that had led

Table 2. Benefits and Costs Relating to Fuel Leakage Associated with the Static Rollover Test Portion of FMVSS 208

Benefits
<i>Savings:</i> 80 burn deaths, 180 serious burn injuries, 2,100 burned vehicles.
<i>Unit cost:</i> \$200,000 per death, \$67,000 per injury, \$700 per vehicle.
<i>Total benefit:</i> $180 \times (\$200,000) + 180 \times (\$67,000) + 2,100 \times (\$700) = \$49.5$ million.
Costs
<i>Sales:</i> 11 million cars, 1.5 million light trucks.
<i>Unit cost:</i> \$11 per car, \$11 per truck.
<i>Total cost:</i> $11,000,000 \times (\$11) + 1,500,000 \times (\$11) = \$137$ million.





What is the value of life?



Value of life – a few calculations...(1)

NHTSA in 1972

• Future Productivity Losses	173,300	
• Medical Costs	1,125	
• Property Damage	1,500	\$ 200,725 in 1972
• Insurance Administration	4,700	$\triangleq \$ 1,175,471$ in 2017
• Legal and Court	3,000	$\triangleq € 999,354$ in 2017
• Employer Losses	1,000	
• Victim's Pain and Suffering	10,000	
• Funeral	900	
• Other	5,200	
		\$ 200,725

Source: Dowie 1977/1994, p. 26



Value of life – a few calculations...(2)

Market value of body

• Oxygen (O)	ca. 63%	133.48	
• Carbon (C)	ca. 20%	713.00	
• Hydrogen (H)	ca. 10%	0.02	
• Nitrogen (N)	ca. 3.0%	120.00	€1,022.45 in 2008
• Calcium (Ca)	ca. 1.5%	20.85	≈ € 1,037 in 2017
• Phosphor (P)	ca. 1.0%	13.90	
• Potassium (K)	ca. 0.3%	10.25	
• Sulfur (S)	ca. 0.2%	8.00	
• Other	ca. 1.3%	2.95	

€ 1,022.45

Source: Klarne 2008, p. 68



Conclusion

- Some misconducts in the past and the increasing power of companies highlight the relevance of business ethics.
- Additionally, consumers demand and companies acknowledge the increasing importance of corporate social responsibility.
- To what extent business ethics becomes ever more important in the age of globalization will be the next focus in this lecture.



Introduction to Business Ethics: Business Ethics in the Age of Globalization

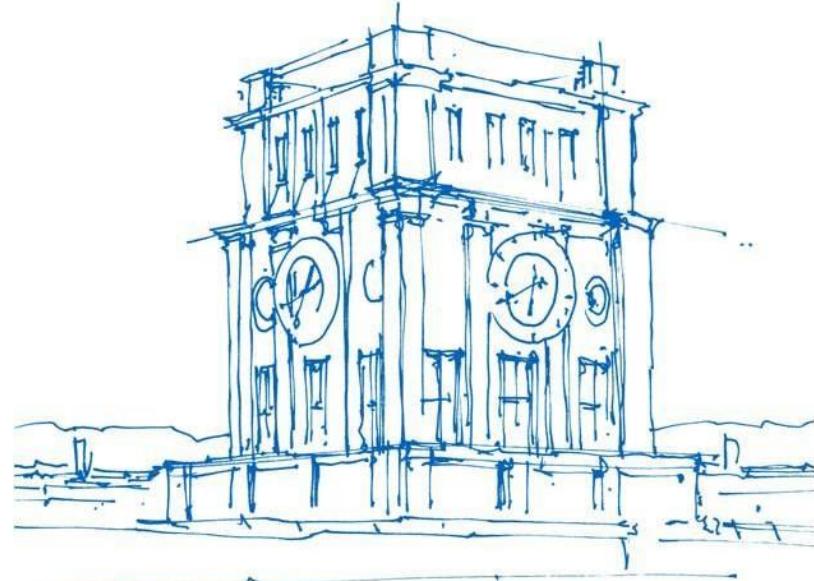
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Chapter 1

Business ethics in the age of globalization

1.1 The phenomenon of globalization



Globalization and Business Ethics

What is globalization?

What are the assumed effects of globalization on normative concepts?

What do empirical studies say concerning the effects of globalization?

What are the causes for problems associated with globalization?



What is globalization

Value-free perspectives:

- Globalization is “the extension of social relations across world-space.” (Paul James)
- Other definitions include not only economic but also political, technical and cultural phenomena (Giddens, 1999)

Value-laden perspectives:

- Globalization is “a doctrine for the promotion of neoliberalism” (Chomsky, 2006).
- “A scam perpetrated against everyone by powerful groups.” (Wallerstein, 2000)



The Characteristics of Globalization

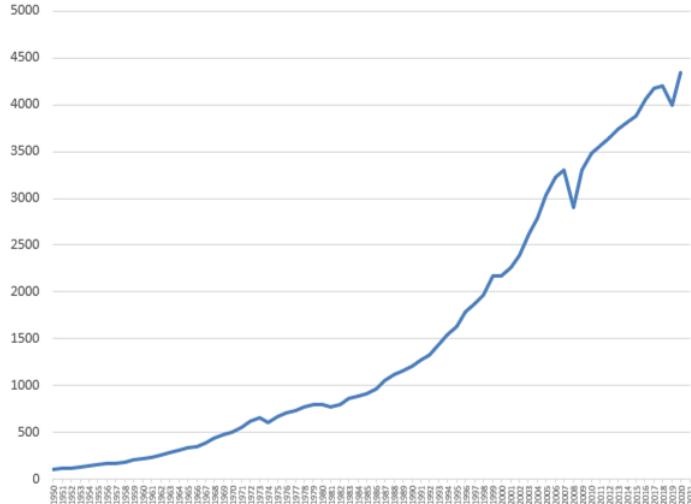
To eliminate potential biases, we take a step back and define globalization as:

“Increase of commercial and social ties on a global level.”

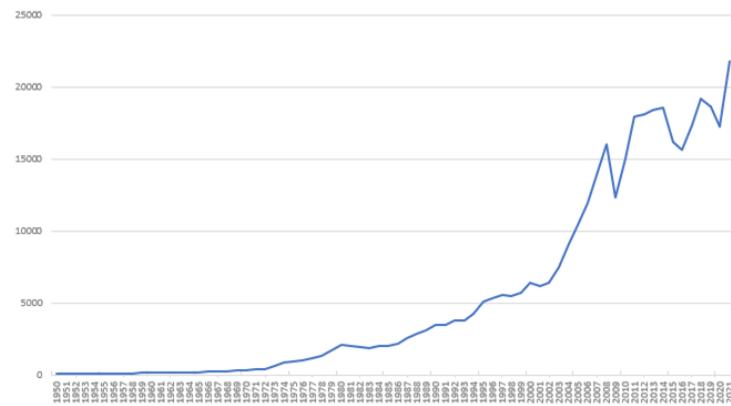
The ethical judgement of “the increase of commercial ties between different economic actors” depends on the assumed properties and effects of globalization and on the “models of mind” we employ to judge these effects and properties.

Evolution of world trade, 1950-2021

Volume index, 1950 = 100



Values, Billion uSD



Source: WTO, 2022

The properties of globalization

- *Denationalization*: The borders of nation states are becoming more permeable to **goods, travel and financial transactions**.
- *Deterritorialization*: Culture (e.g. food, music, fashion) is **less tied to geographical areas or nation states**.
- *Reduction of spatial and temporal distances*: New technical developments (Internet, mobile telephony, high-speed trains, air traffic) **minimize spatial distances**.
- *Interconnectedness*: **People interact across borders** and increasingly exchange.



Source: Wikimedia Commons

The first wave of globalization

Milestones of the modern phase of globalization:

- First multinationals (Dutch East India Company; 1602-1799)
- Discovery of mass production (economies of scale) and population growth → increased demand for consumer goods
- Temporary peak of globalization before World War I.

Implication:

We should not regard globalization as a completely unique phenomenon in history, but rather as expression for higher levels of global integration.



Source: Wikimedia Commons



The current wave of globalization

After World War II and in the wake of de-colonialization, the current wave of globalization began:

- Conferences in Bretton Woods and Dumbarton Oaks (1944): Foundation of the United Nations, the World Bank, and the International Monetary Fund.
- Collapse of the USSR (1989-1991) and Economic Opening of China (1978-1990)
- New technological achievements (such as digitization) strengthen the interconnectedness of the global economy (“the extension of social relations across world-space”)
- Globalization is a comprehensive phenomenon and rests on economic, political, ecological and cultural pillars.



Chapter 1

Business ethics in the age of globalization

1.2 The implications of globalization for business ethics



Cultural Aspects

Cultural Diversity and Globalization:

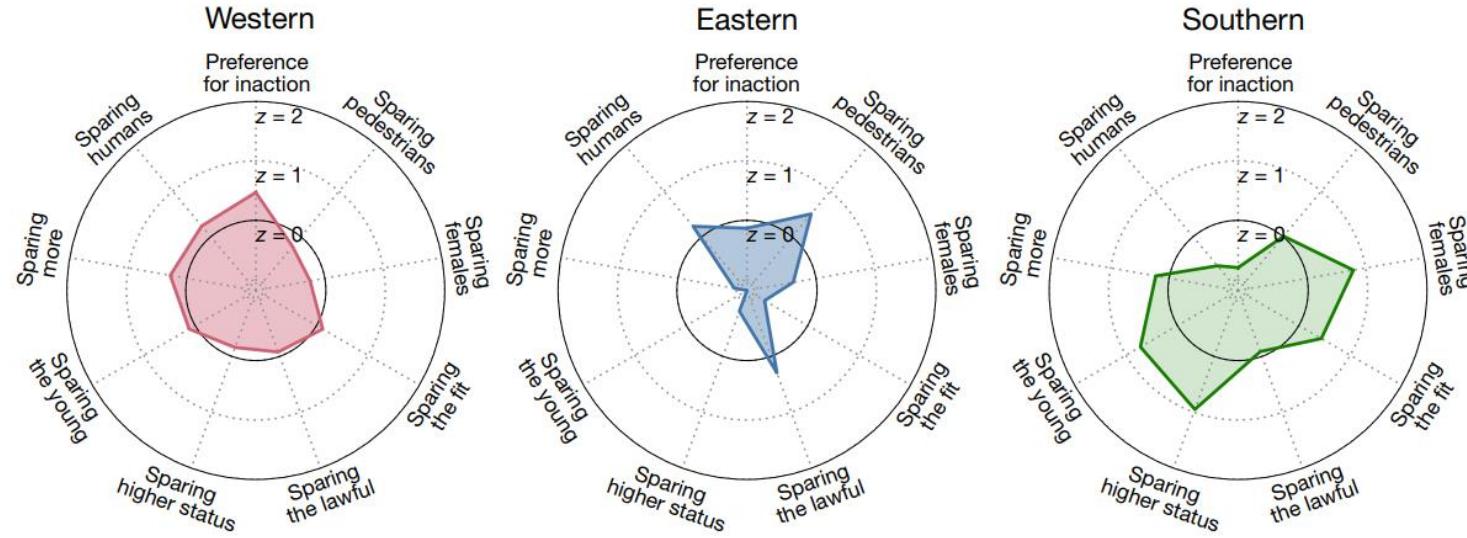
- Diversity within nation states increases [150 million migrant workers worldwide (ILO, 2003)]
- Diversity among nations states decreases [e.g. increasingly similar business practices, dominance of the English language, global brands such Apple, BMW, Starbucks, Subway (presence in 119 states) etc.]

Implications:

- Likelihood for cultural clashes rises (even within the same national culture)
- Increasing modernization and multi-culturalism might be tougher challenge which developed more rapidly than Western countries. → “overarching values” are likely to play a more pronounced role in future.

Cultural Aspects

Value pluralism and its challenge for virtue ethics



Source: Awad et al. 2018



Political Aspects

Emergence of international organizations:

Regionalization and new political organizations (EU, ASEAN)

Tendency towards Global Governance (United Nations, WTO, OECD)



Consequences:

Declining number of war casualties since the end of the Cold War. (Peace Research Institute Oslo)

International Labor Migration: As early as 2003, 150 million migrant workers worldwide (ILO, 2003)

Implication:

International organizations and economic globalization reinforce each other. Without international agreements trade would be much more difficult. More trade leads to a higher demand of standardization.



Economic Aspects

Main factors of economic integration:

Foreign trade and investment → outsourcing and offshoring [Trade as part of world GDP: 19,8% (1960) vs. 53,3% (2008)]

Increase in number of multinationals worldwide [9,000 (1990) vs. 65,000 (2000); 30% of world trade is company-intern]

Regulatory changes:

The global average tariff rate has fallen from 45% to 5%. (Fifka, 2013)

285 regional trade agreements worldwide. (Statista, 2018).

Implication:

Closer economic interaction drives global standardization and regulation processes (interdependences create institutions).



Ecological Aspects

Negative externalities and overuse of resources:

Negative externalities of “interconnectedness”: Increase of CO2 emissions (number of passenger kilometers has increased one hundredfold from 1950 to 2008) → driving factor of climate change.

Problem of scarcity: Crude oil consumption increased from 60 million barrels per day (1980) to 99.6 million barrels per day (2018).

Consequences:

Environmental Kuznets Curve Hypothesis postulates an inverted-U-shaped relationship between CO2 emissions and per capita income (environmental pressure increases up to a certain level as income goes up; after that, it decreases).

Growing polarization over environmental policies (industrialization in developing countries) and different interests (maybe also perceptions) concerning environment protection.

Emergence of a global civil society and globally acting NGOs (e.g. Greenpeace)

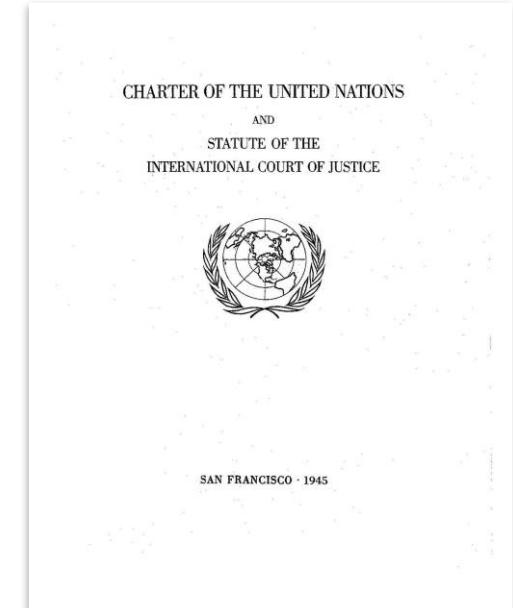


Globalization: Finding Collectively Binding Norms

Finding collectively binding norms is also more difficult than in the case of nation state legislation:

- American/Western unilateralism vs. multipolar vision of international affairs (BRICS)
- Sovereignty vs. human rights
- Sanctions as a legitimate part of economic statecraft?
- Humanitarian interventions

International law as we know it today is influenced by Western elites and based on European experiences (e.g. Balance of power, secularism, human rights and interventionism)





Globalization: Norm Enforcement

Prisoner's dilemmas in international relations appear not only in trade conflicts but also in other areas such as protectionism, nuclear proliferation (cf. Iran, North Korea), environmental issues and intellectual property legislation.

- In difference to the nation state level, it is more difficult to find a common ground for international governance, due to power asymmetries, conflicting interests and clashing norms.
- From an institutional ethics perspective, anarchy (the lack of common institutions, which are able to legislate and realize norms) is one of the key problems of globalization.



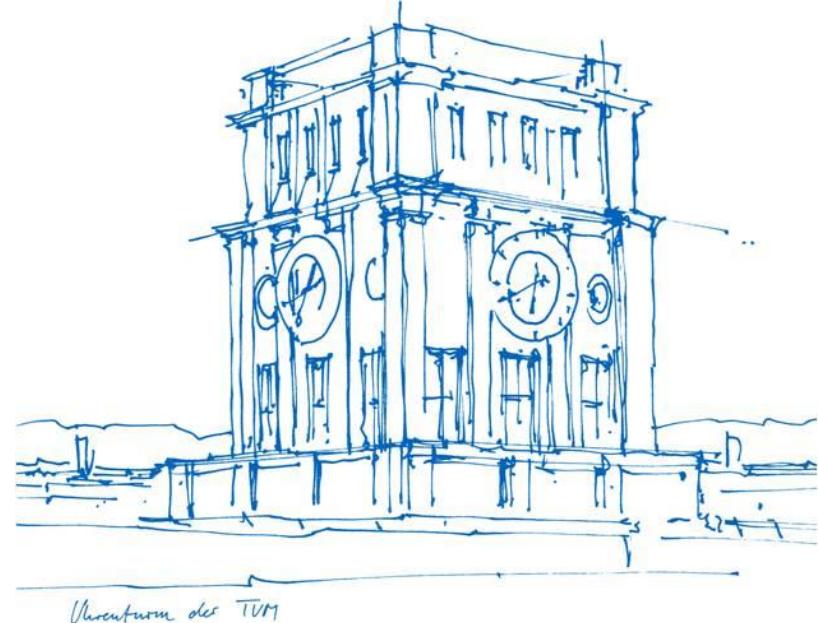
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Chapter 2

Basic Concepts

2.1 Problems in Business Ethics as Interaction Problems

Robinson Crusoe and Friday



Robinson Crusoe alone on an island:
Daily struggle for survival
Scarcity as biggest problem
Producer and consumer at the same time →
"Robinson Economics"

FRIDAY COMES INTO PLAY

Two individuals are competing for limited resources
Scarcity becoming a problem of social interaction
→ Interaction problem as economic problem



Basic Elements of Problems in Business Ethics

1st Element:
At least two actors

2nd Element:
An environment of scarcity

- **Scarcity leading to conflicts**
- Focus on interaction of individuals
 - Individual problems becoming social problems
 - How to respond to conflicts? Possibilities: fighting, sharing, cooperating

- **Business Ethics begins when Friday arrives on the island**



Cooperation as a Solution to Scarcity Problems (1/2)

There are two approaches to think about scarcity problems

1. Criterion of **Distributive Justice**: How should a given cake be split?

Existing quantity of goods is given

Distribution based on rules

Criterion is usually to get a result as **equitable** as possible

- Distributional issues treated in isolation, however: problem of scarcity itself is not addressed and persists



Cooperation as a Solution to Scarcity Problems (2/2)

There are two approaches to think about scarcity problems

2. Criterion of **Allocative Justice**: How can we improve the supply of goods quantitatively or qualitatively to satisfy more demand than before?

Best possible allocation of scarce production factors (labor, raw materials, capital, etc.) is crucial, in order to increase yields

Determine which scarce production factors should be allocated and used to satisfy demands

- Gains from cooperation mitigate the problem of scarcity



Allocation Problems in Economics (1/2)

Scarcity problems should be understood as allocation problems to counteract scarcity problem

Connection to economics

Interdependence of production and distribution; have to be discussed simultaneously. (different distribution of "cake" influences its size)

Shareholders invest in the production of goods or services and anticipate return on their investment

- Efficient allocation of means of production through redistribution that causes little distortions in incentive mechanisms



Allocation Problems in Economics (2/2)

Example: Economic Policy

Governments redistribute wealth and income by levying taxes and social security contributions including the payment of social benefits

Which criteria (equity, equality etc.) do we use to arrange redistributions?

Which combination and distribution of produced goods does maximize productivity?

How can we prevent undesired effects such as free-riding or negative externalities?

➤ Institutional design determines whether gains from cooperation can be achieved



Limits of Individual Moral Actions

Example: The virtue-ethical question "What should I do?" makes Robinson to give up half of his stocks to Friday.

Result: Nobody gets enough to eat.

“It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.“

(Adam Smith, "Wealth of Nations", 1846, p. 26)

➤ **Decoupling** of motive and result → **morality** is interpreted as an **unintended result of intentional action**



Outcome for Business Ethics

Solution: Business Ethics should not be based on actions and their motives, but on the **conditions** under which actions are carried out.

Reasons

1. Individual virtues cannot overcome structural problems
2. Problems in Business Ethics are by nature **interaction** and **interdependence problems**
3. Conditions of the modern world:

Rising degree of complexity in economic relations

Prevalence of mutual interdependences between individuals, firms and nation states



Chapter 2

Basic Concepts

2.2 Ethics and Economics –
Definitions and Methodological Deductions

Classification of Philosophy (1)

- Theoretical Philosophy

What does exist? (Ontology)

What is the order of the world? (Metaphysics)

What can I know? (Epistemology, Philosophy of Science)

What is the relation of language and reality?

(Philosophy of Language) ...

- Practical Philosophy

What should I do? (Ethics)

What is the best means to achieve an end? (Economics)

What is the best order of society? (Political Philosophy)

- History of Philosophy



Source: tetrakty.de



Classification of Philosophy (2)

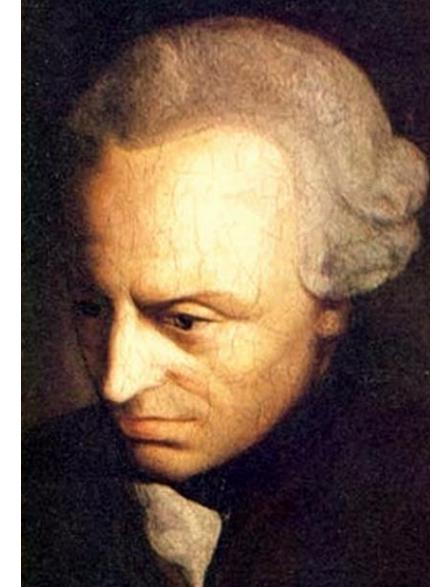
Immanuel Kant

1724 – 1804

German philosopher

According to Kant, philosophy ultimately aims at answering three questions:

“What can I know? What should I do? What may I hope?”



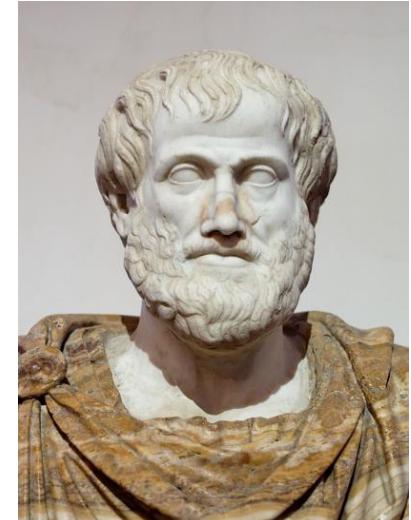
Source: Immanuel-kant.net

Ethics and Ethos

Basic idea of "ethos":

- "ἔθος" = originally: Space of living, position, horse stables, then also: habit, custom, tradition
- "ἦθος" = Character, disposition, custom, tradition, habit

Aristotle: Triad of politics, ethics and economics



Source: wikipedia.org

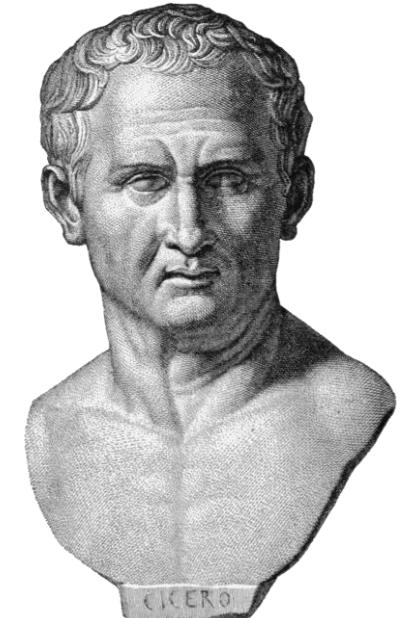
Ethics and Morality (1/2)

Since Cicero: Ethos/Conventions = "mores," → Morality

Colloquially often used interchangably:
"Ethics" instead of "morality"

Philosophical usage:

- **Morality** as a complex of rules and norms that determine people's actions in practice
- **Ethics** as theory of morality (reflecting on morality)



Source: wikipedia.org



Ethics and Morality (2/2)

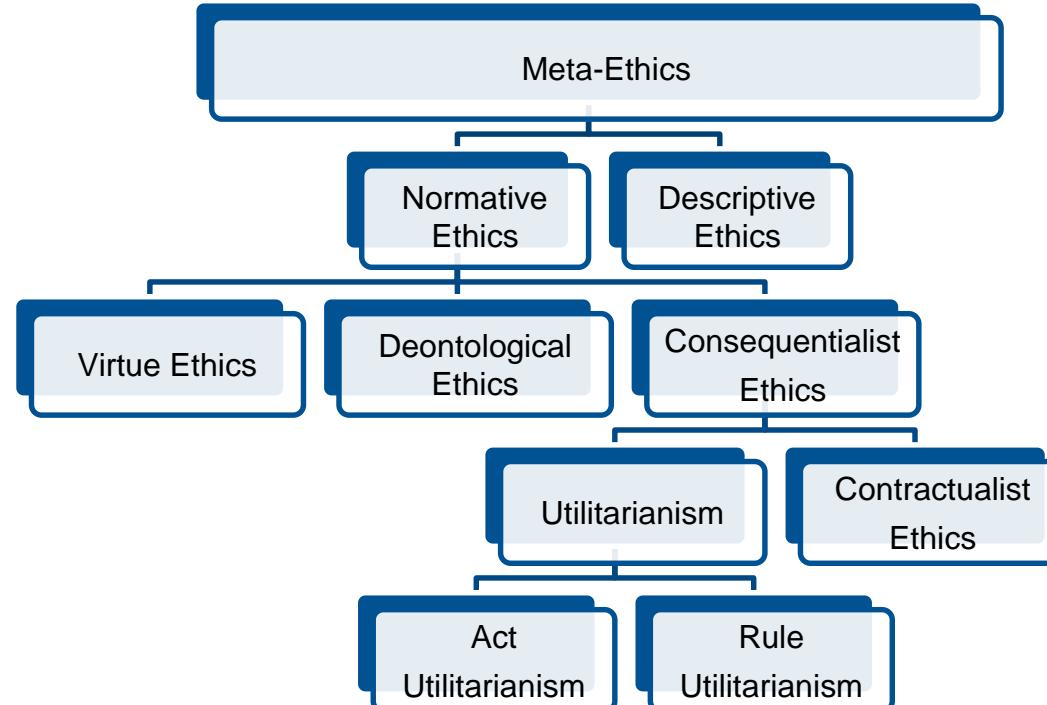
Morality:

Aggregate of rules of action, standards, norms, values, conceptions of significance that guide or ought to guide the actions of human beings

Determines actions or *ought* to determine actions

Violation leads to violations of oneself and/or others

Ethics - Overview





Descriptive, Normative and Meta-Ethics

Descriptive Ethics:

- Description, systematization und explanation of normative systems
- e.g. ethnology, moral psychology, evolutionary biology, behavioral economics

Normative Ethics:

- Ethics is the analysis of human conduct from the perspective of "good" and "bad" respectively "morally right" and "morally wrong"
- Similarly, evaluation of an economic order as "just" or "unjust"
- Different from psychology and humanities

Meta-Ethics:

- Focuses on nature of morality, often relies on semantic analysis of moral judgments
- Second-order theory examining the metaphysical, epistemological, semantic presuppositions of ethics such as difference between cognitivism and non-cognitivism (can moral statements be true?)
- Not directly related to content of rules or norms



Meta-Ethical Questions

According to Richard Garner and Bernard Rosen

(1967: *Moral Philosophy: A Systematic Introduction to Normative Ethics and Meta-Ethics*)

1. Moral Semantics:

What is the meaning of moral terms or judgments?

2. Moral Ontology:

What is the nature of moral judgments?

3. Moral Epistemology:

How may moral judgments be supported or defended?



Example: Different Levels of Ethics

"Human dignity is inviolable." (Article 1, German Constitutional Law)

Descriptive:

- According to the German Constitutional Law human dignity is inviolable.

Normative:

- No one, not even public authorities, ought to compromise human dignity. (Human rights!)

Meta-Ethical:

- What does "is" mean? Does the statement imply a normative meaning? Is an embryo a "human"? What about a corpse? What does "dignity" imply? Can it be reduced to physical integrity?

Different Types of Normative Ethics

Moral judgments based on...

Action as such

Purpose of action

Rationale behind action
(mens rea)

Conse-
quences of
action

Utility of action

...to be continued in the lecture on 10.01.2023!



Economy and Economics (1/2)

Economy

"Household": Domain of the discipline economics

Economics

Traditionally: Science of the domain "Economy"

- Meanwhile it comprises also phenomena such as culture, political offices, elections, education, family, phenomena of addiction, health

Nowadays rather characterized by certain methodology



Economy and Economics (2/2)

Economics

DEFINITION OF ECONOMICS

ECONOMICS DEALS WITH THE EXPLANATION AND DESIGN OF THE CONDITIONS AND CONSEQUENCES OF INTERACTIONS ON THE BASIS OF INDIVIDUAL BENEFIT / DISADVANTAGE CALCULATIONS.

(following Gary S. Becker, 1930 - 2014)

Sometimes described as "economic imperialism", initially understood in negative sense, later on adopted by representatives (such as Gary Becker) themselves



Business Ethics (1/2)

Two Concepts

1) Business Ethics as "Hyphenated Ethics"

Ethics "for the economy"

Just like Medical Ethics, Bioethics, Media Ethics, Engineering Ethics, ...

2) Business Ethics as ethics with economic method

Ethics viewed from a certain perspective:

- Implementation of norms: transfer of rules into (social) world

Morality is reconstructed by economic means



Business Ethics (2/2)

DEFINITION OF BUSINESS ETHICS

BUSINESS ETHICS IS A DISCIPLINE OF PRACTICAL PHILOSOPHY THAT EXPLORES WHICH NORMS CAN BE ESTABLISHED AND BROUGHT TO BEAR UNDER CONDITIONS OF MODERN SOCIETY.



Chapter 2

Basic Concepts

2.3 Situating Business Ethics in Philosophy



Ethics and Economics

Fundamental Contrast or Two Sides of Same Coin?



Two Options for Theory in Business Ethics (1/11)

Dualistic vs. Monistic Business Ethics

What ought to be done in light of conflicting demands for action?

e.g., shareholders vs. stakeholders

Fundamental contrast of

- Morality and Business
- Ethics and Economics



Two Options for Theory in Business Ethics (2/11)

Dualism vs. Monism

Dualism

Calls for decision on one position or at least "mediation" between both positions

Final aim: "domestication" of economy

Proximity to everyday intuitions of many if not most people



Two Options for Theory in Business Ethics (3/11)

Dualism vs. Monism

Dualism

Examples:

- Morality OR Economy
- Altruism OR Egoism
- Solidarity OR Competition
- Ecology OR Economy
- Common Welfare OR Self-interest
- Common Welfare OR Efficiency



Two Options for Theory in Business Ethics (4/11)

Dualism vs. Monism

Dualism

- Close to perception of human beings (shareholder's benefit from mass dismissals)
- Consequences: Appeals to conscience and postulation of values (prioritization of "moral values")
- Attribution of blame, search for culprits dominates discussion
- Question of norm implementation plays subordinate role



Two Options for Theory in Business Ethics (5/11)

Dualism vs. Monism

Examples for Dualistic View (1/2)

Karl Kraus (ca. 1920)

"You want to study Business Ethics? Then you have to decide on either Business or Ethics!"

Ulrich Döring ("Allgemeine BWL", FAZ 2010)

Making profit is ethical: Shareholder approach is right; morality in the economy is simply dysfunctional

„The Stakeholder approach tries to make entrepreneurs act morally via collective decisions at the round table. In business practice the discourse-ethical approach is doomed to fail. Customers, suppliers, investors, staff, and the public have conflicting concerns.“



Two Options for Theory in Business Ethics (6/11)

Dualism vs. Monism

Examples for Dualistic View (2/2)

Erich Fromm (1976)

"To Have or to Be"

Leaving the realm of "possession"; aiming towards an attitude of "being":

"True needs of the human being" vs. "Requirements of economy"

"Exploitation of nature by man" vs. "Cooperation between man and nature"

"Mutual antagonism between man" vs. "Solidarity"

"Maximum consumption" vs. "Reasonable consumption" (for benefit of human beings)

Two Options for Theory in Business Ethics (7/11)

Limit of Dualistic Approach: Problem of Implementation

Actors involved agree that postulated goal (e.g., implementing environmental protection) is desirable



Actors in competition comply with moral requirement

Reason:

If actors follow moral appeal, they are vulnerable to exploitation and expect to suffer competitive disadvantages



Two Options for Theory in Business Ethics (8/11)

Dualism vs. Monism

Monism

"Economics as a continuation of ethics by other means"

Central normative criterion:

Mutual improvement

Therefore, all parties can agree on certain rules

- Morality and Economics are considered two sides of the same coin.
Basis: modern understanding of economics



Two Options for Theory in Business Ethics (9/11)

Dualism vs. Monism

Monism

- Ethics can't make individuals work constantly against their own interest.
- Ethics has to show that acting according to moral rules is in the aggregate (not in an individual case!) more advantageous than breaking these rules



Two Options for Theory in Business Ethics (10/11)

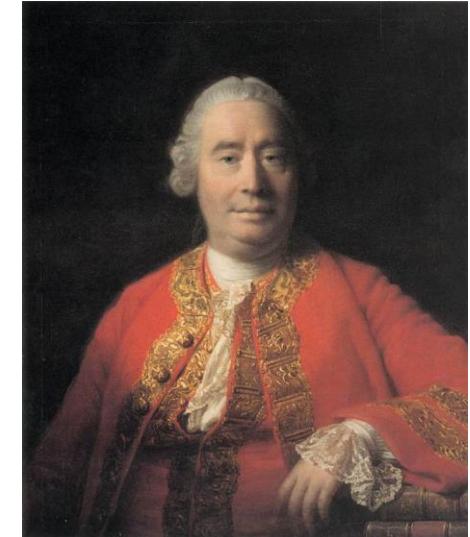
Dualism vs. Monism

Monism

Correspondence with **David Hume's** (1711-1776) view:

Finally, it is the aim of moral philosophy to show that all its demands are in the interest of the individual

Only with (general) advantages can one expect people to act according to moral norms in everyday life



Source: wikipedia.org

Two Options for Theory in Business Ethics (11/11)

Dualism vs. Monism

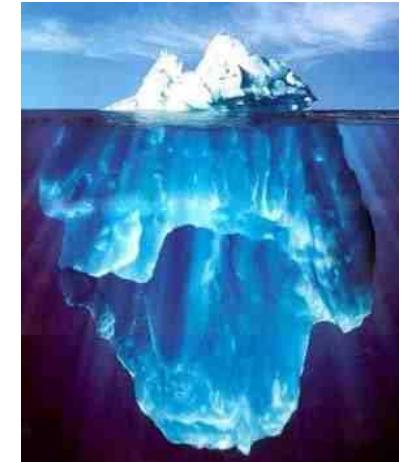
Monism

Morality is surface

(In daily life) ethical phenomena are just surface

Underneath (mutual) advantages are hidden

Nine tenth of iceberg are under water surface



What if competition does not lead to mutual benefits and does not increase benefits on aggregate level?



Term "Business Ethics"

German term "Wirtschaftsethik" without adequate equivalent in English

English:

"Business ethics"

"Economic ethics," → very uncommon

Corporate Social Responsibility = CSR

French:

"Éthique des affaires"

"Éthique de l'économie," → very uncommon



Ethics and Economics: Two Sides of Same Coin

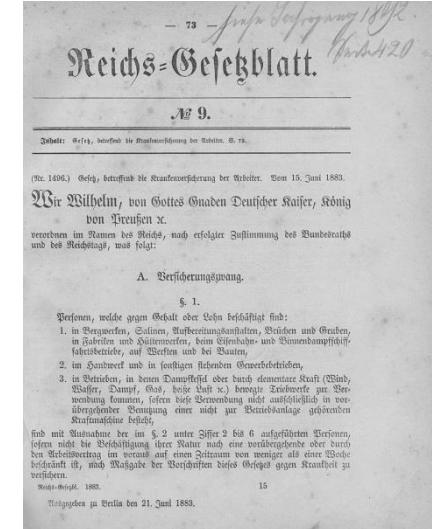
Coincidence of ethics and economics can be illustrated with debate over introduction of universal health insurance in USA

Ethical argument

Right to general primary health care regardless of income

Economic argument

Bad health conditions of working population are detrimental to economy as whole and create high opportunity costs



Source: wikipedia.org



Moral Quality of Economics

- Economics does not maintain its moral quality through individual moral acts – its moral quality is in overall system
- To understand and induce changes in system, actors (e.g., managers) need to be modelled as self-interested beings
- Moral concept of solidarity has to be implemented through suitable order framework



Relevance to Corporate Ethics (1/2)

Ideal:

Perfect economic condition/ framework (all actions fixed in details) →
Business ethics is systemically relevant

Real:

"Complete" framework is practically impossible due to dynamic nature of global markets → Corporate ethics is complementary to business ethics



Relevance to Corporate Ethics (2/2)

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



Parallelism of Corporate Ethics and Business Ethics

Two important aspects:

1. Business ethics (level of regulation) and Corporate ethics (level of action) must not be in conflict with each other
2. Dualism vs. Monism

What is relationship between profits and morality?



If companies and business partners anticipate that a company will be protected from insolvency due to its systemic relevance, the market risk premiums lose their significance and incentives are created for taking large risks at the expense of the general public.

➤ If morality is *systematically* implemented at the expense of profits, does it then have a realistic chance in the long run?

Risk of a Dualistic Corporate Ethic

Example: Klaus Stielmann (1929 - 2009)

German businessman who founded company "Klaus Stielmann GmbH & Co. KG" in 1958

Company evolved due to a strategy of low prices to one of the main players in Europe

Globalization put the company under strong pressure to lower costs starting from the 1990s

Stielmann kept his German staff despite their higher labor costs

Bankruptcy in 2006 could only be avoided because of a take-over by the Italian manufacturer "Radici-Group"



Source: wikipedia.org



Corporate Ethics as Risk Management (1/2)

Monistic Corporate Ethics:

Postulate of incentive-compatible implementability

Importance

Moral actions have to be reconstructed as self-interested actions

Moral missteps can involve high risk for the company's success

Example: Consumer boycotts

Result

Morality is part of entrepreneurial calculus

Moral behavior and pursuit of profit become two sides of the same coin



Corporate Ethics as Risk Management (2/2)

Reputation

- Goal: Represent yourself as reliable producer/trading partner
- Signaling reliability through collective or individual action
- Therefore, customer loyalty and maintenance of business contacts in absence of specific contracts
- Reputation serves as check on Opportunism





Three Types of Responsibility

Behavioral responsibility

Companies are responsible for their actions and resulting consequences.
(Compliance, product responsibility, advertising methods, etc.)

Regulatory responsibility

Entrepreneur is obliged to participate in improvement of the social or political order.

Discourse responsibility

Companies are called upon to participate in public discourse on social and political foundations of global society.



Introduction to Business Ethics: Historical-economic Background

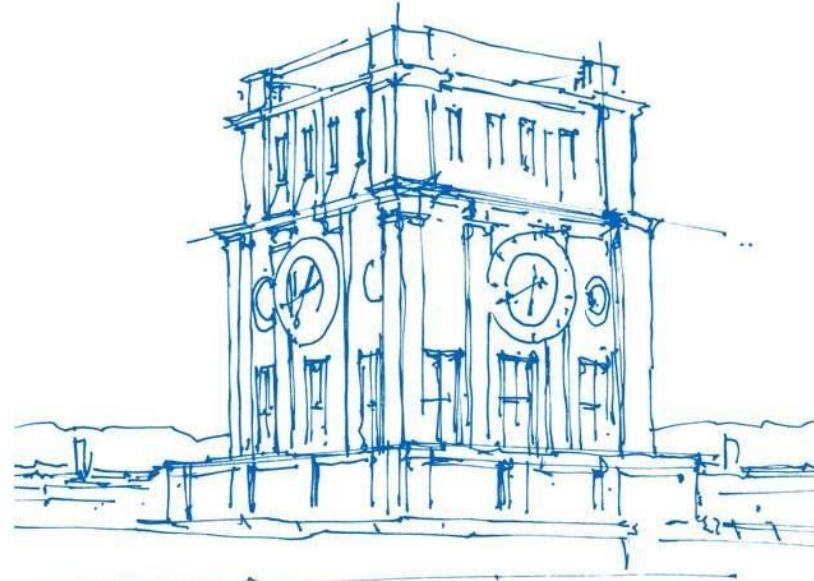
20./21. December 2022

Prof. Dr. Christoph Lütge

Peter Löscher Chair of Business Ethics

Technische Universität München

Winterterm 2022/23



Uhrenturm der TUM



Overview of Lecture:

Introduction

Chapter 1: Business Ethics in the Age of Globalization

Chapter 2: Basic Concepts

Chapter 3: Historical-economic Background: Premodernity and Modernity

Chapter 4: Foundations and Tools of Business Ethics

Chapter 5: Problem Areas of Business Ethics

Chapter 6: Corporate Ethics



Economic Conditions and Moral Norms

The validity of moral norms in business ethics depends (above all) on the prevailing economic conditions

- ❖ We can observe a strong change in the economic conditions and structures:
Premodern and modern worlds are systematically distinguished from each other
- ❖ Ethical concepts from philosophies of the past century are not easily transferable, as the historical developments of the last 200 years are unique
- ❖ Earlier ethical concepts were not wrong in themselves, but moral thought could not catch up with developments sparked by **technological and economic progress**



Economic Conditions and Moral Norms

Premodern societies are characterized by the following structural features:

1. Belief in a **predetermined** and unchangeable social order
2. **Societal organization according to estates** until modern times
3. Focus on **economic survival** and not on economic growth
4. **Low degree of social mobility** (e.g. slavery, guildes and castes)

In the following, we explore some of the features of **premodern society** in detail.

Historical Background (1/2)

Small communities and only a few isolates cities

(until 1000 AD: Only 10 cities with more than 100,000 inhabitants):

Rome (the largest city around 100 AD)

Cordoba (around 1000)

Beijing (from 1500 – 1800)

London (around 1900)



Low interregional communication options (Lütge, 2005): Interactions mostly among known individuals.

Adherence to moral norms is monitored through face-to-face control.

Source: Leo von Klenze, wikipedia.org

Historical Background (2/2)

External factors contributed to a high risk aversion:

- Strong reliance on agriculture for peasants and nobility
(cf. Garnsey et al., 2015)
- Objectives of the political economy: Self-sufficiency and protection from natural forces (risk aversion)
- Economy as a private affair (oikos = house; nomos = law)
- Premodernity saw famines with exceptionally high death tolls



Source: wikipedia.org



Social Classes in Antiquity

Moral values have supported and reinforced the **notion of an unchangeable and predetermined social order:**

"All of you in the city are certainly brothers,' we shall say to them in telling the tale, 'but the god (sic!), in fashioning those of you who are competent to rule, mixed gold in at their birth; this is why they are most honored; in auxiliaries, silver; and iron and bronze in the farmers and the other craftsmen."
(Politeia, 442, a-c)

- Ranking of professions and exclusion of particular groups from political / economic participation (guilds and casts)
- Belief in inherent class differences of human beings by nature



Economy and Growth in Antiquity

Moreover, the prevailing socio-economic conditions reinforced perceptions of the economy as a **zero-sum game**:

- ❖ Lack of economic growth throughout antiquity
- ❖ Winners of income distributions are either the "poor" or the "rich"
- ❖ Static income distribution: "The profit of one is the loss of another"
- ❖ Political consequence: Distribution struggles and political instability



Ethics of Behavior (1/2)

The prevailing conditions of premodernity heavily influenced moral norms:

Prevailing moral norms of premodern society

➤ Perception of society as zero-sum game:

"By being rich, I make others poor I may not even know."

(Giovanni Ruccelai, 1475 -1525)

➤ Virtue of moderation in consumption (as you might hurt others)
➤ Risk aversion (dependency on agriculture)
➤ Pivot to ethics of behavior (as you cannot change society)

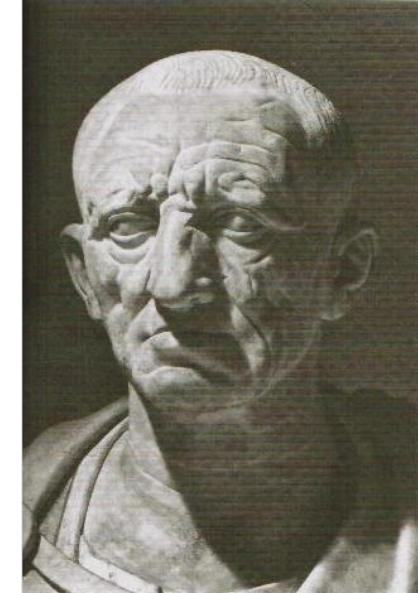


Source: wikipedia.org

Risk Aversion in Antiquity: An Example

"It is true that to obtain money by trade is sometimes more profitable, were it not so hazardous; and likewise money-lending, if it were as honourable. Our ancestors held this view and embodied it in their laws, which required that the thief be mulcted double and the usurer fourfold; how much less desirable a citizen they considered the usurer than the thief, one may judge from this. And when they would praise a worthy man their praise took this form: "good husbandman, good farmer"; one so praised was thought to have received the greatest commendation."

(Cato the Elder, De agricultura)



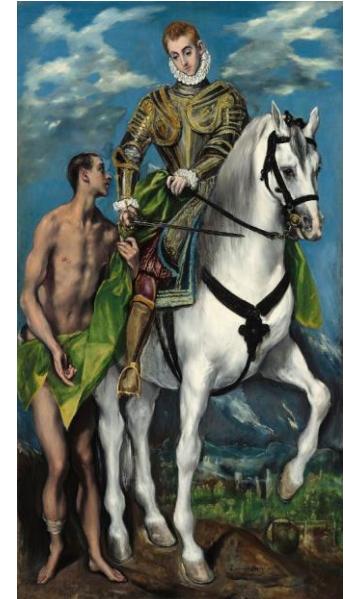
Source: wikipedia.org

Ethics of Behavior (2/2)

A famous example of the ethics of behavior is the story of St. Martin who slices his coat into two parts with his sword, giving one half to the freezing beggar

- This altruistic act is frequently considered to be the epitome of a good deed
- In the domain of the ethics of actions, this example can be viewed from two angles
 - Altruism is the epitome of a good deed
 - Conceived as improvement of individual's character

Ethics of condition: Problem is not solved on a structural level both are freezing



Source: wikipedia.org



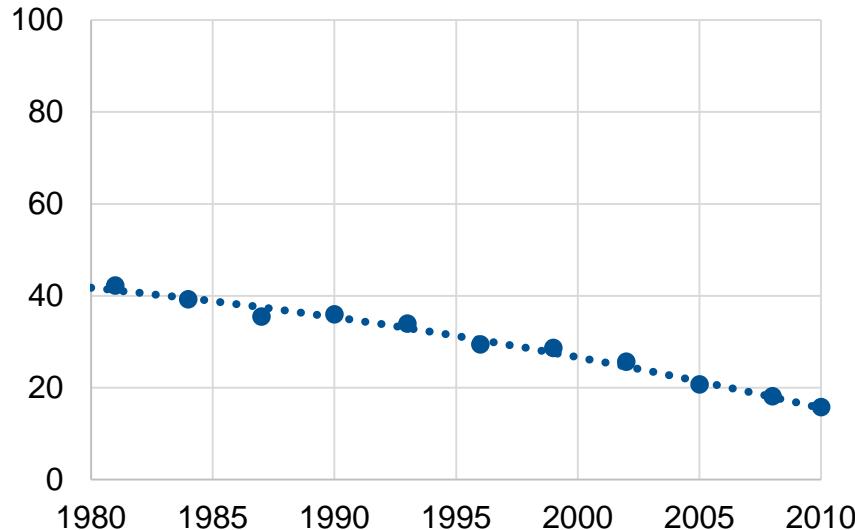
Changed Structures of Modern World (1/2)

Fundamental differences

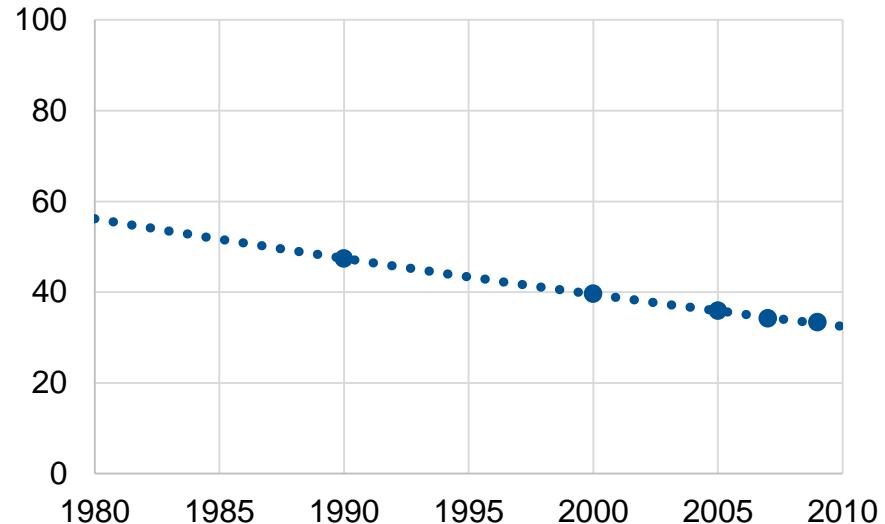
1. People can influence their behavioral conditions (for example: participation in the political / economic sphere), limited degree of predetermined order of things and lack of a universally recognized external authority → **multitude** of different goals and beliefs
2. Strong increase in individual mobility in geographic, social, cultural, and professional dimensions: **Multiculturalism and Pluralism**
3. The **material wealth of humanity** saw an exponential growth since the Industrial Revolution that has intensified since 1945

Economic Growth and Extreme Poverty

Percentage of world population (%) that has less than 1.90 USD (KPP 2011) per day



Share of world population (%) living in slums



Source: Worldbank 2018



Changed Structures of Modern World (2/2)

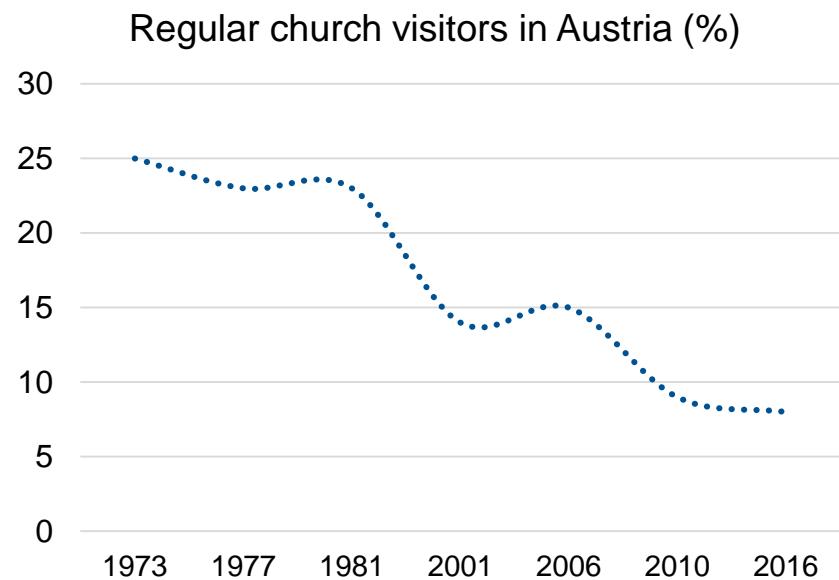
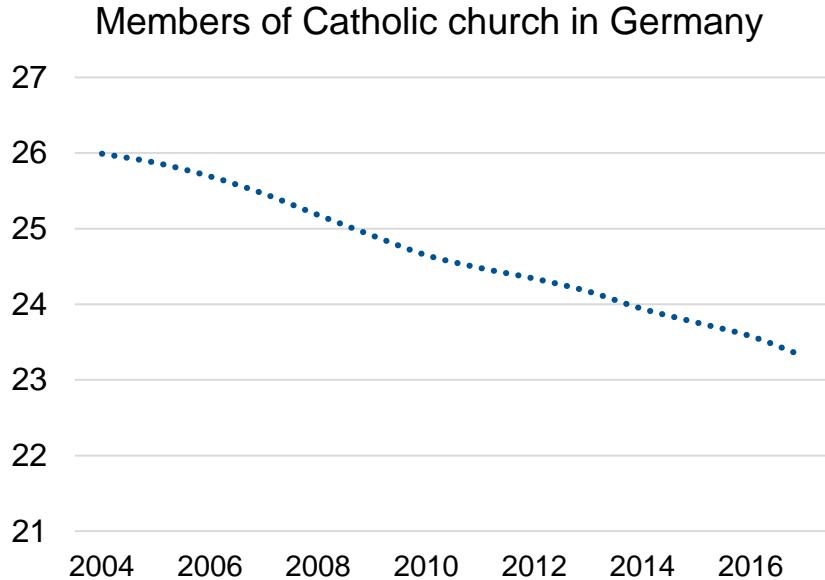
4. Modern society is characterized by the fact that individuals can escape direct "moral" control relatively easily, because social norms are **not enforced by face-to-face control** (excommunication, outlawing, moral appeal)
-

Premodern society: Ethics of behavior = improving the behavior of individuals
vs.

Modern society: Ethics of conditions = improving the conditions for individual behavior

- Change from premodern to modern societies requires a change from “ethics of behavior” to “ethics of order” (Lütge and Uhl, 2021)

Erosion of Traditional "Moral Monopolies"





Causes of Economic Growth in Modern Age

This change was sparked by several coinciding factors:

- ❖ Technological progress (navigation, steam engine) and gain of scientific knowledge (Galileo Galilei, Isaac Newton)
 - ❖ Increasing economies of scale by implementing new technologies
 - ❖ Introduced competition & increasing international trade
 - ❖ Since 1990: Economic transformations in China, India, Russia and Vietnam and the transition to modern market economies
- 1 billion people have been liberated from extreme poverty



Solidarity and Competition

Is there a fundamental conflict between competition and solidarity?

Modern societies are not zero-sum games, due to economic growth:

"Social interaction for the benefit of all, including the disadvantaged" (Homann, 2003)

Competition enables growth and growth increases the size of the cake

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

Does competition promote solidarity more than sharing?



Economic Order (1/3)

Competition is not "war of all against all"

Conditions and rules of competition:

- ❖ Enabling prosperity enhancing competition
- ❖ Prohibit certain types of behavior (violence, fraud, tax evasion)

New (ethical) goal: Performance competition

- Preferences of customers in center
- Quality and cost of the products

→ **Conditions of actions** in focus and not the motivation



Economic Order (2/3)

Causes of re-evaluation of competition and individual striving:

1. Elimination of Social Control

- Premodern: Social control via face-to-face mechanisms → Strong deterrent potential
- Modern: Ever-changing cooperation partners, complex causal connections and effects of actions (externalities)
- Self-control/conscience of the individual leads to competitive disadvantage in competition



Economic Order (3/3)

Causes of re-evaluation of competition and individual striving:

2. Self-interest as a "modern form of charity"

- Crucial: Suitable framework promotes prosperity and induces people to produce what benefits their fellow human beings
 - Self-interested action at the expense of others should be prevented
 - Preferences do not only refer to monetary or material advantages
 - Modern ethics of investment instead of premodern ethic of moderation
- Under this view, traditional conflict between "good" altruistic behavior and "bad" egoism is no longer valid.



Ethical Quality of Competition (1/2)

The following applies if competition takes place in an appropriate regulatory framework:

- Self-interests can be directed in such a way that they bring the greatest benefit to fellow human beings and society
 - Exploitation must be prevented by rules
 - Uncertain consequences of enforcing ethical values irrespective of framework conditions are avoided
 - Recognizing the complexity of contemporary socio-economic systems
- Competitive market economy as systemic approach of business ethics

Ethical Quality of Competition (2/2)

Example of shortcomings of traditional ethics of behavior:

- Burning 105 tons of confiscated ivory in 2016
- Goal: fight against illegal poaching

Ethical perspective:

- Poachers hunt for high profits
- Burning 105 tons reduced supply, but increased prices
- Demands stay constant, price of ivory increased → higher profits attract more poaching



If systematic connections are overlooked, even well-intentioned acts can often lead to unforeseen and above all unwanted consequences



Chapter 3

Historical-Economic Background: Premodernity and Modernity

3.2 The Benefits of the Market and Competition



Competition (1/3)

What does competition mean?

Competition is state of “competitive striving”

“It is merely a metaphor to call competition competitive war, or simply, war. The function of battle is destruction; of competition, construction.” (Mises, 1922, p. 291)

The linguistic distinction between competition and struggle is important

- Struggle: Natural and "without rules"
- Competition: Without a suitable set of rules, competition as an artificial structure can quickly lead to a "ruinous competition." (Hobbes, 1642)



Competition (2/3)

Conceptual history and linguistic usage:

- Latin: *competere* = "trying to achieve something at the same time," → abiding by rules vs. *concurrere* = "collide, converge," → refers to direct combat, not abiding rules
- English: *Competition* = Rivalry → competition from *competere*
- German: *Wettbewerb* → key concept of liberal economics and social science - put into other contexts (for example: Political competition, biological competition, etc.)



Competition (3/3)

Six that are inseparably linked to the success story of market economies:

1. Market as an instrument for the use of distributed and local knowledge
2. Market as a method of discovery
3. Market as an engine of innovation
4. Market as a control mechanism
5. Market as an instrument of disempowerment
6. Market as an instrument of self-discipline



The Market as a Method for the Use of Knowledge

The market as an instrument for the use of distributed and local knowledge

Economist and Nobel Prize laureate Friedrich A. Hayek describes economic relations and human needs as “a complex and spontaneous order”

Planned Economy:

Describe complex social structures and optimize by way of general laws

General production quotas and prices are set

Market Economy:

Human needs and conditions are constantly changing

Market processes dispersed knowledge of all individuals in the price



The Market as a Method for the Use of Knowledge

The market as an instrument for the use of distributed and local knowledge

- Fire in South American copper mine → interruption of production → supply volume is decreasing → price of copper is rising (with steady demand)
- German medium-sized companies using copper can react to this and replace copper with other precious metal that is now cheaper
- Optimization of limited resources
- The price as an indicator of the shortage of a good contains information that can be reacted to without understanding nature of price changes



The Market as a Method of Discovery (1/2)

- Input: Knowledge of millions of people (swarm intelligence); Output: Unimagined market solutions
- Competition: the constant exchange of information and the constant pressure of competition
- Creation of goods, concepts, services and convictions that can not be sensibly controlled
- Findings may not only affect products or services, but also spheres of human coexistence in general



The Market as a Method of Discovery (2/2)

Competition works as an engine for innovations and improvements in products and services

Joseph Schumpeter (1912 - 1950)

"Dynamic entrepreneurial type" and genius cult of the 19th century.

The process of "creative destruction," → improvement and new development of products

William Baumol (1922 - 2017)

Rule-based market economy with competition itself brings forth this type of entrepreneur; incentive systems

Premodern: competition was often suppressed or obstructed in some way (e.g.: guilds)

Feedback: innovations and competition results give rise to a feedback effect



The Market as a Control Mechanism

- Control Mechanism in the Premodern period

Face-to-face control

Social control in small communities

- Modern: control function of the market
- Cost and duration weaken the effectiveness of legal processes
- Instead: companies are subjected to control from outside and inside
 - a) Externally: control over stakeholder relations and discipline of the market
 - b) Internally: Shareholders control mechanism (for example, via the Supervisory Board)



The Market as an Instrument of Disempowerment

Due to its structural features, the market serves as an important instrument of disempowerment

- Impartiality of the market
- Market mechanisms reward only what meets demand
- Automatically, limitation of power positions as they are threatened by competition
- No abuse of power

E.g., Microsoft in the late 1990s: Even companies with a large market share and thus a certain power position can never be sure that they will not have competitors

The Market as an Instrument of Self-Discipline

Success is possible only through cooperation with other partners

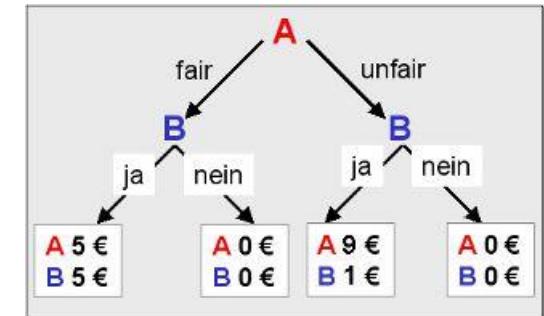
Business transaction occurs if both parties believe that they benefit from the exchange,
competing companies need to reconcile their own idea of advantage with that of their future
partners

Does competition generate fairness?

Ultimatum Game: (9/1) is rejected, which is irrational under
traditional assumptions of money maximization

Empirically: Fair distributions especially among participants from
cultures of competition

Reason: interaction with strangers; reputation building





Chapter 3

Historical-Economic Background:

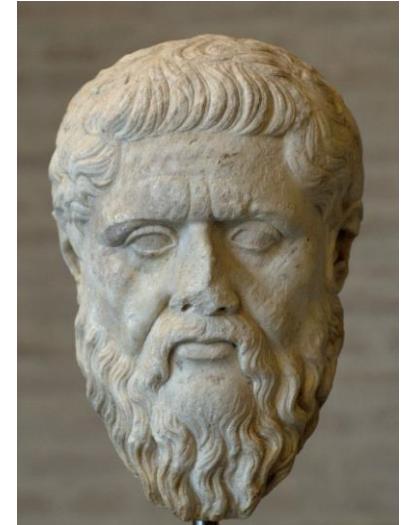
Premodernity and Modernity

3.3 The Fair Price

The Fair Price – Antiquity (1/4)

Economics and ethics from the perspective of Platonic philosophy:

- Main objective: state-sponsored pursuit of virtue (Plato, *Nomoi*)
- Rejection of profit and utility maximization
- Call for an upper limit on ownership
- Special regulations for economic transactions:
 - A fixed daily price per good
 - Profit only in modest margins, as a modest premium on the "value" of a good
 - Seller knows "value" of goods, does not have to charge premium



Source: wikipedia.org

The Fair Price – Antiquity (2/4)

Economics and ethics from the perspective of Aristotelian philosophy:

- Theory of Price: Principle of Equalizing Justice:

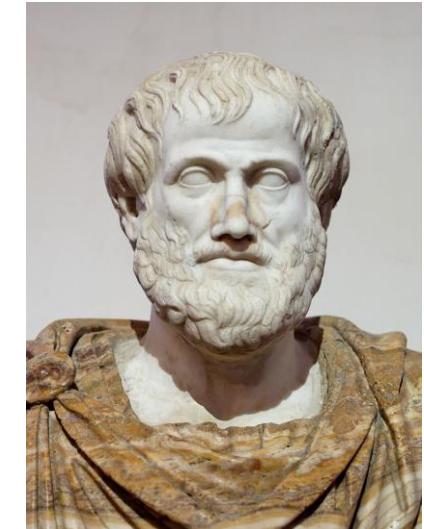
Proportionality of the price depends on need

Assessment of work performance depends on social position

- Economics and Chrematistic:

Economics (Art of house-keeping) takes place within clear limits and is therefore morally permissible

Chrematistic (The study of wealth) as enrichment at the expense of others is immoral (Zero-sum game)



Source: wikipedia.org



The Fair Price – Antiquity (3/4)

Cicero's view on the price mechanism

„During a famine on Rhodes, a trader conveys grain from Alexandria to the island. He knows that more ships with Egyptian grain are under way to the island, but his dilemma is: should he share this information or should he sell at the highest price possible?“ (De Officiis, III, 13, 57.)

- Pro argument: The grain belongs to the dealer (freedom of action and ownership)
- Contra argument: The community of all people forbids exploiting such knowledge. Because there is a "right value" of a good that every person actually knows.
- Objective valuation is typical of antiquity



The Fair Price – Middle Age (1/2)

Morality and economy in the Old and New Testaments

Assumption: The "fair" price is in place: Moses already made the clear demand that no one should "take advantage of his brother" in a transaction (3 Moses 25,14)

An a-priori suspicion: "A merchant can hardly keep himself from doing wrong, or a huckster from sin." (Sir 26.29)

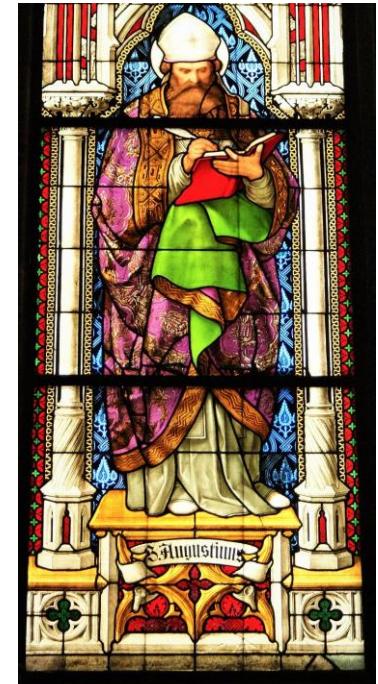
Gospel of Matthew: "No one should go too far" and take advantage of his or her trading partner. (Mt 6,24)

Notion of the Last Judgment: Do not endanger security through wealth

The Fair Price – Middle Age (2/2)

Morality and economy for Augustine (354 - 430)

- Theory of Values and Ranking of These Values (*De Civitate Dei*)
- The purchase price, however, is based exclusively on human needs
- Ranking of human needs from experience: thus an objective value theory
- Augustine does not see trading gains as something bad per se (although he also points out the moral dangers).



Source: wikipedia.org



Chapter 3

Historical-Economic Background:

Premodernity and Modernity

3.4 The Prohibition of Interest and Usury

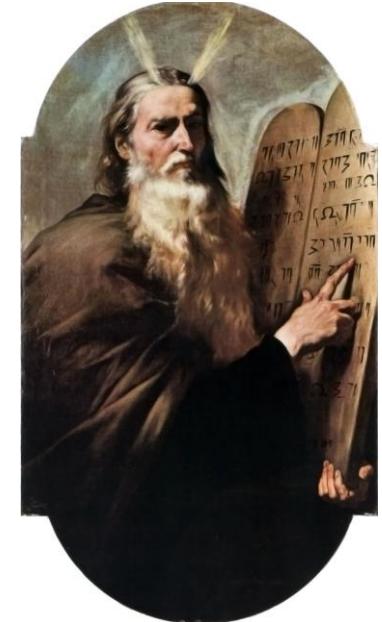
The Prohibition of Interest and Usury in Antiquity

"If your brother becomes poor and cannot maintain himself with you, you shall support him as though he were a stranger and a sojourner, and he shall live with you. Take no interest from him or profit, but fear your God, that your brother may live beside you. For thou shalt not lend him thy money in interest, nor victuals for an additional charge." (5 Moses 23,19f)

- ❖ Clear prohibition of interest
- ❖ Duty to help among relatives
- ❖ Not applied to: behavior towards outsiders

You may charge interest to a foreigner, but to your countrymen you shall not charge interest, so that the LORD your God may bless you in all that you undertake in the land which you are entering to possess." (Deuteronomy 23:19)

- Moral rule that can be maintained in small groups or face-to-face societies



Source: wikipedia.org



The Prohibition of Interest and Usury in Ancient Greece (1/2)

In Plato's "Nomoi":

- Great assets through interest = power that can undermine the laws of the state
- Contrast between state and capital (analogy to Karl Marx)

The State = highest moral good

Plato rejects lending money for interest because it can destroy the social order

In Plato's "Politeia":

- General intuition: interest is perceived as evil
- Credit trade increases number of poor in the state



The Prohibition of Interest and Usury in Ancient Greece (2/2)

In the Nicomachean Ethics and Politics of Aristotle the profit generated through interest is "unnatural".

Reason: It does not come from work, but from the money itself

"There are two sorts of wealth-getting, as I have said; one is a part of household management, the other is retail trade: the former necessary and honorable, while that which consists in exchange is justly censured; for it is unnatural, and a mode by which men gain from one another. The most hated sort, and with the greatest reason, is usury, which makes a gain out of money itself, and not from the natural object of it. For money was intended to be used in exchange, but not to increase at interest. And this term interest, which means the birth of money from money, is applied to the breeding of money because the offspring resembles the parent. Wherefore of all modes of getting wealth this is the most unnatural."

(Aristotle, Politics)



The Prohibition of Interest and Usury in Christian Doctrine

Council of Nicaea (325 AD):

- Ban on money lending against interest
- Emperor Constantine translated decisions into laws
- Trading in loans against interest was punished with infamy

Other Councils that emphasized the prohibition of interest:

- Lateran Council 1139
- Council of Lyons 1274
- Council of Vienne 1311

Pope Pius VIII announced in 1830 the lifting of the interest ban



The Prohibition of Interest and Usury in Islam (1/2)

The prohibition of interest in the Qur'an and Sharia

- Interest prohibition (Arabic: Riba) applies to the demand and the payment of interest
- Interest as non-Muslim, because it is acquired without "achievement"
- Interest is understood as a premium for which there is no consideration
- "But those who devour interest become like the one whom Satan has bewitched and maddened by his touch. This because they said, "Selling is the same as taking interest." But Allah has allowed selling and forbidden taking interest (Sure 2, Verse 275)
- The waiver of consumption is not recognized as consideration



The Prohibition of Interest and Usury in Islam (2/2)

Islamic banking as an alternative?

- Lender participates in the profit and loss of a credit financed company (equals equity)
- Profit only if risk of loss is also borne
- Problems:

No distinction between equity and debt. Borrowing is usually less risky (priority) and therefore important for many companies

Many social policy instruments rely on interest

all kinds of insurance policies are rejected in Islam according to the traditional understanding if they are not based on donations

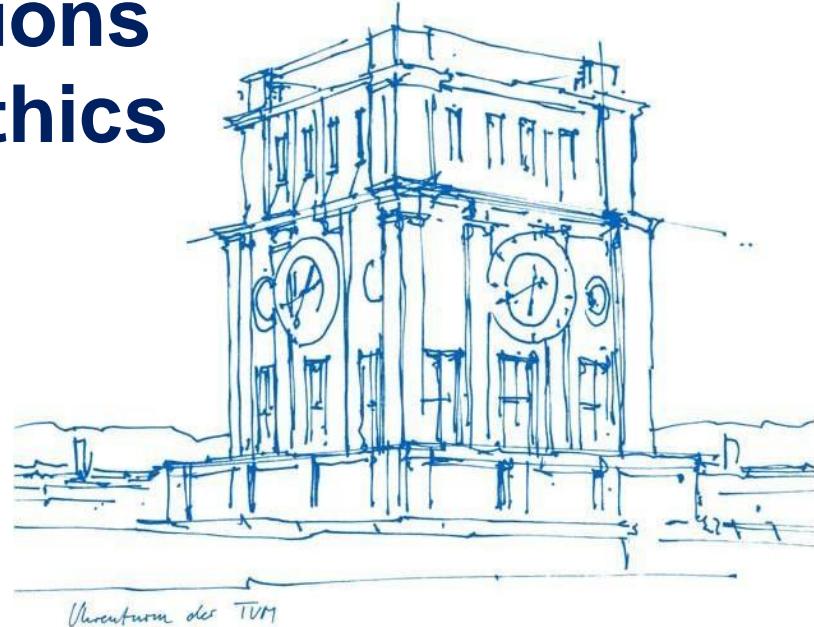


Introduction to Business Ethics: (Philosophical) Foundations and tools of Business Ethics

21. December/10. January 2023

Prof. Dr. Christoph Lütge
Peter Löscher Chair of Business Ethics
Technische Universität München

Winterterm 2022/23





Focus of today

Introduction

Chapter 1: Business Ethics in the Age of Globalization

Chapter 2: Basic Concepts

Chapter 3: Historical-economic Background: Premodernity and Modernity

Chapter 4: Foundations and Tools of Business Ethics

➤ **Philosophical foundations and tools**

Chapter 5: Problem Areas of Business Ethics

Chapter 6: Corporate Ethics



Foundations and Tools of Business Ethics

3.1 Philosophical principles and tools



An overview of ethical theories

Metaethics

- Deals with the meaning of ethical terms, the nature of moral discourse and the foundations of moral principles

e.g.:

- What is the meaning of ethical terms such as ‚right‘ or ‚wrong‘?
- Are there moral facts? Or are moral judgments relative?

Descriptive Ethics

- Deals with the description, systematization and explanation of normative systems; a form of empirical research into attitudes of individuals

e.g.:
ethnology, moral
psychology, evolutionary
biology, behavioral
economics

Normative Ethics

- Deals with criteria of what is morally right and wrong

Various ethical theories,
e.g.:

- Virtue Ethics
- Deontological Ethics
- Consequentialism / Utilitarianism
- Liberalism
- Contractualism

Applied Ethics

- Deals with the application of ethics to real-world problems

e.g.:

- Business ethics
- Medical ethics
- Environmental ethics
- AI ethics

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Virtue Ethics

Good and happy life = virtuous life

- Goal: Enhancement of certain virtues
- Examples of virtues: Wisdom, justice, courage, moderation
- For example: Aristotle
 - Goal: Happiness (eudaimonia) of human beings
 - Virtue as attitude, determined by rationality and educational background / practice
 - Virtuous life = to find a reasonable mean between two extremes
 - For example: Bravery as a golden middle way between daring and cowardliness
 - The golden mean is the best, that can be achieved individually.



Deontological Ethics

- deon = duty or obligation
- “Some choices cannot be justified by their effects [...] no matter how morally good their consequences, some choices are morally forbidden” (Stanford Encyclopedia of Philosophy)
- *Action as such* is crucial to evaluate it as good or bad (e.g., intention, conformity with certain rules, duties or rights)
- Calculation of the consequences only additional, not as crucial normative criterion!

Deontological Ethics: Example in Business context

- CSR example: Corporate marketing and PR measures to give a more social or environmentally friendly image.



Is this behavior ethically positive?

- Deontologically: no, because the goal is pure profit maximization.

➤ Deontological ethics does not only look at results for making ethical judgements but also at certain characteristics of the behavior!

Deontological Ethics by Immanuel Kant (1724-1804) (1)

Action is only obligatory if it satisfies the **categorical imperative**:

"Act only according to that maxim whereby you can, at the same time, will that it should become a universal law."

? Test procedure: May I lie / deceive?

- Do we want "lying" to become a generally morally permissible act?
- Example: A person who seeks to borrow money without intending to pay it back. If it were a universal action, no one would lend money anymore as he/she knows that they will never be paid back.

→ Lying / deceiving is morally unacceptable



Immanuel Kant
Source: Wikipedia



Deontological Ethics by Immanuel Kant (1724-1804) (2)

The Humanity Formulation of the categorical imperative:

*“So act that you use humanity, whether in your own person or in the person of any other, always at the same times as an end, **never merely as a means.**”*

- Introduction of the idea of “respect” and “dignity” for individuals
- Humanity is of absolute value, beyond a price

Deontological Ethics: Manifestations in law

Legal basis: Right to life and physical integrity (Art. 2 Basic Law)

Case: Kidnapped plane flying towards a football stadium (evacuation impossible); government has to determine whether or not it should shoot down the plane

Is shooting down the plane ethically justifiable?



NO!

Deontological: Art. 2 GG must not be violated, no matter how high the damage will be.



YES!

Consequentialist: minimize harm, life must be balanced against each other.

The film „The verdict“ deals with this question



Sources: <https://www.imdb.com/title/tt5680442/>;
<https://www.amazon.de/Terror-Ihr-Urteil-Burghart-Klaussner/dp/B01IGSOF94>;
<https://www.film-rezensionen.de/2016/10/terror-ihruurteil/>



Drawbacks of Deontological Ethics

Example: Lying is always morally wrong. Even if a murderer asks about the hiding place of his victim, one is obliged to tell the truth.

→ Imposed duties seem absurd and contradict inner moral compass

Further critique – implementation issues:

- Can put individuals at risk (e.g., here the victim)
- Issue of value pluralism; clash of different duties (e.g., do not lie and do not kill)



Consequentialist Ethics

- (*Foreseeable*) consequences of actions are crucial to distinguish between good and bad actions: If the consequences are good, the act is right; if the consequences are bad, the act is wrong.
- This theory emphasizes ends over means

Consequentialist Ethics: Example in Business context

- CSR example again: Corporate marketing and PR measures to give a more social or environmentally friendly image.



Is this behavior ethically positive?

- Consequentialist: Yes, because the measures have positive effects on humans, animals or nature

➤ Consequences are crucial for an evaluation, the reasons (e.g., profit maximization) are irrelevant!

Behavioral implications as ethical evaluation

Example: When John tries to rescue a child from a well, a bumblebee is chased up and flies into a cabin of a truck, whereupon the driver loses control and drives headlong into a crowd of people.



Was John's attempt to rescue the child immoral?

- Unintentionally, John's action caused more harm than good
- Consequentialism: Only predictable consequences are considered in the evaluation of an action!

Variation of Consequentialist Ethics: Utilitarianism

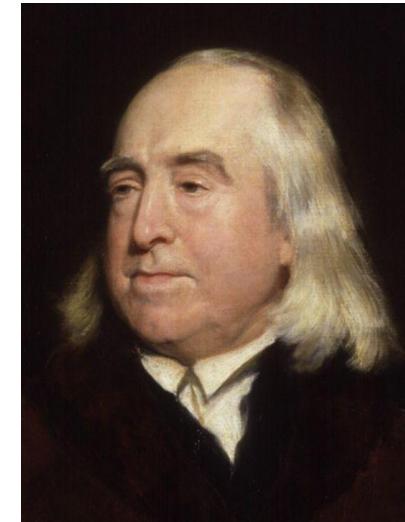
Utilitarianism

Jeremy Bentham

1748 – 1832

English philosopher, legal scholar and social reformer

“It is the greatest happiness of the greatest number that is the measure of right and wrong.”



Jeremy Bentham
Source: Wikipedia



Utilitarianism

- Jeremy Bentham and John Stuart Mill as founder of utilitarianism
 - Utility is crucial to distinguish between good and bad actions
 - Utilis = useful; utility here is often defined in terms of well-being, happiness or related concept
 - Utility of the „greatest number“; not utility of the individual
 - The best decisions:
 - 1) generate the most benefits as compared to disadvantages
 - 2) benefit the largest number of people
- **Maximization of happiness:** Do the greatest good for the greatest number of people

Consequentialistic Ethics: A few considerations



What is the target variable or the bundle of targets to be maximized?

- Utilitarianism: Maximization of happiness → But: **What is happiness?**
- *John Stuart Mill*: distinguishes between different qualities of happiness
- *Peter Singer*: Target variable = preference fulfillment; Action is aimed at achieving certain goals, not cognitive happiness; Goal achievement does not have to lead to happiness



In what consequences should we be interested in?

- Maximization of favorable consequences for all people living today or for those living today and in the future? → Question of **intergenerational justice**
- Maximization of human happiness or the happiness of all sentient beings in general?



Drawbacks of Consequentialist Ethics/Utilitarianism

- **Limit on practical implementation**
 - How to know/determine the consequences of actions? E.g., long-term vs. short-term consequences? What about (unintended) side-effects?
 - How to compare the happiness and preferences of many different people?
 - How can utility be calculated?
- **Excessive demands on the individual**
 - Benefit of all should be maximized → Every single decision becomes a moral issue
- **Injustice: Happiness of the individual could be sacrificed for happiness of the mass of people**
 - Humans as means to an end?
 - Individual and its rights are less important than overarching benefits



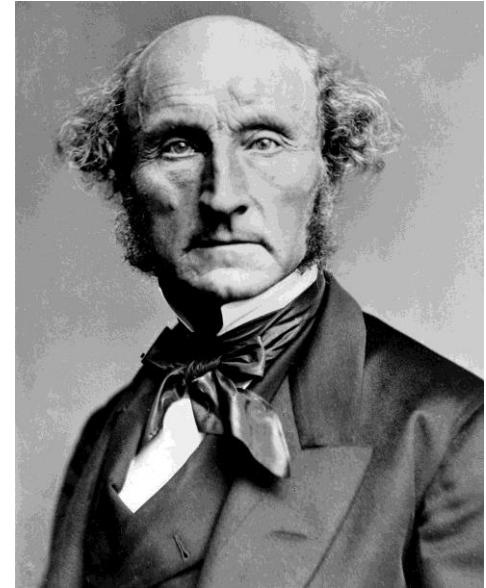
Liberalism (1)

John Stuart Mill

1806 – 1873

English philosopher and political economist

"That the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others."



Source: wikipedia.org



Liberalism (2)

"On Liberty" 1859

- The freedom of thought and emotion. This includes freedom to act on such thought, i.e., **freedom of speech**
- The **freedom to pursue tastes** (provided they do no harm to others), even if they are deemed "immoral"
- The **freedom to unite** so long as involved members are adults, involved members are not forced, and no harm is done to others



Liberalism (3)

Harm Principle (J. S. Mill)

"That no one should be forcibly prevented from acting in any way he chooses provided his acts are not invasive of the free acts of others."



But sometimes norms or ethical paradigms clash...

Opposing norms:

- Example: An entrepreneur may be forced to make a choice of either paying expensive bribes in a developing country to win a contract for a large-scale project, or to forgo bribery, thereby jeopardizing jobs in his/her company
 - Violating the prohibition of bribery vs. violating the corporate code (e.g., caring for employees)

Clash between norms and individual cases:

- Norm: Certain ethical paradigm that dictates the maxim of action
- Individual case judgment: value judgment in a real action situation independent on an ethical paradigm
- Example: **Trolley problem**



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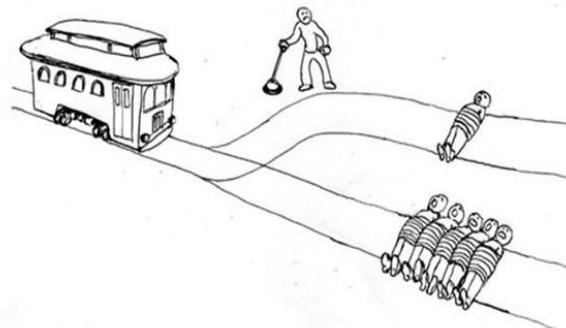
Clash between norms and individual cases:

- Norm: Certain ethical paradigm that dictates the maxim of action
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- Example: **Trolley problem**

A thought experiment: Trolley Problem

Moral thought experiment based on publications by Philippa Foot in 1967:

„A tram is out of control and threatens to overrun five people. By moving a switch, the tram can be diverted to another track. Unfortunately, there is another person. Can the death of one person be accepted (by moving the switch) in order to save the lives of five people?"



Example: Clash between norms and individual cases (1)

General Norm

Judith is a utilitarian.

Norm: Maximize happiness of all i.e. sacrifice one person to save the others

versus

Individual case decision

Judith's not moving the switch to reroute the train.

Value judgement: You must not consciously decide against a person!



Source: iflscience.com

Example: Clash between norms and individual cases (2)

General Norm

Judith is a utilitarian.

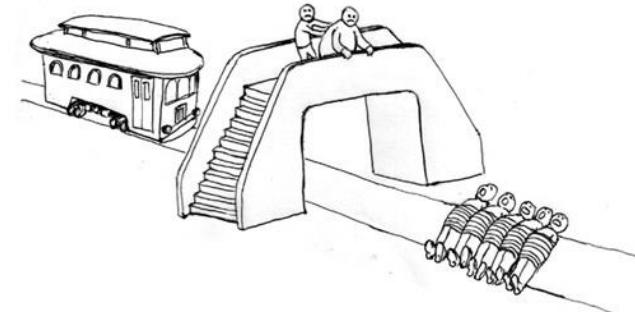
Norm: Maximize happiness of all i.e. sacrifice one person to save the others

versus

Individual case decision

Judith **doesn't throw the person on the tracks to stop the train**

Value judgement: You must not push the person down.





What does the law say to this decision?



Is it legitimate to weigh life?

Legal situation in Germany:

German Aviation Security Act (before 2005): Legal permission to shoot down passenger aircraft in the event of hijacking in order to **minimize fatalities**.

Judgment of the Federal Constitutional Court 2006:

*„The authorization of the armed forces to shoot down an aircraft intended to be used against human life by force of arms by direct impact in accordance with § 14 (3) of the Aviation Security Act is incompatible with the **right to life** in accordance with Article 2 (2) sentence 1 of the Basic Law in conjunction with the **human dignity guarantee** in Article 1 (1) of the Basic Law to the extent that people on board the aircraft who have **not been involved in an act** are affected“.*



Modern Trolley Problem: Moral Machine Experiment (1)

The **Moral Machine** is an online platform developed from a research project at the Massachusetts Institute of Technology (MIT).

The aims of the platform are:

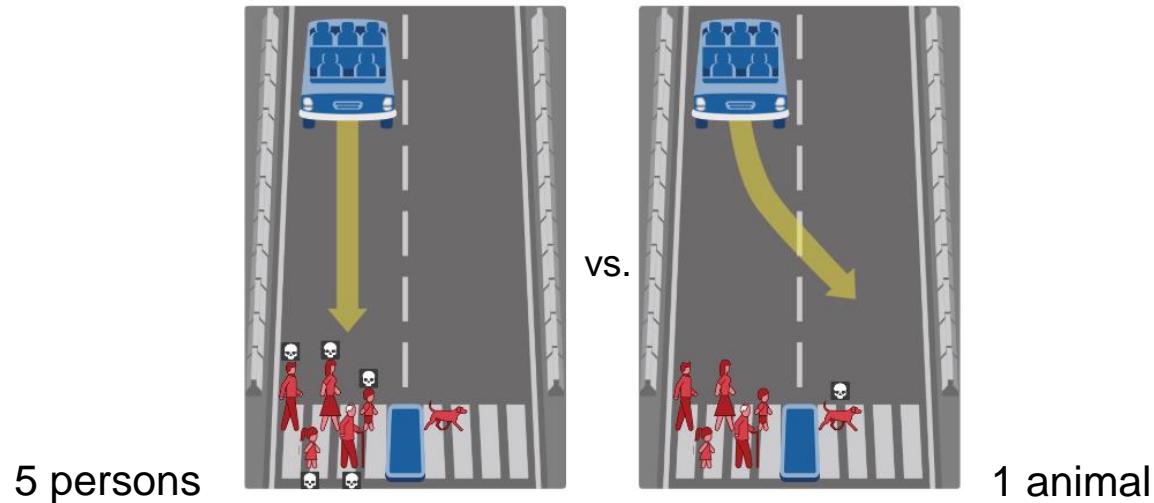
1. Identifying a broad view on how **machines should solve moral dilemmas**
2. Offering a forum where the **public can discuss** the collected, potentially morally problematic scenarios.



Source: Awad et al. (2018)

Modern Trolley Problem: Moral Machine Experiment (2)

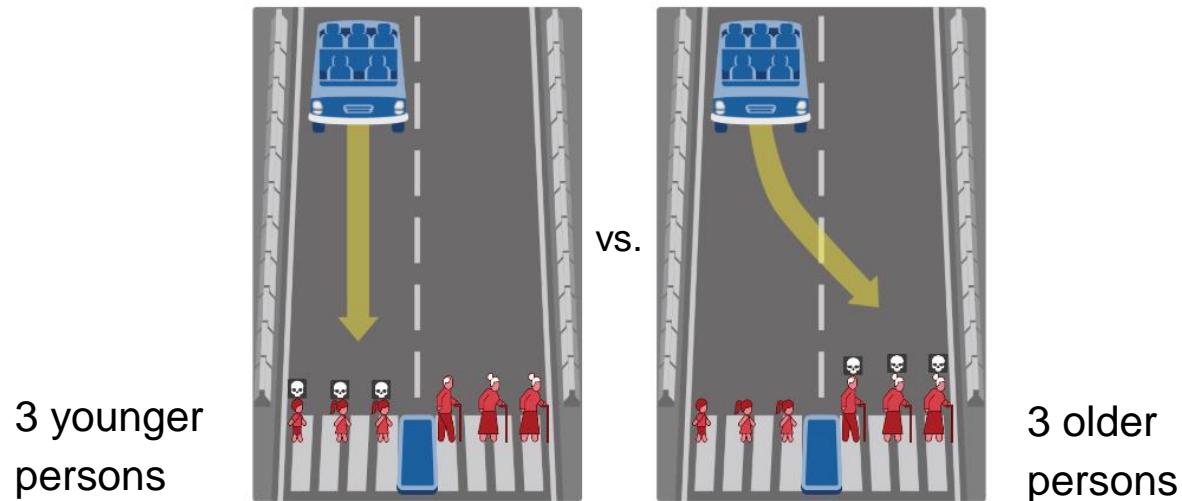
What should the self-driving car do?



Source: Awad et al. (2018)

Modern Trolley Problem: Moral Machine Experiment (3)

What should the self-driving car do?

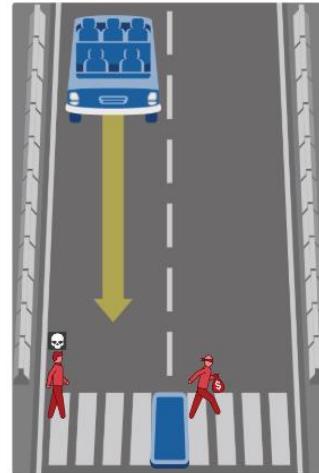


Source: Awad et al. (2018)

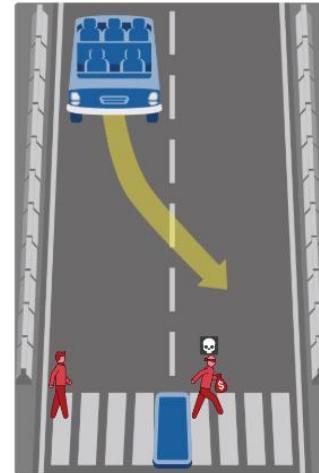
Modern Trolley Problem: Moral Machine Experiment (4)

What should the self-driving car do?

1 law-abiding
person



vs.



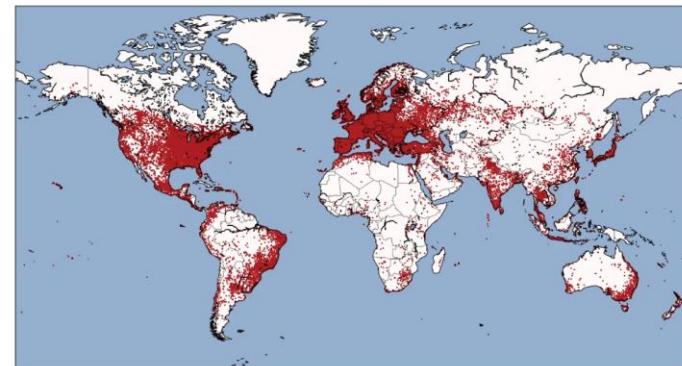
1 criminal

Source: Awad et al. (2018)

Modern Trolley Problem: Moral Machine Experiment (5)

Results:

- collected 39.61 million decisions from 233 countries, dependencies, or territories
- showed broad differences in relative preferences among different countries
- in general the data indicates that people support **minimizing loss of life** and **protecting children**, **favoring the fit and wealthy**, and sacrificing people who are old, overweight, or homeless.



Source: Awad et al. (2018)



Ethical Guidelines for Autonomous Vehicles

Ethics Commission for Automated and Networked Driving of the Federal Ministry of Transport and Digital Infrastructure: **World's first ethics guidelines for automated driving, presented in Berlin, June 2017**

20 Ethics Guidelines, e.g.:

- Personal injury takes precedence over damage to property
- Liability passes from user/owner to manufacturer and operator of software
- General programming to reduce the total number of personal injuries permissible



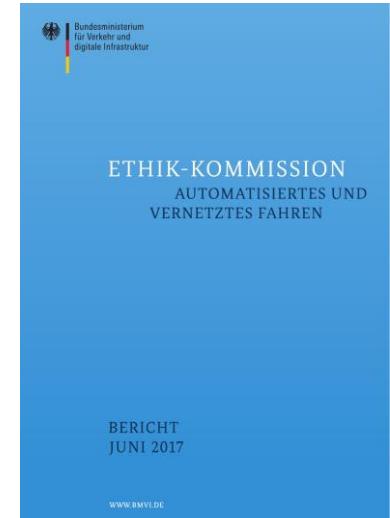
Source: bmvi.de; Lütge (2017)



Ethical Guidelines for Autonomous Vehicles

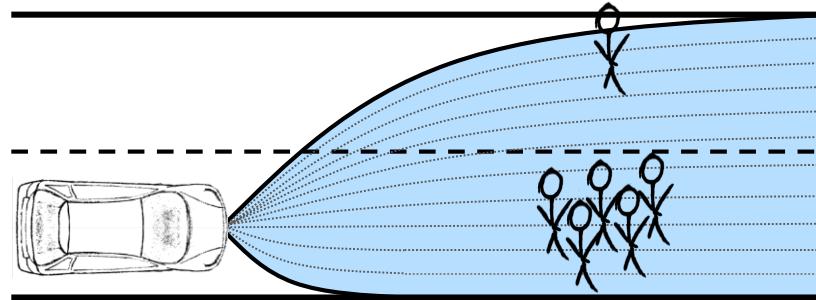
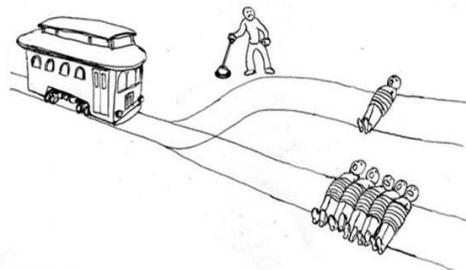
Guidelines of the Ethics Committee (touching on dilemma situations):

7. *In hazardous situations, which prove to be unavoidable despite all technical precautions, the **protection of human life** has the **highest priority** in a balancing of legal interests. Programming must therefore be designed within the framework of what is technically feasible in such a way as to accept **animal or property damage** in the event of conflict if this can prevent personal injury.*
8. *In unavoidable accident situations, any **qualification according to personal characteristics** (age, sex, physical or mental constitution) is **strictly prohibited**. A general programming to reduce the number of personal injuries can be justifiable. Those involved in creating mobility risks must not sacrifice uninvolved persons.*



Source: bmvi.de; Lütge (2017)

The Trolley Problem & its Practicability



Benefits of the Trolley problem

- raises reflection, understanding and awareness of normative theories
- gives insights into societal reasoning and opinions

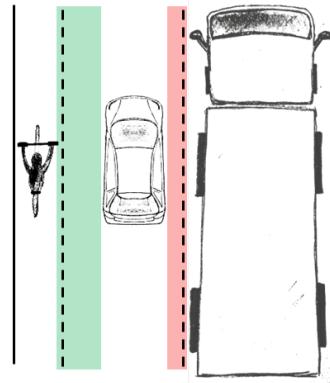
Shortcomings for autonomous driving

- postulated consequences as certain event
- limited number of options
- missing contextual information (obligations, responsibility?)

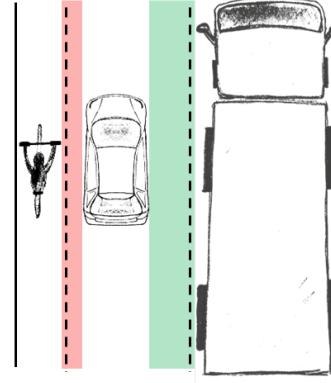
→ The Trolley problem is straight-forward (which makes it easy to explain / comprehend issues in autonomous driving ethics) but it is not as relevant in practice!



Reframing the AV Debate Towards Ethics of Risks

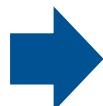


More risk on ego vehicle



More risk on cyclist

No decision about life & death, but how risks are distributed (also in mundane traffic scenarios)

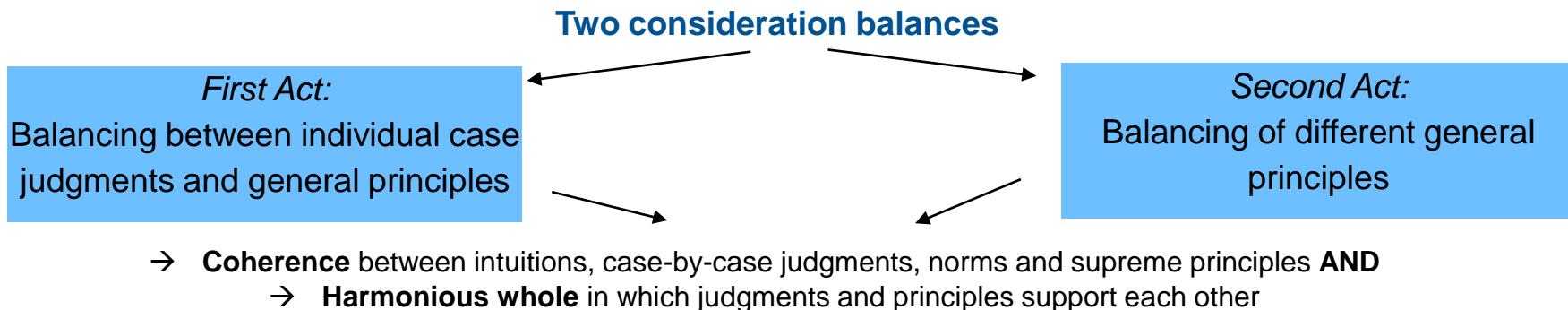


Stay up-to-date with our progress within the ANDRE project: <https://ieai.mcts.tum.de/research/andre-autonomous-driving-ethics/>

So, what to do when general principles & individual judgments contradict?

John Rawls (1971) suggests that we should try in such cases to bring our norms and one-off judgments into reflective equilibrium in a process of mutual adjustment.

- “**Reflective equilibrium**”: is the end-point of a deliberative process in which we reflect on and revise our beliefs about an (moral) area of inquiry. The inquiry might be as specific as the moral question, “What is the right thing to do in this case?” (Stanford Encyclopedia of Philosophy)



Weakness: Problem of operationalization

Coherence  moral truth

- Coherent system of case-by-case judgments, intuitions, rules and general principles do not need to be right
- Example: Slavery was essential to the social and economic order of ancient Greece. A young man growing up in ancient Athens learned that slaves were not treated with the same respect, much less accorded the same rights as the citizens of Athens. It is not difficult to imagine that such a young man – assuming he brought his beliefs into a reflective equilibrium – could very well have had a coherent system of beliefs that did not grant certain people fundamental rights.

➤ Coherence criterion alone is not enough, danger of ethical relativism (= norms and values are time-bound/expression of the respective epoch)

Two Types of Dissent in Modern and Pluralistic Societies

What is a **good life**?

- Urban areas are teeming with millions of people
- Different backgrounds, languages, hobbies, lifestyles
- No consensus on how to live your life

➤ Dissent does not lead to problems

What is **morally imperative**?

- Controversies especially in ethical and economic issues
- E.g. fair price / salary? Freedom vs. Exploitation? Markets for blood, organs, sex? Distribution of wealth? To what extend is inequality socially acceptable?

➤ Dissent leads to problems



Three Philosophical Tools for Establishing Norms under Dissent

Goal: generate ethical principles to deal with differences of opinion

- Contractual concepts
- Democratic majority principle
- Justification and Deliberation



Contractual Concepts

Basic Idea:

moral norms, institutions, and the institutional structures of societies are only legitimate, if they have the **consent of the population**

Criterion: Instead of maximizing utility via *rules* → Consent (of all people) to a rule

- **Ability to consent** instead of actual consent: consent can be expected on the basis of interests/preferences
- **Hypothetical contracts** instead of de facto contracts: Large number of hypothetical contract participants
- understand contract-theoretical logic as a kind of **thought experiment**.

Contractarianism vs. Contractualism

	Contractarianism	Contractualism
<i>Traditionally by</i>	Thomas Hobbes (1588-1679)	Immanuel Kant (1724-1804)
<i>Contracting parties</i>	maximizer of one's own utility	morally motivated agents
<i>conditions of use</i>	divergent interests + little moral common ground	Similar interests + common moral basis

For pluralistic societies with cultural differences

For communities with a strong cultural foundation

Hobbesian Contractual Concepts

Two insights:

- 1) **Conflict between groups of people had always the potential for war and destruction.**
→ peace as a necessary condition for the good life in private life
- 2) **Peaceful cooperation creates additional value for everyone (specialisation, economies of scale)**

Example: 10 million families living on 10 million single islands

Cooperation can overcome subsistence economy

→ Cooperation creates prosperity



Kantian Contractual Concepts (1)

Three main differences between Kantian and Hobbesian concepts of a contract:

1 Modelling of the contract situation:

additional moral ideal (e.g. Equality, fairness) in initial situation of contract situation
Thus: counteract unequal power relations in Hobbesian contract concepts

- starting position of a contract greatly determines its outcome.



Kantian Contractual Concepts (2)

Three main differences between Kantian and Hobbesian concepts of a contract:

2 Rejection of the Pareto principle (ethically inadequate):

morality cannot be reduced to a mutual exchange of benefits (as merely improving both sides' positions can run counter to essential intuitions of fairness)

3 Type of communication between contracting parties:

Hobbesian contract theory: participants discuss the means that would be best to promote everyone's means (Question: should one not also deliberate the various aims?)

Kantian contract theory: discussion of choice of means separately (parties have to abstract from their own wishes)

→ Not easy!



Kantian Contractual Concepts (3)

How does one arrive at a fair choice of goal and means?

→ Asking for justice regardless of one's own wishes and interests

Rawls' veil of ignorance:

Moral problems should be discussed behind veils

Contract participants know neither

- social status
- religious / ethnic affiliation
- mental / physical nature

→ Discussion of impartial observers instead of self-interested individuals

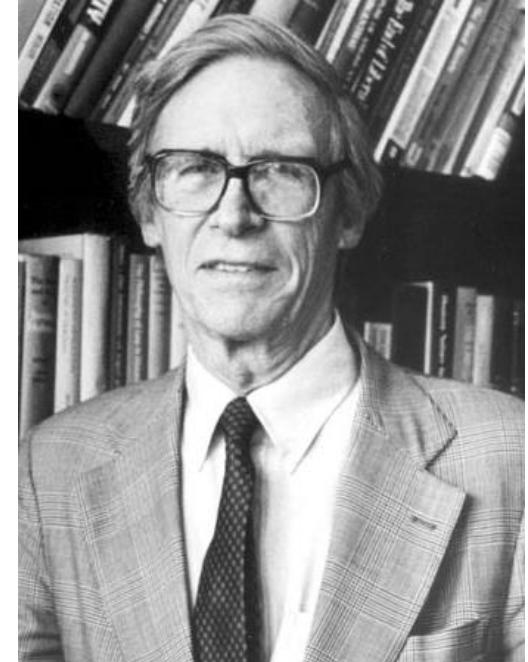
Veil of ignorance in more detail (1)

John Rawls

1921 – 2002

US-American philosopher

"A Theory of Justice" (1971)





Veil of ignorance in more detail (2)

Thought experiment: Imagine you have to found a society. Which five guiding principles would you choose?

John Rawls – "A Theory of Justice"

VEIL OF IGNORANCE

IN THE ORIGINAL POSITION ALL INDIVIDUALS ARE BEHIND THE VEIL OF IGNORANCE, THEY DO NOT KNOW WHICH ROLE THEY WILL PLAY IN THE FUTURE SOCIETY. AGAINST THIS BACKGROUND THEY HAVE TO NEGOTIATE A SOCIAL CONTRACT, EVERYONE WILL AGREE WITH. THE NEGOTIATED RULES WILL BE APPROVED OF, IF ALL INDIVIDUALS IN ALL POSITIONS ARE BETTER OFF IN THE END.

Kantian Contractual Concepts (4)

Problem: moral overload of the parties of the dispute:

- Citizens of a society must have certain common abilities or characteristics
- stronger conditions than the Hobbesian contract concepts
- Legal perspective: Ethical judgments are made by impartial judges who have no self-interests

➤ Implementation of solutions can be difficult or even impossible

Democratic Majority Principle

Idea:

- dissent votes on moral questions
- majority opinion as a tool for establishing standards

Serious problems:

- Discrimination against minorities possible (e.g. majority prohibits catholicism/ cars/ same-sex marriages)

➤ Majority principle can lead to suppression. It needs additional normative regulations (e.g.: fundamental rights)

Discourse Ethics - Consensus as a Goal

The ideal of Discourse Ethics:

"No speaker shall be prevented from exercising (his) established rights by coercion within or outside the discourse."

Essential principles:

- "Equal participation in the discourse"
- Securing "rule-free discourses"
- Only the better argument counts
- possibility to put yourself into the position of the opponent

➤ Aim of Discourses: Consensus Finding: But is that really realistic in practice?

Source: Jürgen Habermas 1983: *Moralbewusstsein und kommunikatives Handeln*. Suhrkamp, Frankfurt/M., 97-99.



Three Difficulties for Reaching a Consensus

According to discourse ethicist **Peter Ulrich (2008)**:

Fundamental reasons

- some affected of a moral norm are in principle excluded from discourse
- Example: underages, non-born (intergenerational justice!)

Pragmatic reasons

- Number of people affected is too big to involve everyone.

Motivational reasons

- Some participants are unwilling to search for a viable solution.



Discourse Ethics as a Business Ethic according to Ulrich (2008)

Business Ethics:

"Profit making must be justified in corporate policy deliberation processes vis-à-vis all stakeholders."



Conclusion

- There are different ethical theories in normative ethics (e.g., deontological ethics, virtue ethics, consequentialism...)
- These can help determine – based on different criteria – whether an action is morally right or wrong
- Sometimes norms and ethical paradigms clash (example: Trolley Problem)
- There are a few philosophical tools (e.g., contractual concepts, the democratic majority principle...) for establishing norms under dissent

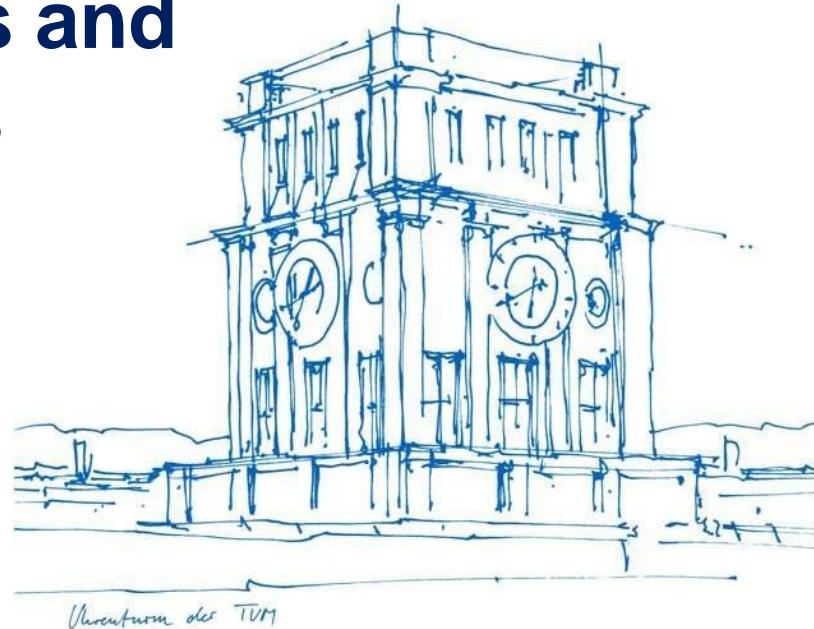


Introduction to Business Ethics: (Economic) Foundations and tools of Business Ethics

11./17. January 2023

Prof. Dr. Christoph Lütge
Peter Löscher Chair of Business Ethics
Technische Universität München

Winterterm 2022/23





Focus of today

Introduction

Chapter 1: Business Ethics in the Age of Globalization

Chapter 2: Basic Concepts

Chapter 3: Historical-economic Background: Premodernity and Modernity

Chapter 4: Foundations and Tools of Business Ethics

➤ **Economic and socio-scientific foundations and tools**

Chapter 5: Problem Areas of Business Ethics

Chapter 6: Corporate Ethics

Rationality

Derived from Latin "ratio"

Translated: "calculation", "reason"

Max Weber: Two distinctions

Purposive rationality

- Relationship between a goal and the means

vs.

Value rationality

- Reasonableness of a certain goal

Individual rationality

vs.

Assessment of social conditions



Max Weber 1864 - 1920



Instrumental Rationality and Value Rationality

Instrumental Rationality

Goal-Means-Relationship:

- Goal is exogenous
- Hypothetical Imperative: „If objective A is to be achieved, then means B fulfills this purpose.“

Efficiency:

- "things are done right"
- In relation to a certain predetermined goal

Value Rationality

Reasonableness of a certain goal:

- Goals have to be justified
- Correctness of the goal dependent on e.g. moral, religious or aesthetic beliefs

Effectiveness:

- "right things are done"
- Correctness dependent on criteria



But: Interdependency Between Goals and Means

Homann 1980: no consideration in isolation possible!

Permanent feasibility study:

Feedback between goals and means is consequently necessary

„Ought implies can“

Focus only on instrumental rationality not enough for economics

➤ No strict separation between instrumental rationality and value rationality

Source: Karl Homann 1980: *Die Interdependenz von Zielen und Mitteln*. Mohr Siebeck, Tübingen.

Open Concept of Advantage in Economics

Stigler/Becker 1977: „matters of taste cannot be disputed“

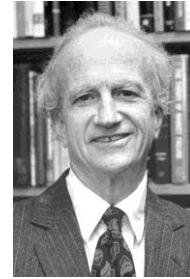
Question: What should be the subject of scientific research?

Preferences

- Actions can be explained by changing preferences
- Lack of theory on development of preferences
- ➡ Methodologically sufficient to consider preferences as exogenous and stable

Situative Restrictions

- Objectively observable across individuals
 - Allow an interpretation of corresponding behavioral conditions
- ➡ Methodologically meaningful subject of investigation



Gary Becker (1930-2014),
Nobel Prize 1992



George Stigler (1911-1991),
Nobel Prize 1982

Source: George Stigler/Gary Becker 1977: *De gestibus non est disputandum*. In: The American Economic Review, 67 (2), 76-90.



Methodological Individualism

Question in background: How can social phenomena be explained?

Every analysis of a society begins with the individual.

What it is NOT: A statement about true nature of man/concrete form of human behavior
(= ontological individualism)

- ❯ Methodological individualism makes statement about how to develop good theory about social phenomena



Methodological Collectivism/Holism

Contrary to methodological individualism

Starting point of holism: Every individual behavior is based on social circumstances.

Macro phenomena can not be explained by individual behavior.

➡ Example: System Theory (Luhmann) – systems as a whole have certain peculiarities and a certain internal law that does not merely result from the aggregation of entities.

Subjective Concept of Advantage (1/2)

Subjective concept of advantage :

Value of a good depends on individual advantage it brings
to the respective consumer

+

Gossen's First Law:

The marginal benefit of a good decreases with increasing
consumption

Subjective Concept of Advantage (2/2)

Anticipation of the marginal principle in John Law, 1705 :

„Goods have a Value from the Uses they are apply'd to; And their Value is Greater or Lesser, not so much from their more or less valuable, or necessary Uses: As from the greater or lesser Quantity of them in proportion to the Demand for them. Example. Water is of great use, yet of little Value; Because the Quantity of Water is much greater than the Demand for it. Diamonds are of little use, yet of great Value, because the Demand for Diamonds is much greater, than the Quantity of them.“

Quelle: John Law 1705/1750: *Money and Trade Considered: With a Proposal for Supplying the Nation with Money*. R.&A. Foulis, Glasgow.



Classical Paradox of Value (1/2)

Why is a diamond more expensive than water?

	Exchange Value	vs.	Value of Utility
Water	low		very high
Diamond	very high		low

Already Adam Smith saw no direct connection of both value concepts.

Classical Paradox of Value (2/2)

Why is a diamond more expensive than water?

Labor theory of value

- Objective value theory
- The value of a good can be explained by amount of working time spent on it



Unable to solve the classical
value paradox

Marginalism

- Subjective value theory
- Individual use of a good is directly dependent on its available quantity



Solves the paradox

➤ Exchange value of water in desert high, in a city rather low



Theory of Revealed Preferences

Using this theory (Revealed Preference Theory), utility functions can be constructed from the actor's observed choices.

Example: Decision maker has choice between good A and good B or good B and good C

One observes, following preferences:

A is chosen over B

B is chosen over C

Revealed Preferences:

Good A is preferred to good B

Good B is preferred to good C

Criterion of Transitivity

Derivation of complete order of preferences

Two revealed preferences ($A > B$ and $B > C$)

+

Assumption of transitivity : if $A > B$ and $B > C$
 $\rightarrow A > C$

Result: Decision maker prefers good A to good C. Order of preference: $A > B > C$

IMPORTANT: Last preference itself was not observed!

It is an *indirectly* revealed preference

Assumption of transitivity must be fulfilled

Instrumental Use of Utility Functions

Wrong interpretation: one decision maker prefers one good over another because it maximizes his utility

A utility function is merely a formulation of consistent individual choices

Certain consistency requirements must be imposed on the choices, since idiosyncratic behavior cannot be modeled

→ Empirical studies that violate axioms pose a challenge to neoclassical theory

➤ Descriptions of behavior through utility functions are just an "as if".
Success depends on success of the prediction



Ordinal Utility Function

What must be present in order to specify an ordinal utility function?

1. Transitivity
2. **Completeness**

Any pair of goods X and Y can be compared

This means: either a good is preferred or one is indifferent between the two goods

Result:
Ordinal order of goods, this means the alternatives can be ranked from best to worst



Concept of Indifference

Meaning:

A good X is liked as much as a good Y

Delineation from **indecisiveness**:

Indecisiveness

- Period of reflection time is needed to weigh the respective benefits of the two goods

Indifference

- There is no period for reflection needed, someone knows that both alternatives have the same value



Rationality of Decision Maker

Sufficient criteria for an ordinal utility function:

Transitivity + Completeness

Additional axioms that can be posed on decision makers as a requirement for rationality, for example:

Irrelevance of third alternatives

From a set of alternatives of goods X and Y, preference is given to X.
→ Preference relation must not change if a good Z is added



Homo Economicus

A picture of man ascribing a selfish motive to man?

→ NO!: only a postulate of consistency for decision making

Open concept of advantage on the example of Mother Teresa:

Puts welfare of children above her own

Compatible with homo economicus model if behavior is consistent

Egoistic action in the narrow sense is due to logic of situation (for example in anonymous markets)

➤ What constitutes a benefit to the individual is up to him!

Economics as Situation Theory

Falsification of homo economicus by psychology/behavioral sciences?

Economic method is still successful

Reason: its special scope

No behavioral theory, but *situation theory*

- Reality and world view of the people are hidden
- True motivation of actors irrelevant

➡ Actors do not act as homo economici per se, but by situationally accounting for actions of others in their decision

➤ Modeling of interaction processes that forces individual actors to adapt behavior based on situational incentive structure

Economics and Economic Policy

1. Step:

Economics asks for ...

- Actions of individual actors under given framework conditions
- Type, quantity and mode of production of goods to be produced
- Distribution of goods among members of society

2. Step:

Economic policy asks for ...

- Institutions to implement the answers
- Regulatory policy/economic framework
- Process policy to influence process of economic activity

Which social condition is desirable? ➡ **Open concept of utility**

➤ How can social common good be operationalized?



Hayek 1967: Distributive and Procedural Justice (1/2)

Respectively: consequentialist vs. procedural theories of justice

1. Distributive Justice:

Theories:

E.g. Utilitarianism

- Social interpretation of happiness
- Fair state means: greatest happiness of the greatest number

Exhibited in the context of specific welfare functions

vs.

Pareto-Criterion

- Result-oriented minimum consensus

Source: Friedrich August von Hayek: *Rechtsordnung und Handelsordnung*. In: E. Streißler (Hrsg.), Zur Einheit der Rechts und Staatswissenschaften. CF. Müller, Heidelberg, 3-20.



Hayek 1967: Distributive and Procedural Justice (2/2)

Respectively: consequentialist vs. procedural theories of justice

2. Procedural Justice:

Equality ideal of formal civil liberties

Issues of procedural justice, rather than result orientation

Theories:

Entitlement Theory (Robert Nozick)

Friedrich A. Hayek: The market as place of spontaneous order

Source: Friedrich August von Hayek: *Rechtsordnung und Handelsordnung*. In: E. Streißler (Hrsg.), Zur Einheit der Rechts und Staatswissenschaften. CF. Müller, Heidelberg, 3-20.



Distributive Justice

How can different social conditions be compared?

1. Value judgments must be traced back to judgments of individuals
2. Individual value judgments can be described as revealed preferences about utility functions
3. In order for utility levels to be intersubjectively comparable, a cardinal scale level is necessary
4. Through welfare functions different benefit levels can be compared. Depending on choice of welfare function, different results emerge



Economics and Value Judgments

Normative individualism:

Value judgments are attributed to wishes and needs of individuals

Individual sovereignty:

Every member of society can judge its own situation

Methodological individualism:

There is no superordinate social value that can not be attributed to value judgments of individual members of society

Utility Function

Concept of **utility function**:

Individual objectives can be indirectly derived from choice actions

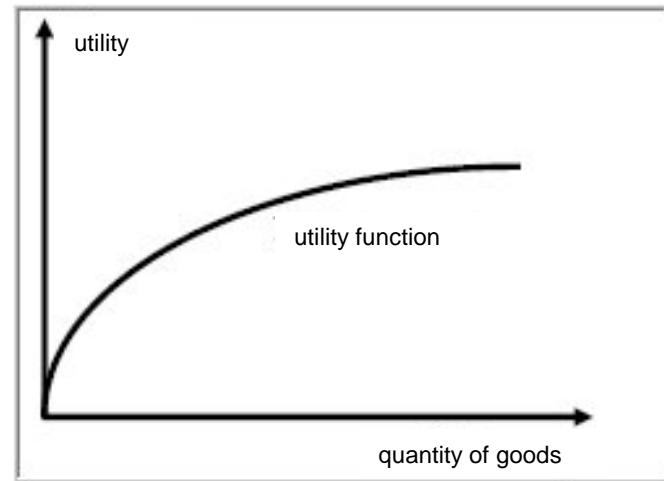
Revealed preferences can be described by utility functions (assumption: certain consistency requirements).

Only **functional role**:

Keep metaphysics out of decision theory

Individuals "have" no utility function.

Individuals behave *as if* they maximize function.





Cardinal Utility Scale

Intention is to individualistically substantiate social goals

→ Question: How can individual benefits be aggregated/compared?

Necessary: **cardinal scale level**

Distances between the utility values can be meaningfully interpreted

Intersubjective comparability of benefits is ensured.

Examples:

- Temperature in degrees Celsius
- Time

→ Temperature difference between 10° C and 20° C is the same as between 5° C and 15° C

Utilitarian Welfare Function

Formula:

$$W^U = \sum_{i=1}^n \alpha_i u_i(x)$$

W^U : Utilitarian welfare function

u_i : utility for individuum i

α_i : weighting factor for individual i. Special case: $\alpha_1 = \dots = \alpha_n = 1$

x : state of society

➤ Social welfare as the weighted sum of the individual utilities of individuals

Nash Welfare Function

Formula:

$$W^N = \prod_{i=1}^n [u_i(x)]^{\alpha_i}$$

W^N : Nash welfare function

u_i : utility for individuum i

α_i : weighting factor for individual i

x : state of society

➤ Sensitive to variations of individual utility (example.: $u_{384} = 0 \rightarrow W^N = 0$)

Rawlsian Welfare Function

Formula:

$$W^M = \min[u_1(x), \dots, u_m(x)]$$

W^M : Rawlsian welfare function based on John Rawls's "Theory of Justice"

u_i : utility for individuum i

x : state of society

➤ Operationalization of maximin criterion: W^M at maximum when individual of society who is worst off, realizes the maximum benefit

Problem of Previous Welfare Functions

Assumption: interpersonal comparability of utilities

Example: Utility of a beer = 100 vs. Utility of tomato juice = 10

→ But: Beer is ten times as attractive as beer is not a meaningful statement

Contemporary utility interpretation: only *ordinal* statements like e.g. "better"/"worse", distances between utility values are not interpreted

➤ Cardinal utility concept is rejected today by most economists

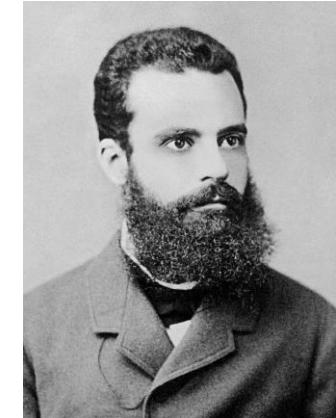
Pareto Criterion (1/3)

Assumption: Social conditions can only be judged from individual point of view



Definition **Pareto-efficiency**:

State A is Pareto-superior compared to State B, if at least one individual is better off in State A and no other individual is worse off.



Vilfredo Pareto (1848-1923)

- Social conditions can be classified with this criterion

Pareto Criterion (2/3)

State X:

Certain utility level for 1 and 2

Under utility-possibility frontier

→ not Pareto efficient, because better position is possible

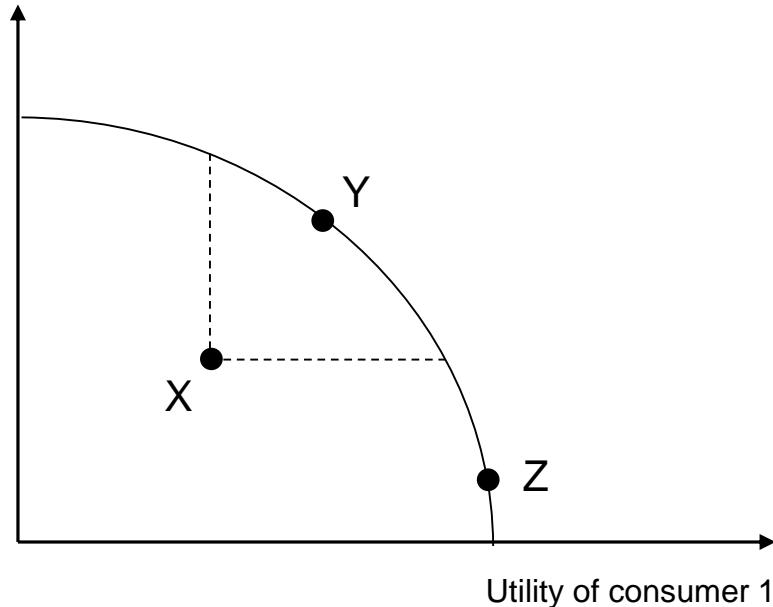
State Y:

1 and 2 are better off than in State X

→ State Y is Pareto-superior in relation to State X

This applies to all points located northeast of State X

Utility of consumer 2



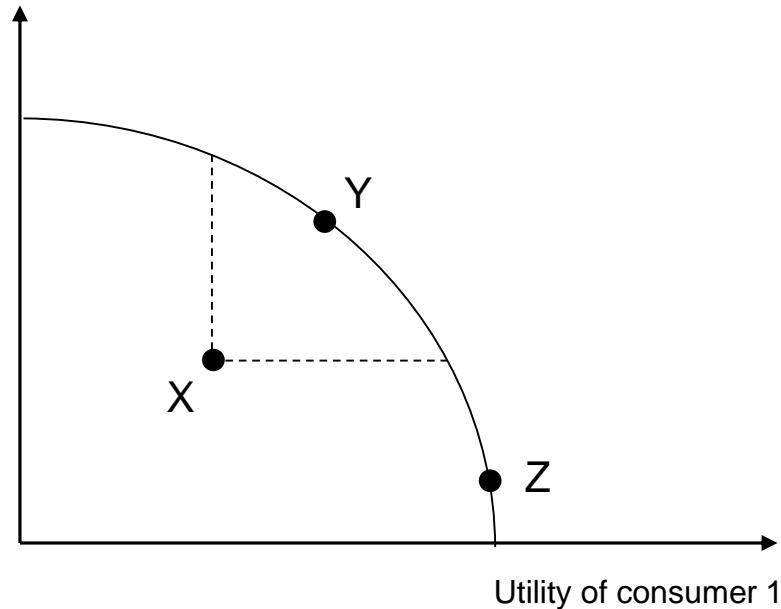
Pareto Criterion (3/3)

Z:

On utility-possibility frontier
No other condition is achievable without discrimination of an individual

- From X to Z: from Pareto-inefficient state to Pareto optimum
- However: no Pareto improvement
Consumer 1 is improving, but consumer 2's consumption is declining

Utility of consumer 2



Pareto Criterion: Results

Pareto efficiency and Pareto optimum:

Movement from Pareto inefficient state to Pareto optimum does not necessarily mean a Pareto enhancement (movement from X to Z)

A Pareto enhancement does not yet imply a pareto-efficient state (movement of X to a point Northeast of it, but below the pareto-efficient curve)

Pareto improvements as a minimum consensus:

Who would object to one side being better off if the other side does not suffer?

Most likely no one. Assumption: no envy!

- Compared to welfare functions: Pareto criterion is normatively more appealing



Strong vs. Weak Pareto Criterion

When is one social State A preferred over another State B?

Strong Pareto Criterion:

In A, *at least* one individual is better off without another being disadvantaged

Weak Pareto Criterion:

In A, *all* individuals are better off

Counter-intuitive?

➡ Mnemonic: the weak Pareto principle is empirically more difficult to realize

Buchanan's Critique of Distributive Justice Approaches

Problem with Robinson Crusoe example:

- Cardinal economic problem of scarcity must not be described solely in individual case
- Danger thereby: inferences from individual to society are often problematic
- Leap from individual utility maximization to maximizing utility of society is wrong
- Essential interactions between individuals must not be hidden



James M. Buchanan (1919-2013), Nobel Prize 1986

➤ Economics is essentially interaction economics

Source: Geoffrey Brennan und James M. Buchanan 1985: *The Reason of Rules. Constitutional Political Economy*. CUP, Cambridge/New York



Buchanan's Critique of Welfare Economics (1/2)

1. Welfare economics tends towards intervention science

Criteria of outcome justice requires orientation toward theoretical ideal (e.g. Pareto Optimum)
If the ideal is not achieved, there is a tendency for state interventions

2. Efficiency criterion is unrealistic

Efficiency criterion: Any equilibrium that occurs in the complete market is a Pareto optimum

Complete market is a theoretical ideal → Efficiency criterion is unrealistic

Abstract scale, instead of criterion of justice

Economics has lost its orientation function in society

Economics should be re-connected and upgraded in the public discourse



Buchanan's Critique of Welfare Economics (2/2)

3. Efficiency ideal regardless of wishes of individuals

Pareto Optimum is determined independently of market process ➔ independent of desires of individuals

Market as "Calculation Machine" (Samuelson 1954, 388)

Deviation of status quo from Pareto optimum = market failure (market prevented from doing calculative work)

Correction: indifference between democratic process and benevolent dictator

➔ Welfare economics raises efficiency to a normative requirement, which is to be achieved by state control

➤ Welfare Economics does not take the actual desires of those affected into account

Source: Paul Samuelson 1954: *The Pure Theory of Public Expenditure*. In: The Review of Economics and Statistics, 387-389.



Buchanan's Criterion of Consensus (1/3)

Buchanan's demand: an **internal and not ideal** criterion, rather than a theoretical ideal for comparing different social conditions

→ Criterion of agreement/consent: Consistent orientation based on status quo

Can a situation be established from here and now
that everyone agrees to?

Buchanan's Criterion of Consensus (2/3)

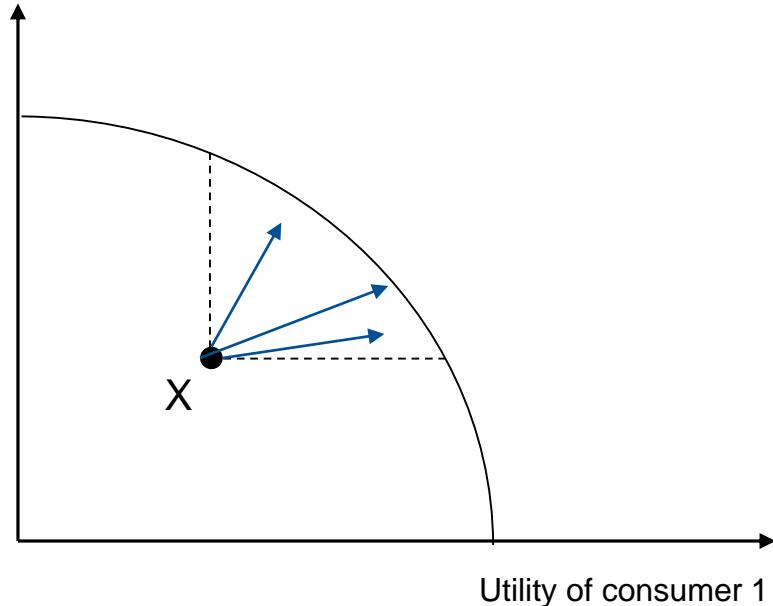
State X as a starting point (status quo)

Focus on all states that reach a consensus between players starting from State X

→ successive movement in northeastern direction

Reference point: status quo and not external Pareto criterion of complete competition

Utility of consumer 2





Buchanan's Criterion of Consensus (3/3)

Three key findings/interpretations:

1. A **heuristic** that changes from external perspective of efficiency to internal perspective of political processes (mutual consent!)
2. Market as an **interaction process** for reciprocal improvement through exchange acts, rather than an algorithm whose performance has to be measured against the efficiency ideal
3. Move away from Pareto optimum as distribution criterion and return to Pareto improvement as process criterion → should refer to rules, not individual actions



Example of a Consensual Rule

Criteria:

Rule must be derived from metarules/rules of higher order

These metarules must sometimes be sufficiently general to be unanimously approved

Example:

Establishment of a state with a monopoly on the use of force

End of Hobbes' war of all against all

Generate universal peace dividend



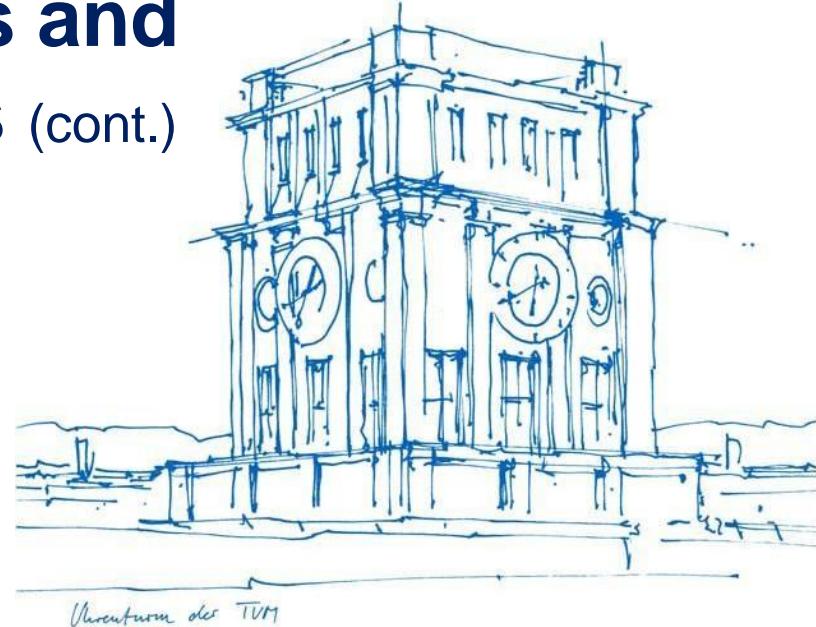
Introduction to Business Ethics: (Economic) Foundations and tools of Business Ethics (cont.)

17. January 2023

Prof. Dr. Christoph Lütge /
Franziska Poszler

Peter Löscher Chair of Business Ethics
Technische Universität München

Winterterm 2022/23





(Dilemma Structures vs.) Pure Coordination Games

Pure coordination games:

There are basically no divergent interests between individuals

However, it requires a well-known rule for coordination with each other

Example: left or right-hand drive

Assumptions:

No driver has a preference for driving on the left/right side

All have preference for everyone driving on same side

Coordination:

If achieved, no individual incentive to deviate from rules

Equilibrium is self-enforcing

Rule violations do not have to be sanctioned

Pure Coordination Games: Example

Assumption: $a > b$

		Player 2	
		drive left	drive right
Player 1	drive left	I a, a	II b, b
	drive right	III b, b	IV a, a

Dilemma Structures

Basic assumption:

Theoretically possible and mutually desired gains from cooperation can not be realized

Behavioral interdependencies as main reasons:

No interaction partner can control outcome alone

Anyone who acts with respect to common interests risks being exploited

➤ **Pareto-inferior equilibrium:** best possible result is not achieved

Prisoner's Dilemma (1/2)

Description of the situation: Two prisoners are suspected of joint crime

They are isolated and interrogated in separate rooms

Maximum sentence for the crime: three years imprisonment

Both are silent (= cooperation): due to minor offenses only one year imprisonment

Both confess (= defection): two years imprisonment

One is silent (= cooperation) and the other confesses (= defection): leniency and thus no imprisonment for the latter, maximum penalty of three years for the former



Prisoner's Dilemma (2/2)

High relevance in theory:

Patterns of interaction:

Two persons interact with each other

Interdependence of behavior:

No person can determine result of the interaction alone

Mirror-inverted situation:

Both persons each have two strategies: cooperate and defect

No behavioral commitment:

Crucial: In advance, there was no effective commitment of people to a strategy

Prisoner's Dilemma: Normal Form

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

Prisoner's Dilemma: Evaluation (1/2)

Situation Player 1 (analogously for Player 2):

Depending on the decision of Player 2:

- Player 2 cooperates: Defection maximizes payoff ($3 > 2$)
- Player 2 defective: Defection maximizes payoffs ($1 > 0$)

→ Defection is the dominant strategy

Both players defect → Quadrant IV (payout: 1, 1)

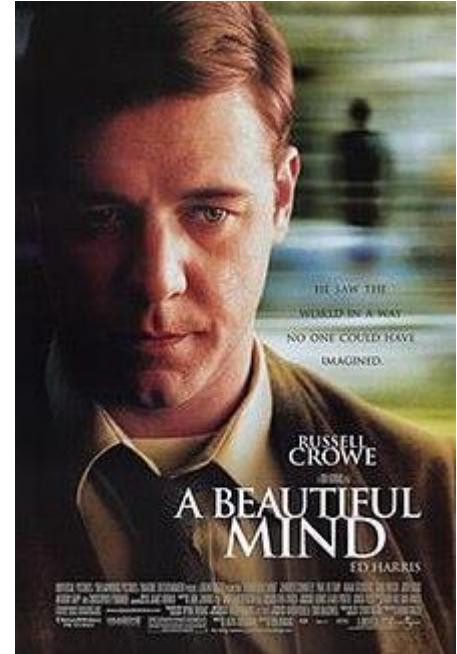
》 No player has an unilateral incentive to change strategy: **Nash equilibrium**



Film recommendation: A beautiful mind

Biographical drama about John Nash

- Tells the story of American Nobel Prize winner Nash: His innovative work on game theory in mathematics as well as how he dealt with mental illness



Prisoner's Dilemma: Evaluation (2/2)

If both players cooperate, payoff would be higher:

$$\text{payoff (Quadrant I)} = 2, 2 > \text{payoff (Quadrant IV)} = 1, 1$$

→ Pareto-inferior Nash-Equilibrium (mutual improvement is possible)

No improvement of the situation by their own effort

➤ Individually rational behavior leads into rationality trap:
realization of shared interests fails because of structure of interaction situation



Dilemma structures: Its application to modern business

Example: Pricing strategy of competing firms

- Two firms sell similar products; each must decide on a pricing strategy
- They best exploit their joint market power when both charge a high price (10 million each)
- If one sets a competitive low price, it wins a lot of customers away from the rival (12 million, 7 million for the rival)
- If both set low prices, the profit of each is 9 million dollars

Source:

<https://www.econlib.org/library/Enc/PrisonersDilemma.html#:~:text=The%20prisoners%20dilemma%20has%20applications,ten%20million%20dollars%20per%20month>

Relevance of Prisoner's Dilemma?

e.g. Ken Binmore 2011:

Prisoner's Dilemma represents a situation in which dice are as loaded against cooperation as they could possibly be

→ Can other dilemmas describe reality better?

Here: prisoner's dilemma as a paradigmatic case that makes cooperation problems salient

Source: Ken Binmore 2011: *Natural Justice*. Oxford University Press, Oxford.



Stag Hunt

Description of situation:

Two hunters can either choose to hunt hares on their own or join forces to kill a stag together

Benefits of split stag > benefit of hare

Hare can be killed alone, stag only in cooperation

If a hunter breaks the agreement to go hunting together and instead goes hunting hares, other one goes out empty handed

Generic payoff matrix: $a > b > c$

Stag Hunt: Normal Form

Assumption: $a > b > c$

		Hunter 2	
		Stag hunt	Hare hunt
Hunter 1	Stag hunt	I a, a	II c, b
	Hare hunt	III b, c	IV b, b

Stag Hunt: Results

Two possibilities:

- 1) Both hunters stick to agreement and cooperate
- 2) One player does not trust other and goes hunting hare, because he fears to go out empty handed. Possible reasons:

If difference between a and b is low → Slight doubt is enough

Maximin Strategy → Maximize lowest payout

➤ Situation more cooperation-friendly than prisoner's dilemma, but mutually beneficial cooperation may still not be achieved



Battle of the Sexes

Description of the situation:

A couple would like to spend the evening together (main concern)

Two possible meeting points: Cinema and football stadium

They forgot to agree on a meeting place

Woman prefers football stadium, man prefers cinema

Generic payoff matrix: $a > b > c$

Battle of the Sexes: Normal Form

Assumption: $a > b > c$

		Woman	
Man	Cinema	I a, b	II c, c
	Stadium	III c, c	IV b, a

Battle of the Sexes: Results (1/2)

Two Nash equilibria in pure strategies:

Quadrant I

If woman goes to stadium, it
is also best for man to go to
stadium

Quadrant IV

If man goes to cinema, it is
also best for woman to go to
cinema

→ no dominant strategy

Cooperation fails if:

Both go to their favorite place OR
Both want to do other a favor

Battle of the Sexes: Results (2/2)

Interest to coordinate is entangled with a distribution conflict

→ No pure coordination game

Clearly diverging preferences regarding coordination solution

→ Connection of converging and diverging interests

➤ Incentive structure suits reality: Often we want to get together with others, but have different ideas about specifics



Overcoming Dilemma Structures (1)

Task of Business Ethics:

Identify factors that prevent or would facilitate cooperation for mutual benefit.

Constitutional Perspective: Buchanan here sees the state as a social institution that is established through a collective act of exchange

-

Example: Traffic Offenders (1/2)

Analysis using Prisoner's Dilemma:

Situation A:

Player 1 (traffic offender) breaks traffic rules

Player 2 (other road users) sticks to it

→ Quadrant III

Situation B:

Constancy of the behavior of others leads to change in behavior of Player 1

→ Quadrant I

		Player 2	
		cooperate	defect
		I	II
Player 1	cooperate	b, b	d, a
	defect	a, d	c, c

Assumption: $a > b > c > d$

Example: Traffic Offenders (2/2)

Result: Consensus of behavioral change fails because

$$\begin{aligned} \text{Utility (Player 1, Quadrant III)} &> \text{Utility (Player 1, Quadrant I)} \\ \text{or } a &> b \end{aligned}$$

→ Traffic offender is better off, if he breaks the rules while everyone else sticks to them

》 Therefore, unilateral behavioral changes fail to pass a consensus test

Ability to Approve

Instead: constitutional consensus test asks for ability to approve of rules

Is a general violation of rules preferred over a general compliance of rules?

Example of the traffic offender: general rule violation = Quadrant IV

$$\begin{aligned} \text{Utility (Player 1, Quadrant III)} &> \text{Utility (Player 1, Quadrant IV)} \\ \text{or } b &> c \end{aligned}$$

- Crucial: comparison between general defection (**status quo minor**) and general cooperation (**Pareto-better alternative**).



Overcoming Dilemma Structures (2)

More potential solutions – some factors that facilitate cooperation:

- Iteration
- Communication
- Change of payoff matrix (e.g. introduce reward: reduce the cost of cooperation; introduce penalty: increase the cost of defection)
- Non-rationality, non-self-interest of individuals

For fun: How individuals communicate & decide in reality

Example from the game show *Split or Steal*



		Player 2	
		split	steal
		I	II
Player 1	split	50, 50	0, 100
	steal	100, 0	0, 0

https://www.youtube.com/watch?v=7FbkwrhW_0I



Game Theory and Behavioral Evidence

- Game theory could be treated as a normative theory that tells people what they ought to do if they wish to act rational in strategic situations
- BUT there is not always one strategy that can be recommended and assures highest payoffs (for everyone)
- Has game theory indeed helped empirical researchers make new discoveries about human behavior?

Source: Stanford Encyclopedia of Philosophy



Experimental Economic Research...

...as method for Business Ethics

Actual behavior of actors can be examined within context of economic incentives

No "cheap talk" (like in hypothetical surveys), actual behavior is observed instead of mere statements of intent

Method to put implementability of desired moral actions under conditions of modern societies to test

Some results from experimental Economic Research

- Experimental economic research has drawn attention to a number of factors that traditional economics has so far neglected in its theory formation.

For example:

- **Fairness considerations** in ultimatum game (Güth et al., 1982)
→ Offers of less than one-fifth of the total amount tend to be rejected with a likelihood of approximately 50 % (Fehr & Schmidt, 2001)



Conclusion

- The concept of rationality plays a central role in economic decision theory.
- There are different result-oriented concepts of justice (i.e., different welfare functions) and process-oriented conceptions of justice.
- The Pareto principle is seen as a prominent test procedure for social conditions.
- Dilemma structures are a central aspects of modern business ethics.



Quiz time

(Questions concerning the lectures on the (philosophical, and economic) foundations and tools of Business ethics)



Question 1

What does descriptive ethics deal with?

- a) It deals with the meaning of ethical terms, the nature of moral discourse and the foundations of moral principles.
- b) It deals with the description and explanation of normative systems.
- c) It deals with criteria of what is morally right and wrong.
- d) It deals with the application of ethics to real-world problems.



Question 1 – correct answer

What does descriptive ethics deal with?

- a) It deals with the meaning of ethical terms, the nature of moral discourse and the foundations of moral principles.
- b) It deals with the description and explanation of normative systems. ✓
- c) It deals with criteria of what is morally right and wrong.
- d) It deals with the application of ethics to real-world problems.



Question 2

What is NOT correct about Consequentialist Ethics?

- a) Its practical implementation is limited since, for example, it is difficult to determine the outcomes of actions.
- b) It may contribute to injustice by sacrificing the happiness of an individual to maximize aggregated happiness.
- c) It puts excessive demands on the individual because every single decision becomes a moral issue.
- d) It emphasizes means over the end.



Question 2 – correct answer

What is NOT correct about Consequentialist Ethics?

- a) Its practical implementation is limited since, for example, it is difficult to determine the outcomes of actions.
- b) It may contribute to injustice by sacrificing the happiness of an individual to maximize aggregated happiness.
- c) It puts excessive demands on the individual because every single decision becomes a moral issue.
- d) It emphasizes means over the end. 



Question 3

Which statement about the veil of ignorance is WRONG?

- a) It is a realistic description of how people reason.
- b) It is a thought experiment.
- c) It was invented by John Rawls.
- d) It is a concept from contract theory.



Question 3 – correct answer

Which statement about the veil of ignorance is WRONG?

- a) It is a realistic description of how people reason.
- b) It is a thought experiment.
- c) It was invented by John Rawls.
- d) It is a concept from contract theory.



Question 4

What does Gossen's First Law describe?

- a) Total benefit of a good decreases with increasing consumption
- b) Marginal benefit of a good decreases with increasing consumption
- c) Total benefit of a good increases with increasing consumption
- d) Marginal benefit of a good increases with increasing consumption



Question 4 – correct answer

What does Gossen's First Law describe?

- a) Total benefit of a good decreases with increasing consumption
- b) Marginal benefit of a good decreases with increasing consumption ✓
- c) Total benefit of a good increases with increasing consumption
- d) Marginal benefit of a good increases with increasing consumption

Clarification of why b is correct answer here:

Gossen's First Law states that the utility derived from each additional unit of product diminishes.

Why a/c is false: Yes, the total benefit of a good could decrease or increase with increasing consumption (see:

https://www.google.com/search?q=gossens+first+law&rlz=1C1GCEU_deDE869DE869&sxsrf=AJOqlzVtelwNSqQI6WZMUrIIxb6dF6Gdrq:1673961121627&source=lmsms&tbo=vid&sa=X&ved=2ahUKEwipvpaQ1878AhXXgP0HHaltBCEQ_AUoBH0ECAEQBg&biw=1164&bih=560&dpr=1.5#fpstate=ive&vld=cid:6f0ba7e2,vid:RBM4GA3WiDs), but this is not what Gossen's First Law is about.



Question 5

Which of the following do NOT exhibit dilemmatic structures?

- a) Stag hunt
- b) Battle of the sexes
- c) Pure coordination game
- d) Prisoners' dilemma



Question 5 – correct answer

Which of the following do NOT exhibit dilemmatic structures?

- a) Stag hunt
- b) Battle of the sexes
- c) Pure coordination game ✓
- d) Prisoners' dilemma



Thank you for your attention!



Introduction to Business Ethics: (Psychological) Foundations and tools of Business Ethics

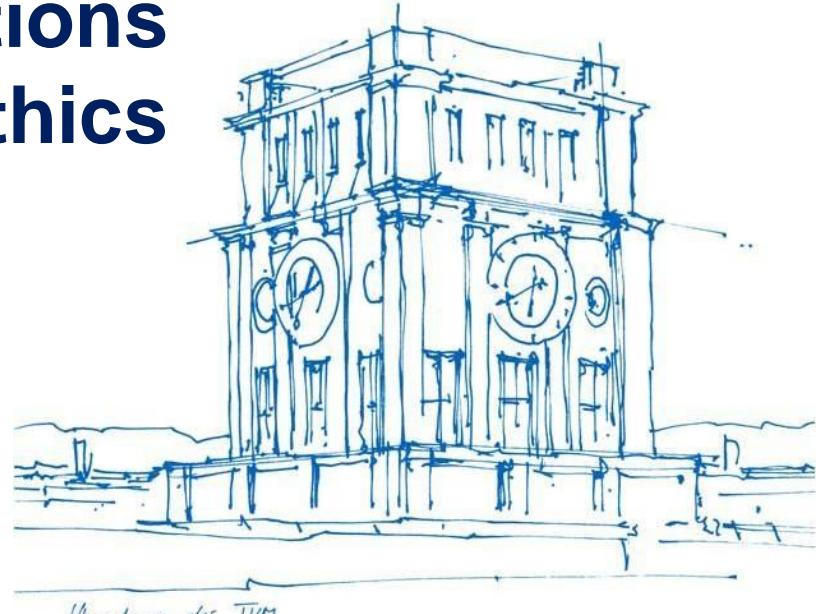
18. January 2023

Prof. Dr. Christoph Lütge /
Auxane Boch

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Technische Universität München

Winterterm 2022/23

Prof. Dr. Christoph Lütge | Introduction to Business Ethics I WS 22/23





Focus of today

Introduction

Chapter 1: Business Ethics in the Age of Globalization

Chapter 2: Basic Concepts

Chapter 3: Historical-economic Background: Premodernity and Modernity

Chapter 4: Foundations and Tools of Business Ethics

➤ **Psychological foundations and tools**

Chapter 5: Problem Areas of Business Ethics

Chapter 6: Corporate Ethics



Introduction (1)

The study of human morality is highly interdisciplinary (Doris, 2013).

- Philosophy as a starting point.
 - Psychology: Initially due to mental processes science. Moral psychology becomes an experimental/empirical field of research.
- = Philosophy has been argued to be light on facts, and psychology to be light on theory.



Introduction (2)

A change in the late 1960s (Doris, 2013).

- On the one hand, morality in philosophy is influenced by naturalism and cognitive science when it comes to epistemology and philosophy of mind.
 - On the other hand, psychology sees the end of behaviorism and the rise of empirical research, including towards philosophical topics.
- = In this lecture, we will trace important insights of moral psychology for business ethics.



The Behavioral Approach to Ethics (1)

Traditional Ethics: Assumption that once a person has understood what is right or wrong, they act accordingly.

Schwitzgebel (2009):

- Across 31 libraries in the US and UK, ethics books are more likely to be stolen than other philosophical books of similar popularity and age.
- Even more frequent for advanced texts of interest to graduate students and professors.

Thus, there seems to be more to it than simple knowledge. There seems to be a **deliberation**.



The Behavioral Approach to Ethics (2)

Kohlberg (1984): Stages of Moral Development Theory

- Building on interviews based on 10 moral dilemmas done with 72 Chicago boys ages 10 to 16; 58 of whom were followed up at three-early intervals for 20 years.
- Kohlberg asked the children to give a reason for their moral dilemma decisions. He found that, with age, the reasoning changed.
- He identified 3 stages of moral reasoning development:
Preconventional, Conventional and Postconventional Morality.

The Behavioral Approach to Ethics (3)

Kohlberg (1984): Stages of Moral Development Theory

Preconventional Morality

Stage 1: Obedience & Punishment Orientation

Stage 2: Individualism and Exchange

Conventional Morality

Stage 3: Good Interpersonal Relationships

Stage 4: Maintaining the Social Order

Postconventional Morality

Stage 5: Social Contract and Individual Rights

Stage 6: Universal Principles



The Behavioral Approach to Ethics (4)

Kohlberg (1984) Theory = Morality would develop with age to become a stable character trait.

Critic from Bazerman and Gino (2012)

- Normative & prescriptive approach to ethics: how people should act when resolving ethical dilemma.
- Business ethics: moral evaluation of practices of people within corporations (Bazerman & Gino, 2012)

= Kohlberg's work is insufficient to understand how ethical dilemmas are actually solved, especially in the context of improving ethicality in organizations.



The Behavioral Approach to Ethics (5)

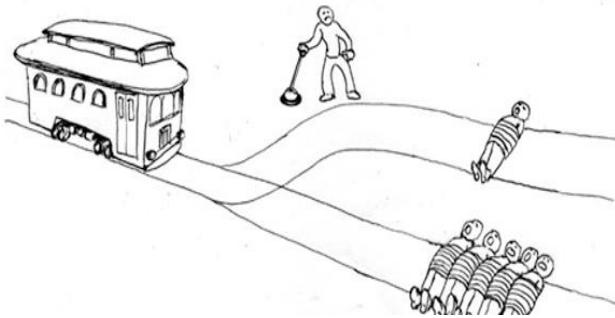
Utilitarian Theory: an act is considered moral if, compared to possible alternatives, it provides the greatest good for the greatest number of people.

Deontological Theory: No matter how morally good or bad the consequences, some choices are morally forbidden.

e.g., Kant's categorical imperative that humans should never be regarded as means to an end.

The Behavioral Approach to Ethics (6)

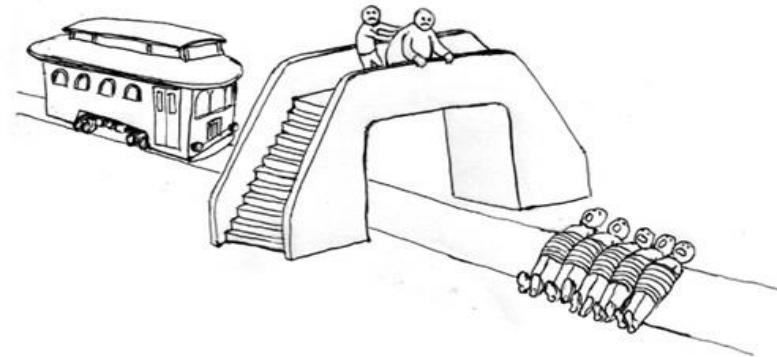
Trolley Problem (“Switch”)



A Utilitarian Answer:

The clear majority of respondents feel like it is morally acceptable to use the switch and kill only one worker over five.

Trolley Problem (“Footbridge”)



A Deontological Answer:

The clear majority of respondents feel like it is morally acceptable to use the switch and kill only one worker over five.



The Behavioral Approach to Ethics (6)

Doctrine of Double Effect = Doctrine of Side Effect

→ There is a line between harm that is caused as a means to an end, and harm that is caused as a side effect.

Footbridge dilemma: without the human to sacrifice on the rail, there would be no trolley stopper.

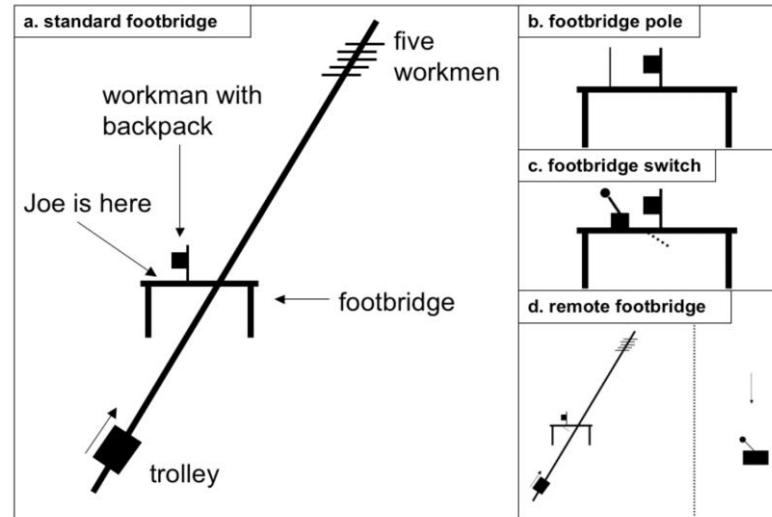
- Deontological answer (Kant): humans should never be used as a means to an end – means to an end.
- Utilitarian answer: there is only one choice: one or five human die – side effect.

= Are any responses to the trolley problems morally justifiable?

The Behavioral Approach to Ethics (7)

Greene (2014): Remote Footbridge

- A railway worker with a backpack stands on the footbridge under which the trolley will run.
- The bystander is standing at some distance from the footbridge at a distance.
- Hitting the switch will open a trapdoor through which the railway worker falls onto to stop the train.





The Behavioral Approach to Ethics (8)

Greene (2014): Remote Footbridge

- Approval rate of hitting the switch from 31% in footbridge to 63% in remote footbridge.
- If the physical mechanism should not matter ethically, it matters psychologically.

Thus, **our intuition** in this dilemmas are not only influenced by the ethically relevant means/side-effect distinction that many of us may find reasonable, but also by a **distinction of physical distance** that most of us probably find rather dubious.



The Behavioral Approach to Ethics (9)

What are factors of a behavioral approach to ethics?

- **Behaviors are prone to incentives**: behavioral ethics looks at how people actually behave, assuming people can act contrary to their best ethical intentions. Thus, it focuses on psychological factors in moral decision-making processes, which are highly situational.
- **Unintentional cognitive drivers** of unethical behaviors explain our inconsistent ethical behavior (Bazerman & Tenbrunsel, 2011). They are predictable patterns that can be understood and therefore addressed. Thus, behavioral ethics regards how people take moral decisions and not how they are supposed to behave in an ideal world.



The Behavioral Approach to Ethics (10)

What are factors of a behavioral approach to ethics?

- **Bounded rationality** in the domain of ethics evaluates unethical behavior that arise **without intentionality** (Simon, 1997).
- It looks at the ethically problematic behavior that is inconstant with the ethics that the people engaged in this behavior prefer for themselves.
- Thus, it is according the decision maker's own standards, and not the external standards of an observer that the ethical behavior is bounded.



Dual Process Theory (1)

→ How thoughts can arise in two different ways, or as a result of **two different processes**, called here System 1 and System 2 (Kahneman, 2011).

System 1 – Intuitive

- Automatic
- Quick
- Effortless
- Emotional

Relates to: impulses, habits, beliefs...

System 2 - Questioning

- Requires Attention
- Slow
- Effortful
- Logical

Relates to: reflection, planning, problem solving...
Monitor and Control thoughts and actions suggested by System 1.



Dual Process Theory (2)

The “Bat-and-Ball Problem”: what happens when System 2 is lazy (Kahneman, 2011).

“A bat and ball cost \$1.10. The bat costs one dollar more than the ball. How much does the ball cost?”



Dual Process Theory (2)

The “Bat-and-Ball Problem”: what happens when System 2 is lazy (Kahneman, 2011).

“A bat and ball cost \$1.10. The bat costs one dollar more than the ball. How much does the ball cost?”

Appealing & intuitive answer: 10cents. Correct answer: 5cents.

- If you gave the right answer, you might have been able to resist the temptation to follow the **rule of least effort** and might have a more active mind.
- If you gave the wrong answer, know that over 50% of participants from Harvard, MIT and Princeton did as well.



Dual Process Theory (3)

Kahneman (2011) concludes:

- People trust their intuition too much and find cognitive effort more than unpleasant.
- Understanding the relevance of System 1 for our thinking is important, and can sensitize us for logical and ethical errors.
- **Moral heuristics to ethical problems:** System 1 intuitive responses to moral problem.
- Acknowledging the role of our intuitive responses for moral judgement is central to behavioral ethics.



Dual Process Theory (4)

Kahneman (2011) concludes:

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- Understanding the relevance of System 1 for our thinking is important, and can sensitize us for logical and ethical errors.
- **Moral heuristics to ethical problems:** System 1 intuitive responses to moral problem.

Acknowledging the role of our intuitive responses for moral judgement is central to behavioral ethics.



The Social Intuitionism Model to Moral Judgement (1)

The Rationalist Approach (Kohlberg, 1969; Piaget, 1965; Turiel 1983)

- ⇒ Moral judgement are reached by reasoning + reflection.
- Moral emotions may feed into the reasoning process.
- Reject the idea that emotions are the direct causes of the moral judgement.

Weighing of right vs. wrong, benefit vs. harm, fairness vs. unfairness.

→ Reach a well calibrated judgement.

The Social Intuitionism Model to Moral Judgement (2)

The Rationalist Approach (Kohlberg, 1969; Piaget, 1965; Turiel 1983)

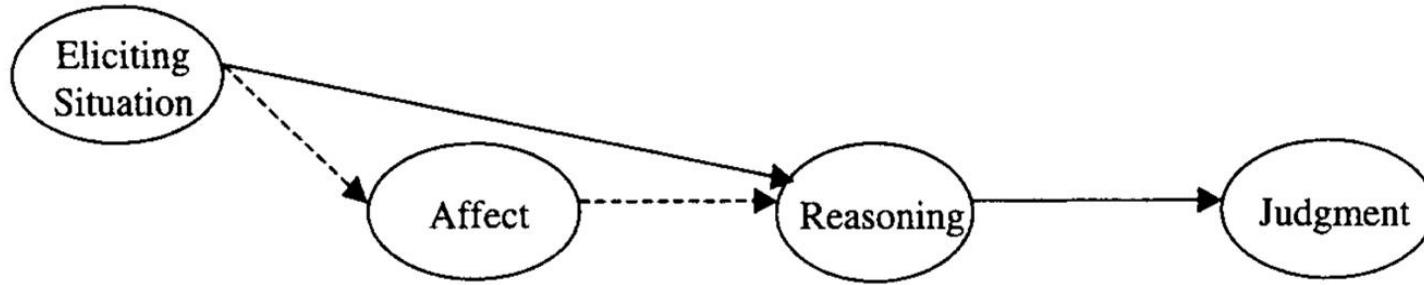


Figure 1. The rationalist model of moral judgment. Moral affects such as sympathy may sometimes be inputs to moral reasoning.



The Social Intuitionism Model to Moral Judgement (3)

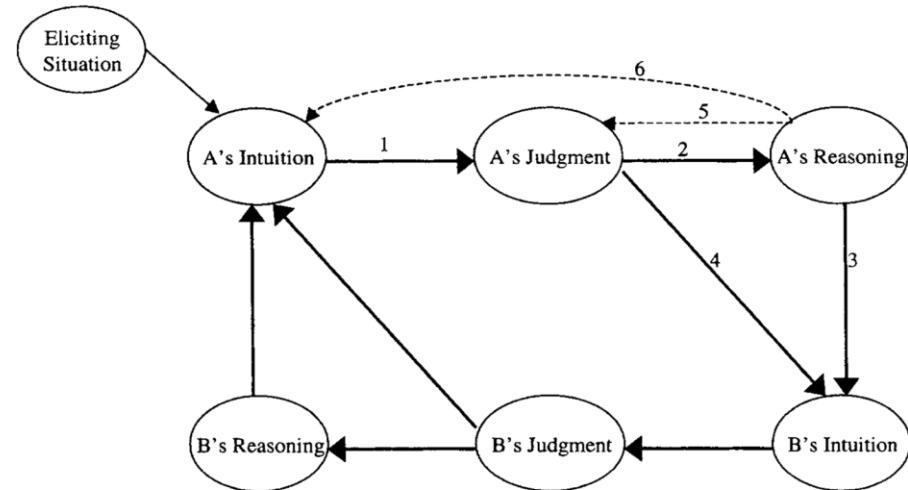
The Social Intuitionism Model (Haidt, 2001)

- ⇒ Emotional reaction precedes moral reasoning.
- Emphasises the importance of social and cultural influences on moral judgement.
- Deemphasises the role of private reasoning done by individuals.
- Intuitionist because moral judgements are generally the result of quick and automatic (intuitive) evaluations. Those are followed by slow *ex post facto* moral reasoning.

The Social Intuitionism Model to Moral Judgement (4)

The Social Intuitionism Model (Haidt, 2001)

The numbered links drawn from Person A only are (1) the intuitive judgement link, (2) the post hoc reasoning link, (3) the reasoned persuasion link, and (4) the social persuasion link. Two additional links are hypothesised to occur less frequently: (5) the reasoned judgement link and (6) the private reflection link.





The Social Intuitionism Model to Moral Judgement (5)

The Social Intuitionism Model - Conclusions (Haidt, 2001)

- Rationalists models made sense in the 60s and 70s when the cognitive revolution thought about moral judgement as a form of information processing.
- Since then, evidence show that most cognition occurs automatically, and moral judgements happen outside of our consciousness.
- People usually cannot explain how they really arrive at a particular moral judgement.



The Limits of Reason for Moral Judgements (1)

Reasons to doubt the causal importance of reason for moral behavior (Haidt 2001)

- There is evidence supporting **dual process models in moral judgement making**. In this case, System 1 is involved based on automatic processes. Regarding first sight impressions (Albright et al., 1988), people seemed to keep a constant attitude towards a specific group from first sight to later on (Ambady & Rosenthal, 1992).
- The problem of **motivated reasoning** suggests that a post hoc reasoning is more important than a reasoned judgement and a private reflection. People would thus be more likely to arrive at their desired conclusion, while this ability is constrained by their ability to come up with reasonable justification (Kunda, 1990).



The Limits of Reason for Moral Judgements (2)

Reasons to doubt the causal importance of reason for moral behavior (Haidt 2001)

- People, post hoc, generate **causal explanations** out of a priori causal theory, such as social norms culturally transmitted supporting the evaluation of other people's behavior.
- The final reason relates to focusing on moral behavior instead of moral judgement. Strong evidence on psychopaths who understand harmful consequences of actions but do not care highlight that moral reasoning matters less for moral actions than **moral emotions**.



Boundedly Ethical Decision Making (1)

- The ability to make ethical choices is limited because of external factors.

Bazerman & Tenbrunsel (2011): in-group favouritism.

- A professor at a prestigious university gets a call from a long-lost friend and is asked to introduce the friends' child to the director of admission. The outcome is usually that the professor will follow through due to the unpleasantness to tell a friend it is impossible to help them.
- Most of us are intuitively comfortable with doing favours for those with whom we identify with. It is not the result of an immoral intention, but the result on focusing on being “nice” to those who are like us.



Boundedly Ethical Decision Making (2)

Decision Making Process:

- The "want/should" distinction explicitly captures the intra-personal conflicts within a human mind (Bazerman et al., 1998) and thus justifies the idea of multitude of self conceptions triggered in different contexts when it comes to decision making (Kivetz & Tyler, 2007).
- The "Should" is based on prediction and remembrance.

Before

Possible Misperception:
Misprediction

During

After

Possible Misperception:
Misremembrance



Before the Decision: Prediction Error

- **Prediction errors** is the human tendency to make inaccurate predictions about how one will behave in a future situation. Humans underestimate the impact that **visceral factors** (emotions, drives, and cravings) have on future behavior (Lowenstein).
- **Hot-to-Cold Empathy Gap:** tendency to consider our desires in emotional states as being more stable than they actually are. An intense desire to act in the moment might evaporate after a “cool off period”.
- We have a tendency to predict our behavior as **more compatible with our ethics** than it will actually be, leading to prediction error. Interestingly, this does not apply to our estimation of other peoples’ behavior (Epley & Dunning, 2000).



During the Decision: Ethical Fading

Ethical fading – should/want (Tenbrunsel & Messick, 2004):

- The “**want**” takes over and the decision-maker is unaware of ethical implications of their decisions which leads to the neglect of ethical criteria for the decision.
 - When judging others ethical behavior, the “**should**” activates over the “want”, and we think we might have acted differently than the person.
- Our predictions of our own ethical behavior are bad because we predict according to the “should” (abstract concepts, moral reasoning) but the “want” (visceral response) usually wins.



After the Decision: Selective Memory (1)

Being “revisionist historians” (Bazerman & Tenbrunsel, 2011):

- When evaluating the ethical implications of our actions, we take distance from the want and base our moral reasoning on the should.
- If faced with a mismatch between our self-image and our unethical behavior, our memory can become selective to describe best the self-depiction we desire.
- We find ways to spin the unethical behavior by rationalising our role in a given situation, interpreting our actions in a more favourable light, or by redefining what is ethical.



After the Decision: Selective Memory (2)

Omission Bias (Tenbrunsel et al., 2010):

- Tendency to believe acts of omission to be morally superior to acts of commission.
- In a context of injustice, we predict that we will have the courage to speak up against injustice, but when the time comes, we often remain silent.
- When recollecting such lack of action, we allow ourselves to believe we were not unethical because we did not create additional harm.



Boundedly Ethical Decision Making

Before

The Should

- Prediction Error
- Hot-to-Cold empathy gap

During

The Want

- Ethical Fading
→ When judging others behavior, the “should” takes over.

After

The Moral Reasoning

- Revisionist Historian
- Omission Bias



Bounded Ethicality in Organisations

The normative approach: Traditionally, the study of business ethics have been based on what managers and employees “**should**” do. This reflects in the popularity of companies’ codes of conducts and moral guidelines (De Cremer & Tenbrunsel, 2011).

- The assumption that people behave rationally and purposively and are aware of their actions’ implications means that business scandals are the result of few bad apples. This misses the impact of the **circumstances** and **psychological processes** underlying an ethical behavior.
- Designing environments in which behaving ethically is easier would probably work better than banning unethical behavior (Dana et al., 2011).



Diffusion of Responsibility (1)

- People have a preference for **sharing responsibility in an ethically difficult decision** (Dana et al., 2011).
- Unethical behavior does not occur because people want to be unethical, but because they want to be truly ethical and go through the costly process of behaving unethically when no-one but themselves would punish them.
- Sharing responsibility allow people to take actions that they would eschew if they were acting unilaterally.

Diffusion of Responsibility (2)

→ People have a preference for sharing responsibility in an ethically difficult decision (Dana et al., 2011).

Vertically

When intermediaries exist and may take over the “dirty work”.

Ex: Outsourcing certain functions to a subcontractor that pays its employees wages below standard firm.

Horizontally

When people fail to behave ethically, because they count on others to do so on their behalf.

Ex: Bystander Effect in which people fail to help another person when others are present but do not do so when alone.



Diffusion of Responsibility (3)

Principal Agents Relationships – Vertical (Hamman et al., 2010)

- Principal agents repeatedly decide how much money to share with a recipient or hire agent to make sharing decisions on their behalf.
- When hiring agents, the sharing was usually reduced.
- Principal agents in this case would not feel like having taken unethical decisions because they were simply hiring people to take the decision for them.



Diffusion of Responsibility (5)

Horizontal Diffusion (Dana et al., 2007)

- Two decision maker had a binary choice between a fair outcome for themselves and a possible bystander, and an inequitable outcome that benefited the two decision makers but harmed the third party.
- The inequitable outcome was implemented **only** if both decision maker choose it. Thus: if one decision maker choose the “fair” outcome, this could be implemented unilaterally. But if choosing the “unfair” outcome, responsibility was split between both actors.
- When given the choice, twice as many decision maker decided to go for the “unfair option”.



The Influence of Unethical Others (1)

- In social contexts, such as organisations, other people's behavior will influence our own ethical conduct (Shu et al., 2011).

Gino et al (2009) define **three ways** in which other's unethical behavior can influence our own ethical behavior:

- **Changing our cost-benefit analysis of the unethical behavior.** Becker (1968) posits that in observing other people get away with unethical conduct may change our beliefs regarding likelihood of getting caught and the cost of such behavior. Thus, leading to assume benefits for the behavior, making it more attractive.

The Influence of Unethical Others (2)

- **Attention on Internal Standards of Honesty:** Mazar et al. (2008) lead an experiment in which an experimental group is being reminded of moral principles before making a decision, while the control group isn't. When making the decision, the experimental group reduced significantly their level of cheating for financial gains as compared to the control group.
- **Norm-focus Theory:** Cialdini et al. (1990) state that two types of norms will impact ethical behaviors: injunctive norms, which make specification on how one ought to behave, and descriptive norms, specifying what is actually done. Both can exist simultaneously.



Crowding-out Effects Through Organizational Measures (1)

The Hidden Cost of Control:

- Tenbrunsel & Messick (1999) report that weak sanctions intended to increase ethical behavior actually reduce it. The ethical behavior is “crowded out”.
- Falk & Kosfeld (2006) show that implementing minimum performance requirement induces the agent to reduce performance.

Example: implementing fine in daycare when picking up children late (Gneezy & Rustichini, 2000).

The decision to arrive late went from an ethical to a business decision because of the financial aspect of the transaction. The number of parents coming late did not reduce.



Crowding-out Effects Through Organizational Measures (2)

Transactional Behavior vs. Ethical Behavior:

- Samuel Bowles (2016) argues that people's preferences are not always stable. They are dependent on the frame put around them: ethical to financial for example.
- When successful, incentives can lead to crowding-in of ethical behaviors.



Fighting Our Unethical Behavior

Recommendations on Improving Ethical Behaviors (Bazerman & Tenbrunsel, 2011)

Use System 2 (reflective) and anticipate that the “want” self will exert pressure at the time of our decision:

- Using **self-control strategies** to curb that influence (Bazerman & Tenbrunsel, 2011); e.g. commitment devices such as publicly committing to a decision.
- Train the abstract thinking by focusing on the **high-level** aspect of a situation.
- Have **more than one-option** choices, as the multitude of options induce more reasoned decision (Bazerman et al., 1998).
- **Avoid uncertainty, time pressure, and short-term horizons** type of decisions as those factors facilitate ethical fading (Bazerman & Tenbrunsel, 2011).



Conclusion

- Simply knowing about ethical theories is not enough for ethical decision-making and behavior; this lecture session highlighted the importance of moral psychology for ethics.
- (Ethical) Thoughts are a result of two different processes, called System 1 (automatic, quick etc.) and System 2 (logical, slow etc.).
- The ability to make ethical choices is limited because of external factors.
- Therefore, various forms of boundedly ethical decision-making can emerge by individuals and organizations.



Thank you for your attention!



Introduction to Business Ethics: Corporate Ethics - Theory

24. January 2023

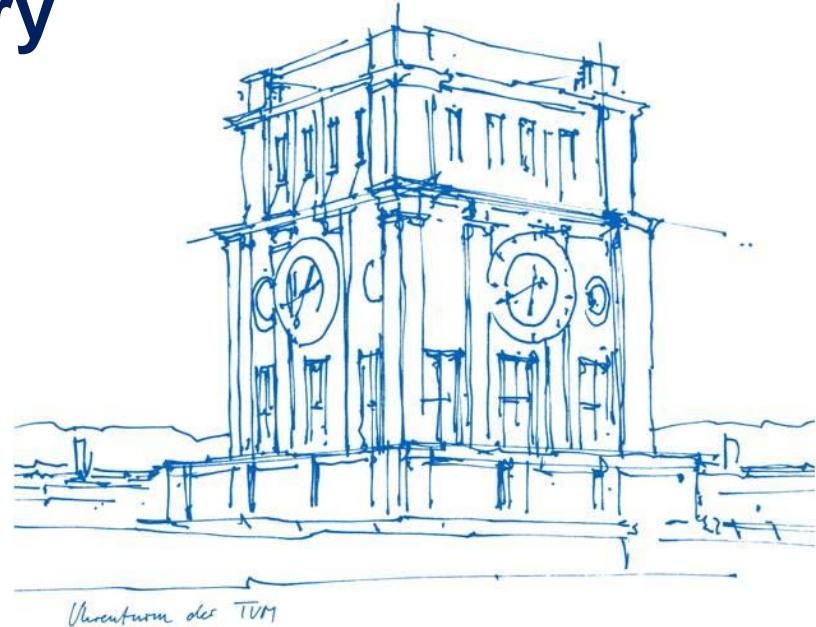
Prof. Dr. Christoph Lütge/

Dr. Marianne Thejls Ziegler

Peter Löscher Chair of Business Ethics

Technische Universität München

Winterterm 2022/23





Focus of today

Introduction

Chapter 1: Business Ethics in the Age of Globalization

Chapter 2: Basic Concepts

Chapter 3: Historical-economic Background: Premodernity and Modernity

Chapter 4: Foundations and Tools of Business Ethics

- Psychological foundations and tools

~~Chapter 5: Problem Areas of Business Ethics~~

Chapter 6: Corporate Ethics



Agenda

24th of January: Corporate Governance & Compliance + two cases of fraudulent corporations
(Enron and Wirecard)

25th of January: Three Cases: Siemens, Lorry Cartel and Cambridge Analytica

31st of January: Principles and Institutions of Corporate Social Responsibility (CSR)

1st of February: Sustainability Reporting and ESG Rating

7th of February: Guest Lecture by Dr. Andreas Nilsson on Sustainability, Sustainable Finance and EGS Rating



Dr Andreas Nilsson is Managing Director and Head of Impact at Golding Capital Partners and responsible for impact investments. Prior to joining Golding in 2021, Mr Nilsson was Managing Partner of Sonanz, an Impact-focused fund-of-funds which he founded in 2015. Before that, he worked as a private equity investor at EQT and UBS.

Mr Nilsson holds a PhD in Finance from the Stockholm School of Economics and spent two years as a Visiting Fellow at Harvard Business School. The topic of his doctoral dissertation was “The Financing of Nonprofits and Social Enterprises”. Mr Nilsson earned his MSc from the Stockholm School of Economics.



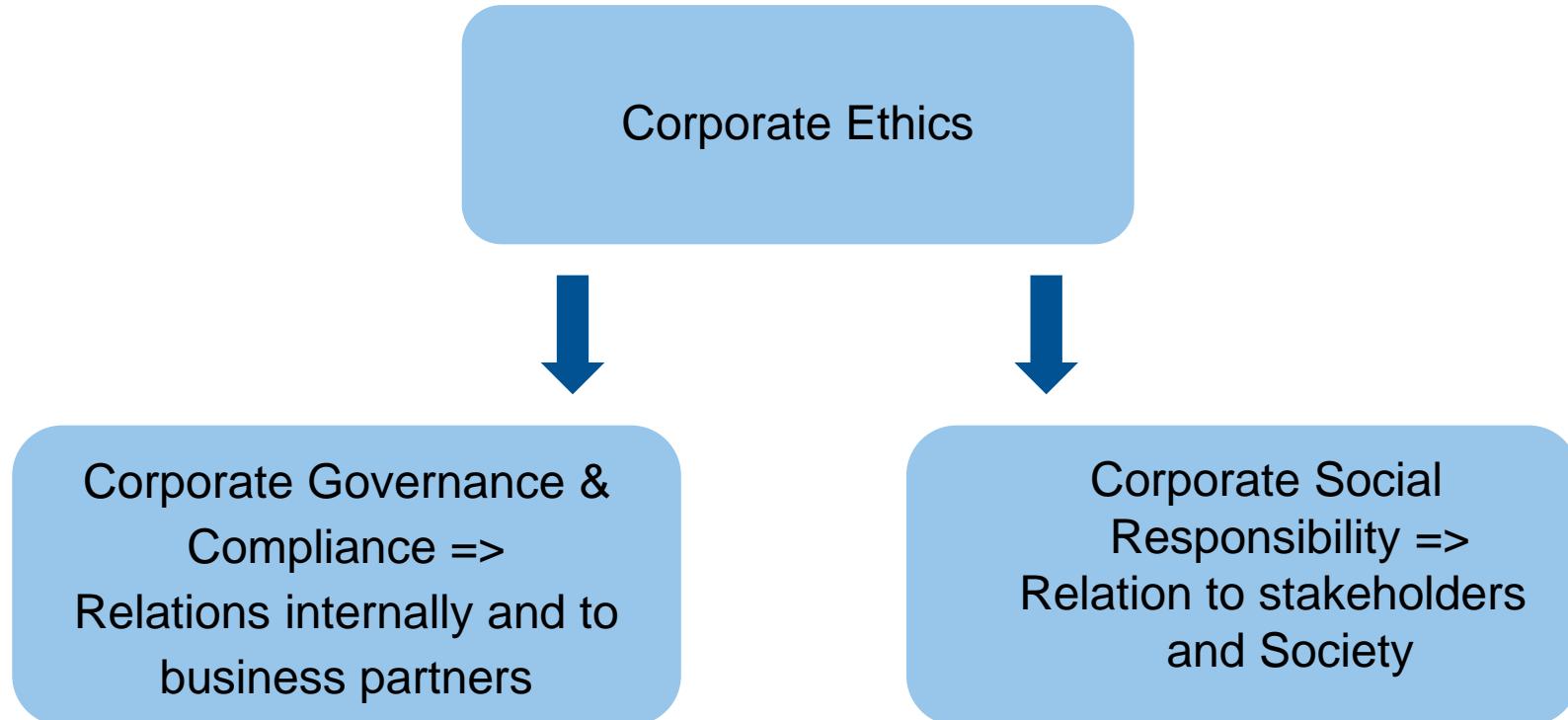


Learning objectives:

Basic insight into the principles of

- Cooperation structures at management level
- Reduction of the risk of mis-management and illegal conduct
- Accommodating the expectations and requirements of society

Slido.com
1174158





Today's lecture

Case illustrated introduction to issues, principles and codes of corporate governance

First case: The fall of Enron

Definitions, concepts and risk mitigation

Second case: Wirecard

Codes of Corporate Governance

Themes of Corporate Governance

Tomorrow's lecture: Three cases of corruption, anti-competitive cartel and abuse of personal data



Bookkeeping fraud

Bookkeeping fraud: Manipulation of annual financial statements in order to give shareholders and the public a incorrect impression of the financial health of a company.

Cases of this and the next lecture show

- why the apparent banalities of good corporate governance principles need to be collectively articulated in corporations
- why explicit management commitment should be imbedded in ongoing communication of values
- how fraud often starts with small misinformation to buy time and in time fraudulent conduct grows out of control

Bookkeeping fraud

The smartest guys in the room believing they could game the system

Enron and Wirecard: Examples of fraud which was revealed. There could be numerous other cases which remain undiscovered

Good corporate governance mitigating risk of incompetence, wrong incentive structures, bookkeeping fraud, corruption, cartels etc

Good corporate governance created transparency, which is not always in the interest of management



Case example Enron 1/6

1985: Founded by merger between gas pipelines Houston Natural Gas and Internorth

1990: Chairman Kenneth Lay hires CEO Jeffrey Skilling and CFO Andy Fastow

1992: Largest gas trader in North America. Beginning of mega-project in India

1996: **Beginning of bookkeeping tricks "Mark-to-Market Accounting"**

- "Mark-to-Market Accounting": the current value of future long-term revenue is counted as present revenue → 2000: \$10.78 billion in revenue reported, but only \$6.27 billion actual revenue

1999: Founding of trading platform "Enron Online"

(Lütge & Uhl: p. 249)



Enron 2/6

Losses were covered up by mis-representation in the book keeping

CFO Andy Fastow created "partner" companies (Special Purpose Entities, SPE) which enabled Fastow to transfer \$30 Billion losses to these fictive companies

The audit firm Arthur Andersen assisted Enron in building this structure

Recording profits and exporting losses to SPEs



Enron 3/6

2000: Stock price reaches all-time high: \$90.56

Oct 16, 2001: Enron admits that accounting rules have been violated; profits were corrected down by 20%

December 2, 2001: Stock falls to \$0.26 => Enron filed for bankruptcy. \$ 60 billion lost. 20.000 employees lost their jobs and their savings

2002: Collapse of accounting firm Arthur Andersen LLP due to involvement in Enron scandal

Arthur Andersen provided both auditing and consulting => conflict of interest

2006: convictions of Kenneth Lay, Jeffery Skilling, Andy Fastow and other managers



Enron 4/6

Consequence: Sarbanes –Oxley Act from 2002 (SOX)

Also known as: "Public Company Accounting Reform and Investor Protection Act"

Code of corporate governance making management responsible for audit. Incorrect financial report is a criminal offence.

Financial reports must certify that the statements truthfully represent the company's financial health, no untrue statements or mis-leading omissions

Auditors should be independent => no conflicts of interest

Auditor rotation



Enron 5/6

Dilemma of management:

CFO Andy Fastow served a six year sentence:

2019 speech:

“Every single deal I did as I was CFO of Enron was approved by Enron’s accountants, the outside auditors of Arthur Andersen, Enron’s attorneys, Enron’s outside attorneys, the bank’s attorneys and Enron’s board of directors.” (<https://ucalgary.ca/news/former-enron-cfo-accounting-hero-convict#>)

Dilemma due to obligation of management towards the shareholders: Use the full legal framework for the benefit of the corporation and at the same time be sensitive towards potentially criminal constructions



Enron 6/6: Ethical aspect

Principles of Sarbanes-Oxley act are principles which ought to be taken for granted

Cases like Enron demonstrate

- 1) Business person under pressure => make use of the entire legal spectrum, every act which is not forbidden will be perceived as legal
- 2) Temptations to make money can weaken ethical sensitivity

British businessman Sanjay Shah involved in cum-ex, a dividend tax fraud scheme

- € 2 billion of Danish tax payers money lost
- Logic: Possible and not explicitly illegal, therefore morally justified



Definitions, concepts and risk mitigation



Definitions Corporate Governance

The system by which companies are directed and controlled => setting the goals and controlling the implementation of these goals. (Cadbury Report 1992)

System of rules, practices and processes by which a firm is directed and controlled
(Investopedia.com)

A **set of relationships** between the company's management, its board of directors, its shareholders and other stakeholders which **provides the structure** through which the objectives of a company are set, and the means of **attaining** these objectives and **monitoring** performance. It helps to define the way **authority is allocated** and the way corporate decisions are arrived at and executed. (www.lawinsider.com)



Central Concepts

Code of corporate governance: Recommendations on how to govern a corporation in accordance with general standards

Compliance: Acting in coherence with legislation

Corporate Integrity: Shared corporate values as foundation for strong compliance culture

Integrity / compliance management: Practical challenges of ensuring law abiding culture in corporations



Corporate Governance as solution to issue

Issue: Separation of ownership and control in publicly listed companies

Mature listed corporations: professional management versus a more or less anonymous group of shareholders/investors

Principal-Agent problem: One party (the agent/management) agrees to work in favour of another party (the principal/shareholders) => challenges of incentivising agent

Owners do not control the company, therefore incentive structures of management need to be aligned with interests of shareholders



Risks of bad corporate governance

- 1) Reduced profitability
- 2) Reputational risks
- 3) Heavy fines and imprisonment
- 4) Loss of public contracts



1) Profitability risk

Good corporate governance organises management processes **systematic** communication

Increases **efficiency**, checks and balances and clear distribution of **responsibilities**

Systematic communication, transparent lines of command and transparent distribution of responsibility **mitigates the risk of mistakes** being made or mistakes remaining undiscovered

Lower risk of informal power structures

Informal power structures can decrease profitability because personal ambitions collide with the need for transparency



2) Reputational Risk

Incompliance makes firms vulnerable to public criticism

Internet, social media and NGOs (e.g. Greenpeace)

Loss of control over company's communication in mass media where perception is reality

Strong public focus on corporate misconduct and general distrust of elites, in particular of managerial elites

Requires monitoring of online activities

(Lütge and Uhl p. 247)



2) Reputational risk

Risk depends on line of business =>

Known brands like VW, H&M and Zara are sensitive to reputation because consumers have many alternatives. This increases the risk of consumer boycotts

Amazon, well known with high exposure to consumers, but low willingness to use alternatives makes them less sensitive to reputational risks

Anonymous corporations who move beneath the radar of public attention => lower risk



2) Reputational Risks

Difficulties attracting talent

Reduced employee motivation, shame of working for the company

Less attractive for investments

=> Example: Large asset managers are required to refrain from investing in non-compliant corporations



Example of reputational damage:

4th of August 1991 article in the German magazine “Der Spiegel”:
“The Death From Ingelheim”

Claim of Spiegel article: The German company Boehringer Ingelheim contributed to production of a chemical called “Agent Orange”. It was used by the Americans in the Vietnam War (1955-1975) to make the trees in the jungle loose all their leaves

Agent Orange made it impossible for the communist enemy (Vietcong) to hide. Agent Orange is known to be carcinogenic (causing cancer) and to cause birth defects. According to Vietnam authorities four million Vietnamese have been affected



19 November 2019

A medical professor by the name of Fritz von Weizsäcker gave a speech in Berlin. By the end of the speech he was attacked by a man with a knife and killed.

Reason for the murder: Fritz von Weizsäcker was the son of the former German Bundespräsident (1984-1994) Richard von Weizsäcker (1920-2015)

From 1962 – 1966 Richard von Weizsäcker was on the management board of Boehringer Ingelheim

The murderer wanted to revenge the four million Vietnamese victims of Agent Orange, and since the father had died, he killed one of his sons



Reputational risk: Homepage 2023 (32 years later)



The image shows the top navigation bar of the Boehringer Ingelheim website. It features the company's logo on the left, followed by a series of dropdown menu items: About Us, Human Health, Animal Health, Science & Innovation, Partnering, and Careers. Each menu item has a small downward arrow indicating it is a dropdown.

Boehringer Ingelheim did not produce Agent Orange. The company did also not contribute to its production by supplying precursors or raw materials.





3) Heavy fines and imprisonment

Incompliance with codified law (Anti-corruption law, competition law, data protection law etc.)

Heavy fines which skim off the economic advantage of the company arising from the unlawful act

Management accepting violations committed by employees => liability

Criminal prosecution up to 10 years imprisonment

Enron: Jeffrey Skilling sentenced to 24 years in prison, released after 20 years

Siemens: Fines € 1,6 Billion

Lorry cartel in Europe from 1997 – 2010: € 3 billion



4) Loss of public contracts: Public Procurement Law

Companies need to be law-abiding and trustworthy to be considered for public procurement procedure (especially in construction and defence industry)

Conviction and fines paid by companies are publicly available in the commercial central register

If companies are exempted from public procurement, it can end up in **a vicious circle** (especially if competitors become more active)

The re-approvement process of companies requires **comprehensible confidence-building measures**



Case example: Wirecard scandal

German Dax corporation insolvent in 2019 due to fraudulent financial reporting

Accounting firm EY responsible for audits

Failed to double check the bank statements =>

Failed to contact the banks and get an independent confirmation, that the information provided by Wirecard for the financial audit was correct.



Wirecard 1/7

Payment service: Connecting the customer in the shop and in e-commerce and shops

Founded in 1999. In 2001 after the dot com bubble, - almost bankrupt.

2001 Markus Braun joined => offered payment services to dubious websites.

2006 Listed on the TecDAX, index of 30 largest companies of technology sector

From 2007: International expansion

2015 Financial Times: “House of Wirecard” –series begins. Journalist Dan McCrum claiming there is something wrong with Wirecard

September 2018: Wirecard listed on the DAX

DAX = An Index of the largest and most profitable publicly listed corporations in Germany



Wirecard 2/7

2018 Whistle blower from Wirecard (Singapore) contacted Dan McCrum from Financial Times who had written about Wirecard in 2016, and told him, he was right ..

30th of January 2019: Financial Times article claiming that contracts were forged.

16 November 2019: Wirecard defends themselves: FT is wrong, and Wirecard is a solid business with 300.000 customers

Wirecard claimed, that the FT journalists has leaked the story to hedge funds in advance so that they could speculate (short sell) against Wirecard



Wirecard 3/7

Wirecard's claim:

Wirecard can connect credit cards of customers with their bank world wide.

In Germany they can act as intermediary bank, but they do not have banking licences abroad, for which reason they need local partners.

Local companies offer Wirecard payment service against a fee.

The fee is paid to an escrow account (intermediate account), and kept there as a guarantee in case there is not enough money on the bank account of the individual customers

=> Wirecard has an account with €1,9 billion



Wirecard 4/7

October 2019: Wirecard forced to call for an independent audit by KPMG.

KPMG: Wirecard did not provide sufficient information, therefore the report is inconclusive

Wirecard: You see, we have done nothing wrong. And we will improve the documentation.

April 2020 EY – the official auditor of Wirecard refused to sign the audit.

The auditor cannot confirm, that the numbers that Wirecard have provided are also correct.

June 2020: According to EY, the 1,9 Billion Euro which according to Wirecard was placed on fiduciary accounts (but the money belonged to Wirecard, as long as the partner companies did not need to make use of the guarantee) Turn out to be non-existent

€ 20 billion lost

Wirecard 5/7

Exit plan (if they had succeeded): Operation Panther

Wirecard taking over Deutsche Bank

Covering up fraudulent business by merging the statements
of Deutsche Bank with those of Wirecard

25th of June: Wirecard filed for Bankruptcy

CEO Markus Braun arrested

CFO Jan Marsalek escaped (believed to be in Moscow)

Court case in Munich from December 2022

 Polizeipräsidium München



Betrug in Milliardenhöhe

Die Staatsanwaltschaft München I, das Polizeipräsidium München und das BKA bitten um Ihre Mithilfe!

Jan MARSALEK, Ex-Vorstandsmitglied der Wirecard AG, steht in dringendem Verdacht, sich des gewerbsmäßigen Bandenbetrugs in Milliardenhöhe, des besonders schweren Falls der Untreue und weiterer Vermögens- und Wirtschaftsstraftaten strafbar gemacht zu haben. Aktuell befindet er sich auf der Flucht.



Jan MARSALEK *15.03.1980

Können Sie Hinweise zum Aufenthaltsort von Jan MARSALEK geben?

Wir bitten Sie, Ihre Hinweise dem PP München unter +49 (0) 89/2910-0 oder jeder anderen Polizeidienststelle mitzuteilen. Außerdem können Sie hierfür das Kontaktformular der Polizei Bayern unter www.polizei.bayern.de nutzen. Ihre Hinweise können vertraulich behandelt werden!

Herstellung und Verlegen: PP München | August 2020



Wirecard 6/7

EY Failure

A company's auditor is obliged to ensure independent confirmation of bank statements

After having received the information from the client company X, the auditors contact the bank and asks if the bank can confirm that the statements provided by company X are correct

With Wirecard, EY did not take this precautionary step

Combination of disregard for principles of corporate governance and lack of auditor diligence



Wirecard 7/7: The Guardian 16.11.2020

EY

Call for three-year ban on EY bidding on public contracts

Anti-corruption group claims 'recurring professional misconduct' should preclude auditor from future business

Simon Goodley

Sun 15 Nov 2020
16.54 GMT





Sliding into fraudulent business

Fraud often starts out as a minor mis-representation for the purpose of buying time to compensate for low performance

Mis-representing high result increases expectation => requires an overcompensation in the following year.

Overcompensating concealed deficit and overcompensating for higher expectations

- ⇒ Success: minor mis-representation can be covered up. Lack of success => requires even higher level of mis-representation
- ⇒ Snowball effect



Codes of Corporate Governance



Deutsche Corporate Governance Kodex

Mixture of legislation and recommendations for corporations listed in the

Legislation (German code: “**Principles**”)

=> concerning persons or companies carrying out economic activities.

=> formal processes of boards of directors

Suggestions/ recommendations: according to the principle “**comply or explain**”

“Soft coercion”: Compliance with corporate governance rules necessary for being listed on stock exchanges



Legislation and recommendations

German code: **Principles** = legal requirements

Principle: **The Management Board is responsible for managing the enterprise in its own best interests.** (Have to)

Suggestions and recommendations are soft law (comply or explain)

Example:

Corporate planning shall include corresponding financial and sustainability-related objectives. (Comply or explain, if you do not comply)



Procedures

Germany: Three bodies:

Annual general meeting (Hauptversammlung)

Supervisory board (Aufsichtsrat)

Executive board / Management (Vorstand/Geschäftsführung)



Annual General Meeting

Meeting of shareholders, supervisory board and management.

Enables shareholders to exercise their membership rights

Management submits fiscal statement for all shareholders to read and informs shareholders about the company's performance and strategy

Shareholders can confront supervisory board and management with questions

Shareholders appoint or re-elect members of supervisory board



Supervisory Board

Shareholders own the corporation and they appoint the members of the supervisory board

Supervisory board are representatives of shareholders and representatives of employees if applicable (Larger corporations in Germany: 1/3 employee representatives in supervisory board)

It oversees the management on behalf of the shareholders

=> Agency problems: Members of supervisory board and managers may have interests which are not coherent with the interests of the shareholders or with the interests of other relevant stakeholders



Supervisory Board (German rules)

For corporations listed on the stock exchange: The supervisory board members meet at least twice a year (four meetings per year are also normal)

Private corporations (not listed): Supervisory board can decide to meet only once a year

Normally, the chairperson calls the meeting

Important documents should be handed over to members of the board in time for them to prepare for the meeting

Meeting has an agenda and decisions are made with regard to the points of the agenda

At least half of the board members and at least three members are required for the board to have a quorum – i.e. to be able to make decisions



Executive Board / Management (Vorstand)

Responsible for managing the company, for developing strategies in cooperation with the supervisory board and for the implementation

Accountable to the supervisory board

Responsible for organising and signing audits

Responsible for ensuring that employees comply with legal requirements



Other national codes of corporate governance:

UK Financial Reporting Council: The UK Corporate Governance Code
(Lütge and Uhl p. 198)

US Corporate Governance Code: Sarbanes-Oxley Act
(A Reaction to the scandals of Enron and Worldcom)



International corporate governance standards

G20/OECD Standards for Corporate Governance: Help nations improve legal and institutional framework for corporate governance

United Nations ISAR (International Standards of Accounting and Reporting) International benchmark for ...

- 1) Auditing,
- 2) Board and management structure and process,
- 3) Corporate responsibility and compliance,
- 4) Financial transparency and information disclosure, and
- 5) Ownership structure and exercise of control rights.



Management and supervisory board

National difference:

One-tier system:

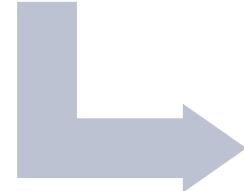
- UK
- US
- South Korea
- Italy
- Malaysia
- AUS
- SA
- India

Two-tier system:

- Ger, Aut, NL, DK
(mandatory)
- CZ, PL, RU, HU
- China
- Japan
- Brazil

One tier governance system

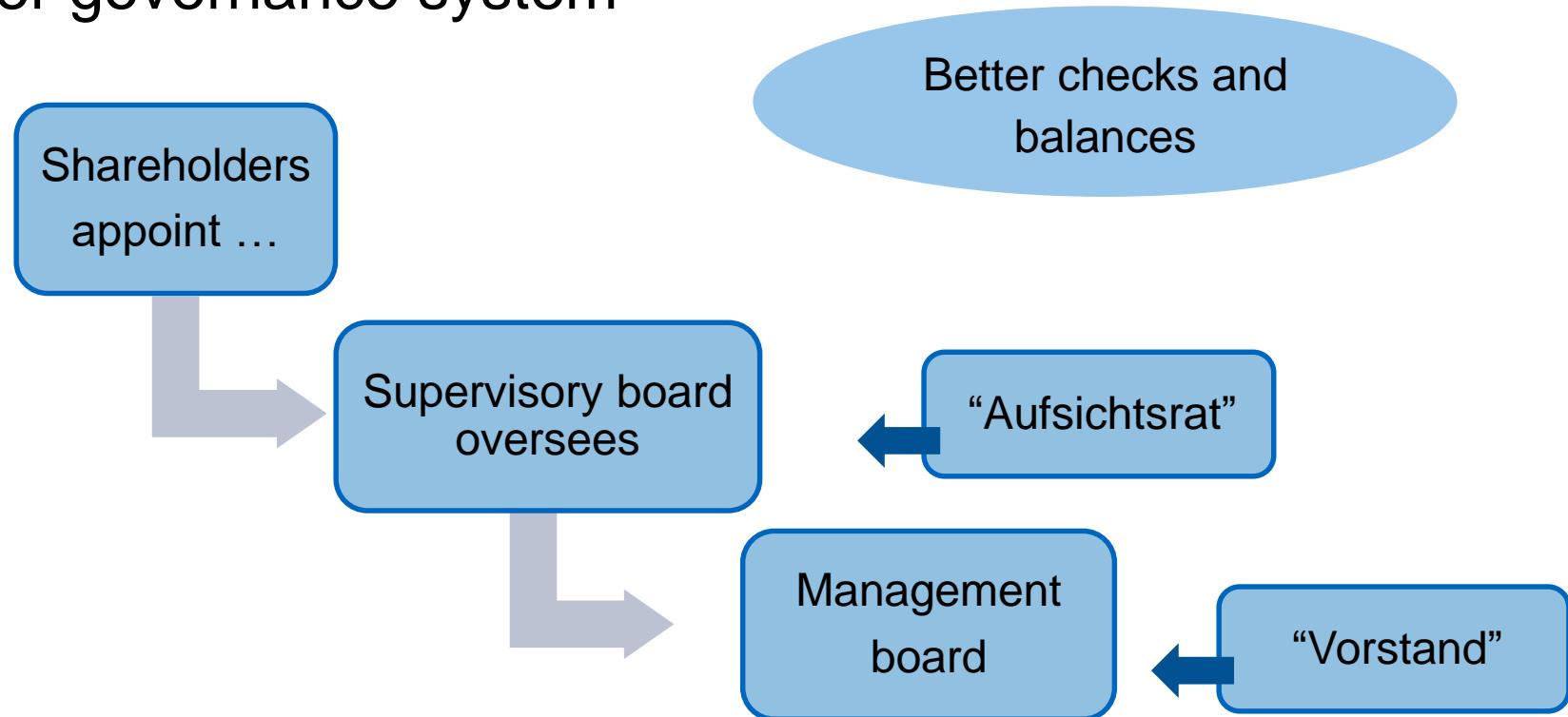
Shareholders
appoint ...



Entire executive board of executive and non-executive directors
(Chair has to be non-executive)

More efficient system

Two tier governance system





Example from two-tier system

German Code of Corporate Governance (two tier)

“The Supervisory Board appoints and dismisses the members of the Management Board.

....it supervises and advises the Management Board in the management of the enterprise and has to be involved in decisions of fundamental importance to the enterprise.

UK Code of Corporate Governance (one tier)

“Non-executive directors have a prime role in appointing and removing executive directors.”

“Non-executive directors should scrutinise and hold to account the performance of management and individual executive directors against agreed performance objectives.”



Themes of Corporate Governance Codes



Conflicts of interests must be disclosed

Lack of board independence from management: Undermines the supervisory function of the board.

Ideally, close personal relations between management and supervisory board members should be avoided

- ⇒ Supervisory board members primarily support management and not the long term interests of the corporation.
- ⇒ Risk of mistakes made by management being ignored
- ⇒ Risk of disproportion between CEO salary (remuneration) and company performance

Insufficient dedication: Lack of independent insight into challenges and issues => uncritical approval of management



Conflicts of interest

Members of management and supervisory boards are not allowed to pursue their own business interests as members of the boards (Principle)

Example of conflict of interest: A supervisor board member has an economic interest in one of the company's suppliers. Supporting the supplier in relation to the company would manifest a conflict of interest

Side-line activities of management board members need to be approved by supervisory board (Recommendation)



Conflict of interest example

Cross board membership

Philippa Smith on
supervisory board
in firm X

Peter Brown on
supervisory board
in firm Y

Peter Brown on
management
board in firm X

Philippa Smith on
management
board in firm Y



Remuneration of the management board and supervisory board

Principle: Salaries and bonuses aligned with the corporation's long term interest

Example: Bonuses tied to long term performance.

Dilemma:

Long term performance of a corporation: six years

Economic bonus to incentivise manager: On annual basis



Preventing Incompliance

Good corporate governance reduces the risk of incompliance

Corruption (Siemens case from 2006)

Cartels (Lorry cartel)

Abuse of data (Cambridge analytica)

Lütge and Uhl pp. 196 – 227



Integrity management: Code of Ethics

Well governed companies => compliance or integrity management system

Purpose:

Inform members of the organisation are informed about rules and regulations

Make members confirm (i.e. sign) that they have received this information

⇒ Determine liability in case of misconduct

Challenge: Prevent information overload => IT based compliance management systems providing employees with relevant information at the right time

Example: Booking of a flight ticket to high risk nation => the employee receives relevant information and is required to confirm (tick box) that this information is received and understood



Integrity management

Coherence with culture

Balance between merit based competitive culture and openness and forgiveness regarding mistakes

Extremely competitive culture leads to a cover-up-mistakes culture and increases the risk of mis-conduct

Recent development: Due diligence of business partners and screening of suppliers

2023: EU supply chain law

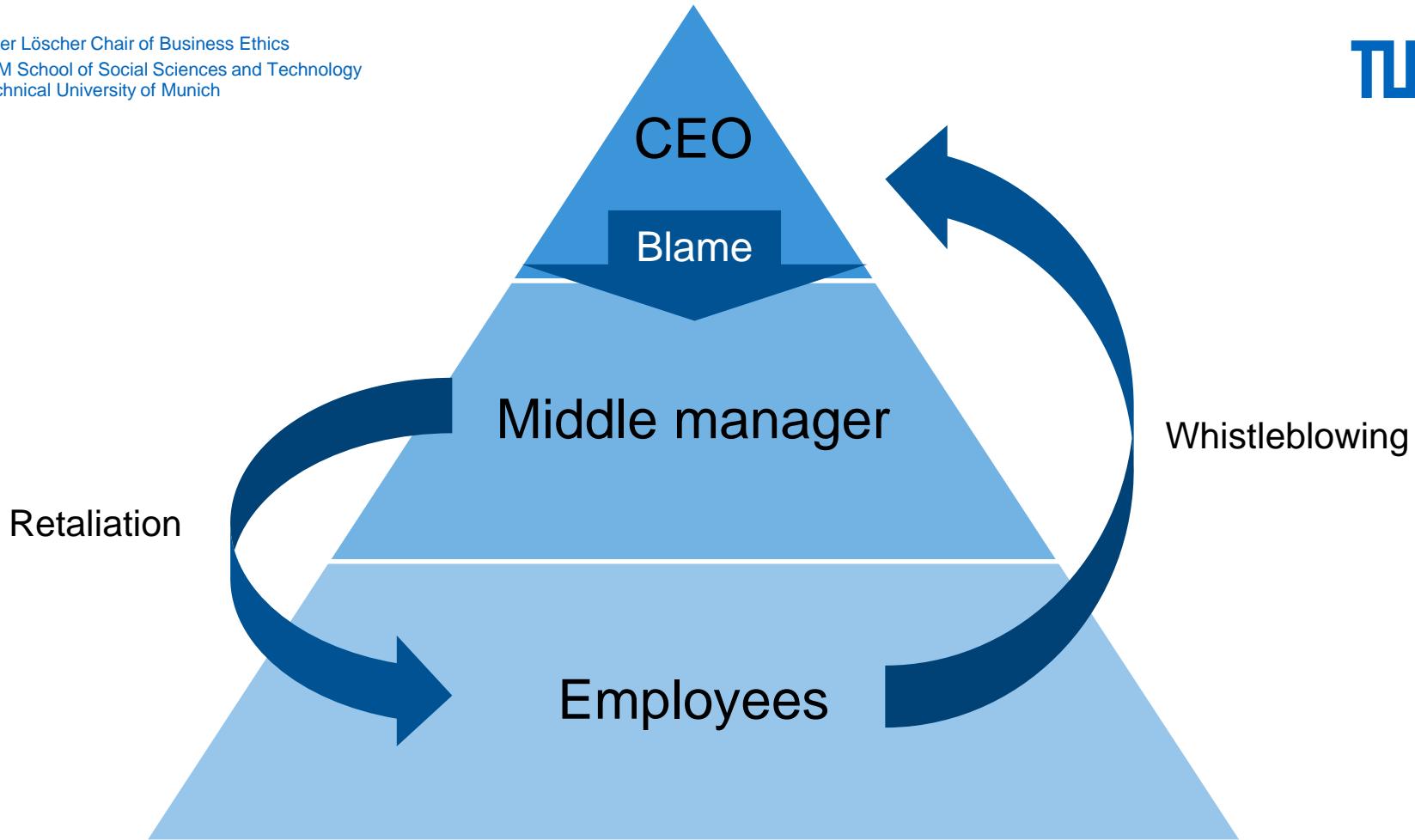


Whistle-blower system

Whistle-blower: Person who informs management or board of directors of misconduct in the organisation.

Risk: Telling on colleagues => perceived as an act of disloyalty => Whistle-blower provides information which can ruin careers and – in case of criminal action – lead to imprisonment.

Whistle-blower system give employees a place where they report anonymously on compliance breach and/or illegal behaviour without risking retaliation from colleagues





Whistle-blower system legislation

Whistle-blower system required for companies with more than 250 employees

Main purpose: Avoid corruption: Estimated that that corruption adds 15% to the costs of publicly funded projects in EU

Whistle-blower system provides a procedure which clarifies

- 1) Whom to report to – the responsible person(s) must react within three months.
- 2) How to ensure confidentiality
- 3) That whistle-blowers cannot be punished for breaking contracts or confidentiality agreements if they believe they are reporting the truth
- 4) That they are informed of their rights to legal aid

(Lütge and Uhl p. 218)



Channels for Whistleblowing

Post-box: Requires that a person can report without being seen

E-Mail: Reporter might want to use anonymous e-mail address

Ombudsperson: An independent person who can receive reports (can be expensive)

Digital whistle-blower system: Anonymous communication between whistle-blower and receivers of the reporting



Example of software solution to anonymity



The leading Pan-European marketplace, representing a **€7 trillion market capitalisation**.
European stock exchange seated in **Amsterdam, Brussels, London, Lisbon, Milan, Oslo and Paris**.



Euronext Corporate Services helps companies make the most effective use of capital markets





Identification Subject Case Review

Case Topic

- Corruption or trading influence ⓘ
- Human Rights ⓘ
- Threat or injury for public interests ⓘ
- Antitrust / Competition Law ⓘ
- Anti-Money Laundering and Combating the Financing of Terrorism ⓘ
- Other crime or criminal offence ⓘ
- Racism / Discrimination ⓘ
- Sexual harassment ⓘ
- Denial of benefits ⓘ
- Intimidation ⓘ
- Termination / Layoff ⓘ
- Conflict of interest ⓘ
- Financial fraud ⓘ
- Gifts and bribery ⓘ
- Inside information breach ⓘ
- Security breach ⓘ
- Safety and Health ⓘ
- Other

Whistle-blower can create anonymous profile, identify case topic, time, date, location, persons involved.

The whistle-blower will receive feedback regarding the development of the case



Introduction to Business Ethics: Corporate Ethics – Use Cases

25. January 2023

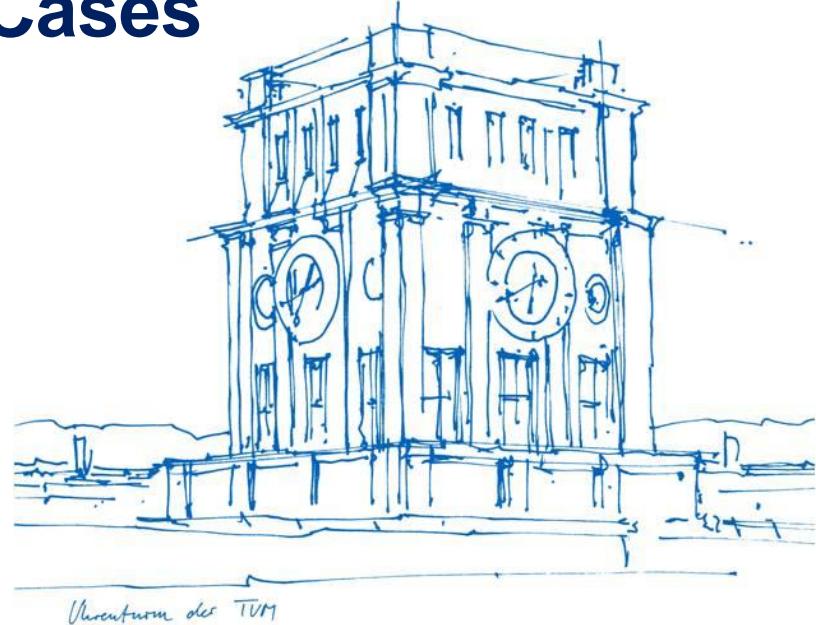
Prof. Dr. Christoph Lütge/

Dr. Marianne Thejls Ziegler and

Auxane Boch

Peter Löscher Chair of Business Ethics

Technische Universität München



Uhrenturm der TUM



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

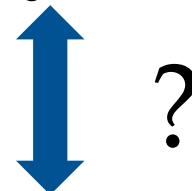
Any management or supervisory board member conflict of interest must be disclosed to the chair of the supervisory board

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

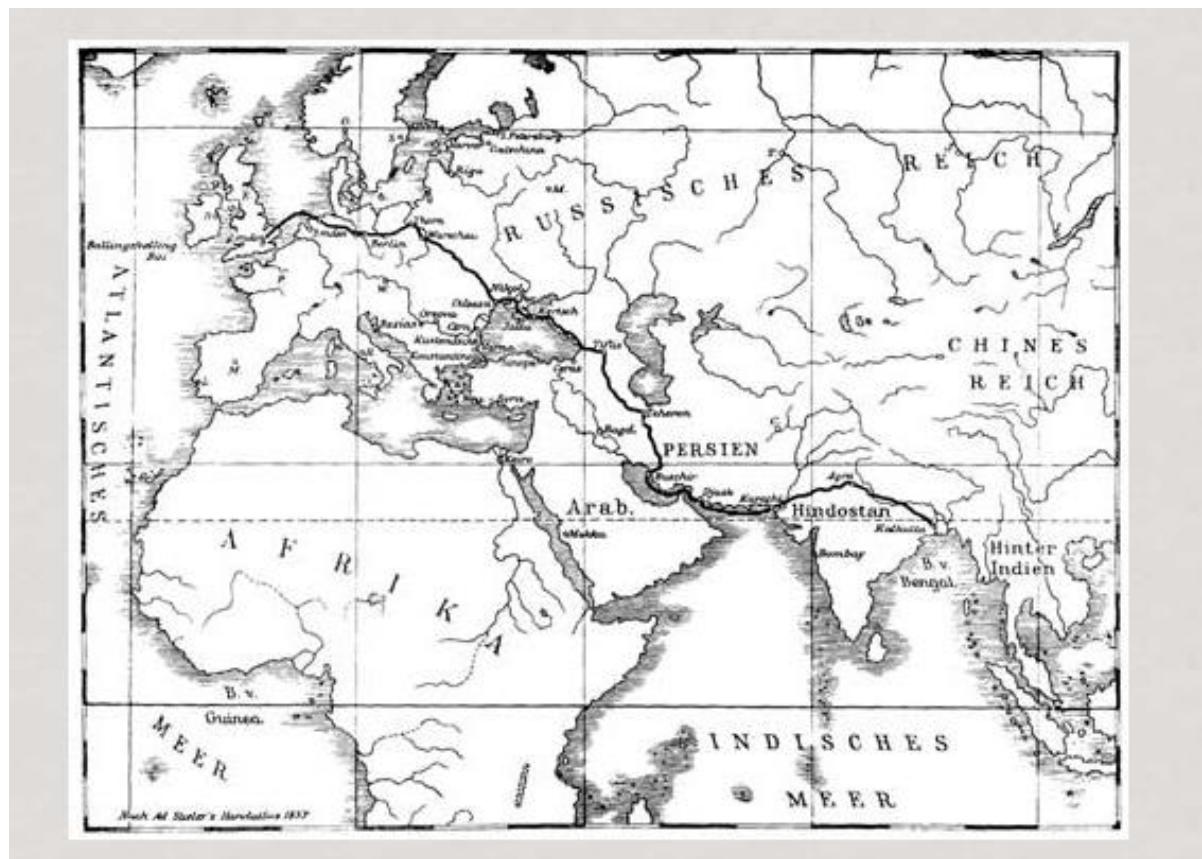
Founded in 1847 by Werner Siemens

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 1st 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

15th 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

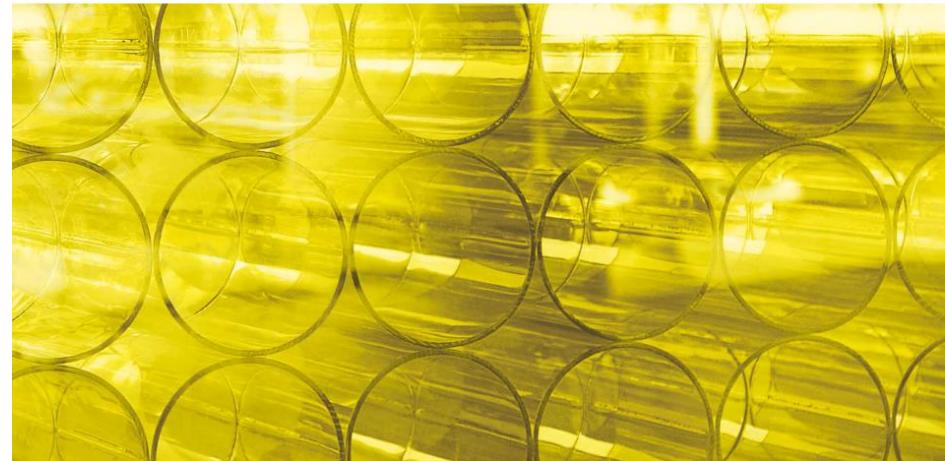


Siemens Integrity Initiative (external)

\$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





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

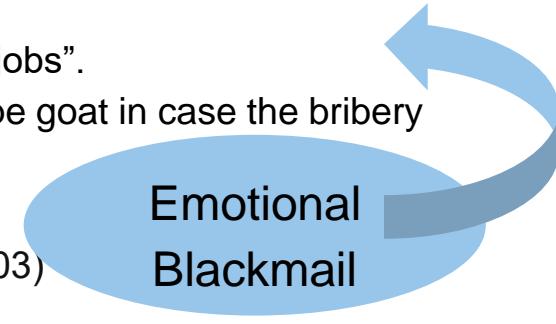
Rationalisation: Justifying corruption => “we do it for the sake of the company”, “other firms bribe as well”

Siekaczek (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 Siekaczek: “If you do not participate, you will be endangering jobs”.

Siekaczek 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 ad 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 1

		Player 2	
		cooperate	defect
		cooperate	I 2, 2
		defect	II 0, 3
		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 20th 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)



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 lenience

“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)



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

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

Dealings 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.

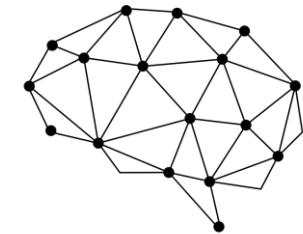




Cambridge Analytica

Who is Cambridge Analytica?

- Founded as a subsidiary of Strategic Communication Laboratories (SCL), a UK company based in the US
- Co-founded with Steve Bannon 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.

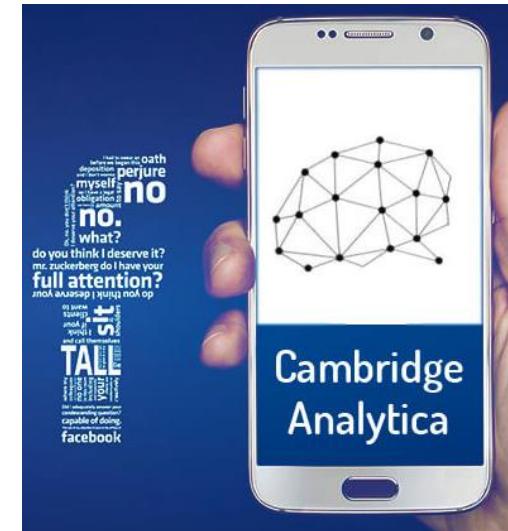
- Combines personality test, facebook profiles and voter records.



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 Alexandre 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.





Introduction to Business Ethics: Corporate Ethics – Corporate social responsibility

31. January 2023

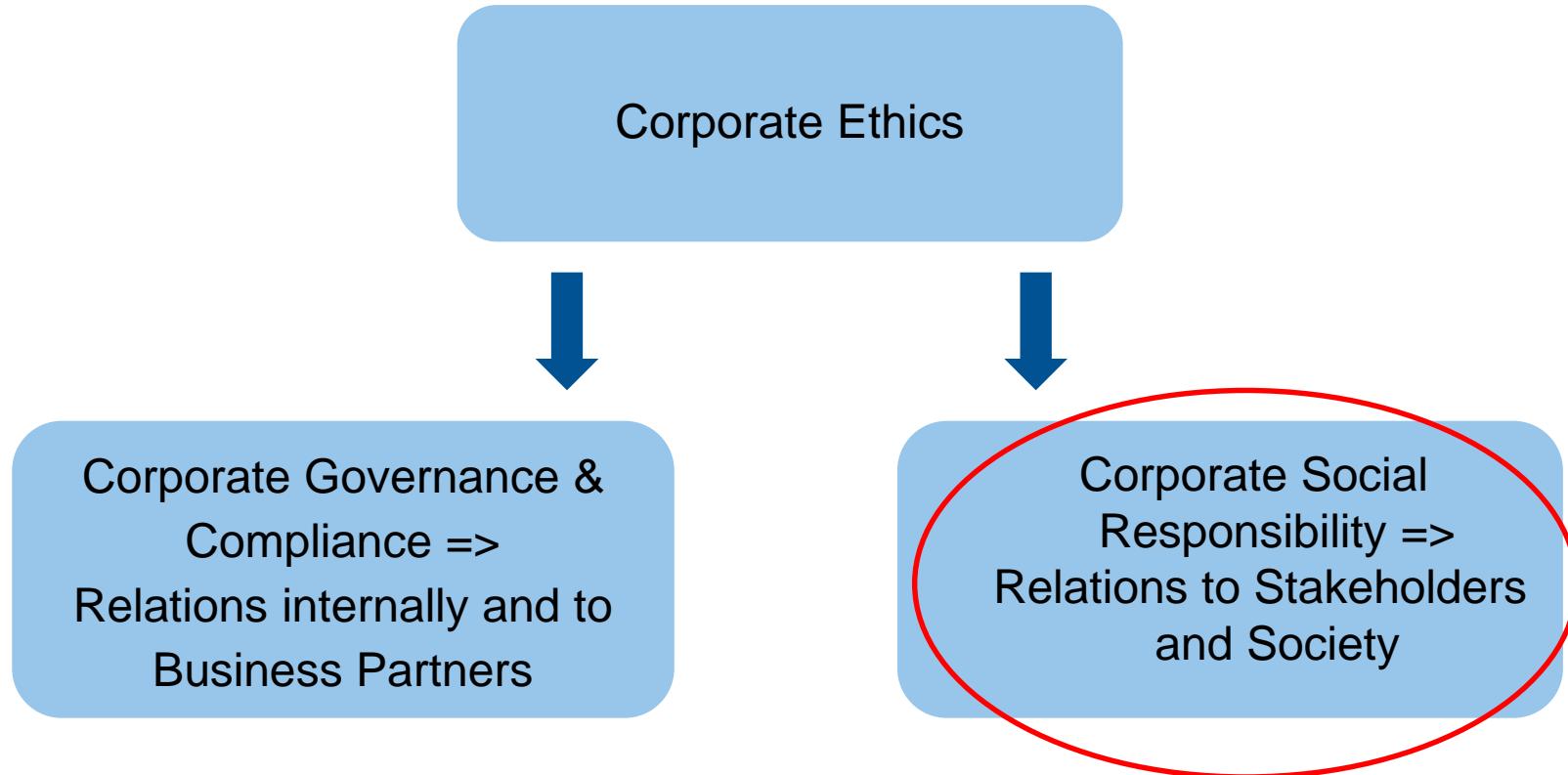
Prof. Dr. Christoph Lütge/

Peter Löscher Chair of Business Ethics

Technische Universität München

Winterterm 2022/23







Content of Lecture:

Milestones in theories on Corporate Social Responsibility



Conceptual Development

Milton Friedman 1970:	“The business of business is business”
Archie B Carroll 1979:	CSR Pyramid
Freeman 1984:	Stakeholder Management
Michael Porter 2011:	Shared Value

Pivotal Question: CSR as descriptive or normative

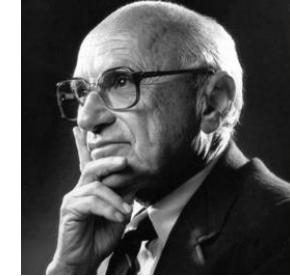
If the descriptive/empirical claim does not hold, i.e. if corporation can be long term profitable as a result of unethical business, then proponents of CSR would have to claim, that corporations have a moral obligation.

=> Appeal to individual ethics of business persons, which might be in conflict with incentives

1970 Friedman: Profit Maximization as Corporate Goal

"The Social Responsibility of Business is to Increase its Profits"

- Milton Friedman



- Friedman's essay „The Social Responsibility of Business is to Increase its Profits” (1970) is regarded one of most influential views in Business Ethics
- According to this view, managers have clear and well-defined goal they should achieve: **Maximization of profits** for shareholders
- "CSR" would be use of resources for goals that are not required by shareholders



Tasks of Managers

- Shareholders employ managers for specific purpose (profit maximization)
→ Use for "moral" purposes (social, ecological, etc.) is thus **improper use of resources**
 - Managers don't have expertise to make good use of resources in areas outside their area of business
 - Resources will be allocated to achieve certain ends that are chosen by management (non-democratic decision)
 - Costs of this behavior will usually be allocated to customers or employees (forced tax)
- Managers thus undermine ownership rights
→ **endangering of liberal economic system**
- Responsibility for **social problems lies with state** - not with companies

Goal of Companies

Companies:

- Friedman: Companies emerged from free association of individuals and their property
- Objective and tasks of companies: determined by owner (has the right to do so)

Who determines tasks of company and who bears responsibility?

→ usually managers, employed by owner

Agent (Manager)

Profit maximization

Principal (Owner)

According to Friedman, a company can **NOT be responsible** for an act because of its nature → "**Corporate responsibility**" is in fact semantic category defect



Social Goals and Corporate Responsibility

Assumption: companies are resource-rich actors → they should be **responsible for society**

BUT:

How can individual know if expenditures of resources serves "**social interest**" if **manager can not know** what "social interest" is?

Through **agent's commitment** to principal, goal of business is to **maximize profits** (fiduciary duty). Principal can easily judge fulfillment of goal and quality of work of agent via data (\neq "**Social goals**")

→ By complying with legal frameworks and basic moral standards, company is already **paying attention to other stakeholders**



Social Goals and Corporate Responsibility

Friedman's examples of misunderstood forms of "social justice":

1. Forego price increase to meet social desire to avoid inflation
2. Environmental protection beyond legal framework (achievement only by cost factor)
3. Recruitment of long-term unemployed rather than better-qualified workers (social integration)

Criticism:

- Managers, as agents, utilize resources that do not belong to them and are entrusted to them for another purpose
- Risk of shifting decision-making power over social developments → undermine central pillar of free society, namely property
- Only small group (of managers) who neither have the mandate nor the competence decides on social investment
- Incentive problem (no means to audit manager's performance)



Social Goals and Corporate Responsibility

Criticism:

Investment in social projects would **diminish profit; it is illegitimate form of taxation** of owners (against paradigm of profit maximization)

- **Illegitimate:** Taxation is not brought about by adequate procedure (**checks and balances**), but by small group of managers who do not have sufficient competence

Danger of **collectivism through corporate social responsibility**: By emphasizing social responsibility, it is implied that **profit motive of companies is wrong**

- Assumption of social responsibility as "**compensation**" for **morally dubious profit** striving
- If managers do not fulfill claims: "**iron fist**" by **state compulsion** (danger for liberal social order)

→ Task of state institutions is to account for social responsibility



Events after Friedman's 1970 article changing the context of business

- 1950 – 1970: Unprecedented economic growth in Europe and the United States. => „The Golden Age“
- 1970s: Economic crisis caused by the Oil Crisis (1973) and early globalisation marking the end of the golden age
- 1980s: Decade of economically liberal and right wing policies favourable to business.
- US President Ronald Reagan: Deregulation (banking sector and antitrust law), tax cuts.
- UK Prime Minister Margaret Thatcher: Privatisation of public enterprises and reduction of trade unions influence
- 1990s: World Trade Organisation. Accelerating globalisation. China joins 2001

Globalisation has enabled the growth of multinational corporations => debates on the role and the power of business in society



Demonstrating the increasing significance public opinion

Two case examples

1. IHC Caland in Burma
2. Brent Spar from 1995

→ Both cases demonstrate how corporations can lose control over public opinion and how civil society and NGOs can put corporations under pressure even though these cases might be controversial



IHC Caland in Burma (1/4)

Compliance to legal and self-imposed rules on its own does not protect a company from a loss of image or boycotts (even in the B2B sector)!

Burma Mid 90s:

- Bad human rights situation in Burma
- 1997: Clinton issued ban on new investments
- Heineken, Interbrew, HP, etc. then withdrew from the country
- US/NL: Consumers threatened with protests against companies continuing to operate

IHC Caland:

Dutch corporation in the offshore gas and oil industry (formerly also shipbuilding), today: SBM Offshore

IHC Caland in Burma (2/4)

IHC Caland's investments in Burma:

- IHC Caland's investment in Burma:
Signature of a 15-year contract with the Burmese Government in 1998 for an offshore project (volume: several hundred million euros, joint venture)
- Previously, US oil company Texaco had withdrawn, presumably because of US investment ban



Protests against the investments:

- Worldwide protests against the involvement of IHC in Burma
- Allegation: support for oppression of the Burmese people/support of the military regime
- Publication of IHC Caland financial networks by protest groups to identify which investors were indirectly involved in business with Burma



Source: <http://www.ib-sm.org/CaseIHCCaland.pdf>

IHC Caland in Burma (3/4)

IHC Caland's point of view:

- Business is legitimate as long as there is no NL/EU embargo
- Duty of company is only to act within the legal framework
- IHC referred to its B2B relationships which played no role in moral issues
- Nevertheless, IHC had difficulty financing the project as Dutch banks refused to finance it



Code of Conduct and compromise:

- In 2000, IHC Caland set up code of conduct
- Nonetheless, they wanted to stick to the policy of signing contracts in countries without official embargo
- Another contract with Burma was closed
- Two important shareholders sold their shares
- In 2003, representatives met with Burma's ambassador to discuss human rights issues
- IHC Caland follows OECD guidelines → FNV and CNV check compliance



IHC Caland in Burma (4/4)

*Deadly Partners:
Dictators, Dollars & Corporate Greed
in Burma*



Further Developments:

- 2003: Stricter sanctions against Burma (President Bush)
- 2013: EU suspends sanctions against Burma

→ Conclusion:

- Regardless of whether investments by western companies promote human rights violations, IHC Caland case shows that public can also exert considerable pressure on B2B
- It is also in the interest of company to calculate reputational risks beyond legal framework

→ **Compliance alone is not sufficient!**



Shell and Brent Spar (1/3)

Brent Spar: Oil container for oil waiting to be picked up by boats, off the Norwegian coast.

1995: The tank was damaged, and Shell's plan was to sink it in the Atlantic Ocean.

Permission granted from British authorities including scientists & wildlife experts.

The tank would have created an artificial reef supporting marine life

Greenpeace: The bottom of the ocean is not a dump for industrial waste. Shell just wants to save money!

Brent Spar contains 5500 tons of poisonous oil residues*. Bring it to shore and recycle the parts.

Brent Spar occupied by Greenpeace activists

*In September 1995, Greenpeace admitted that their estimate of the amount of toxic oil residues in the tank was much too high. In fact, the oil residues amounted to 75 to 100 tons, i.e. about 1.37-1.8% of what was claimed.



Shell and Brent Spar (2/3)

Media attention. Boycott Shell! Employees attacked, Gasolin station burned down

20% drop in sales from Shell stations

Shell underestimated the power of a well orchestrated campaign encouraging consumers not to buy their petrol at Shell.

Shell forced to dismantle Brent Spar and the parts were used to extent the harbour facilities of Stavanger in Norway

1996 General prohibition on disposing redundant facilities at the bottom of the ocean



Shell and Brent Spar (3/3)

After the initial permission from the relevant UK authorities

- No violation of law or regulations.

- Debatable whether dismantling Brent Spar was better for environment

- Assessment of environmental damage: nothing extraordinary; is also undertaken in economic evaluation of environmental protection

Still, a scandal with dire consequences for Shell and demonstrated that corporations can lose control of public communication, even though they have broken no laws



Business and Society (1)

The two cases exemplify public debate on the safety of producing goods and environmental challenges

They are also symptomatic for a problematic relation between business and society rooted in traditional political conflicts

Public hostility towards firms – towards the corporate world – can lead to business hostile political developments

Firms depend on the support of the population => there has to be a certain level of trust between firms and their the and the general population



Business and Society (2)

Symptoms of lacking trust between firms and civil society

Greenwashing: Firms offering green products, which are not really green.

- 1) McDonald's replacing plastic straws with paper straws. Paper straws cannot be recycled and their sourcing and production have raised questions
- 2) Royal Dutch Shell committed to reduction of CO2 emissions and at the same time exploring new opportunities for oil and gas production
- 3) "Coca-Cola Life" as green version of Coca-Cola.

Places the responsibility of environmental pollution on the corporations and corporations reply by engaging in less projects with low credibility



Business Ethics as Business Strategy: Trust (1)

OECD's definition of trust:

- 1) A person's belief that another person or institution will act consistently with their expectations of positive behaviour".
- 2) The willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor irrespective of the ability to monitor or control that other party." (Mayer et al., 1995, S. 712, Lütge & Uhl p. 248)

Trust as reciprocal altruism: A is altruistic towards B in the expectation the B will eventually return the altruism



Business Ethics as Business Strategy: Trust (2)

Trust saves **transaction costs** from economic perspective
Economic perspective on ethical concept of trust:

How can trust be built and maintained in modern society? Which risks arise?

„The definition of trust proposed in this research is the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor“



Trust correlating with prosperity

High level of social trust requires predominantly predictable and law-abiding behaviour

Trust has a positive effect on prosperity of a nation for the following reasons:

- 1) General trust in fellow citizens increases the willingness to cooperate and build business relations with people outside immediate social biotope.
- 2) Trust and being trustworthy reduces transaction costs by making time consuming contractual agreements redundant
- 3) Trust reduced the risk of lawsuits because issues can be solved in informal communication
- 4) Trust as social capital: Trust in multilateral relationships. If A trusts B, then others will also trust B.
Multi lateral trust as social capital requires strong institutions who can impose sanction



Business Ethics as Business Strategy: Social Capital

→ Example: **Alumni associations**

Graduates can expect support from each other, even if unknown

Social capital thus facilitates interaction and saves resources: no costly and time-consuming controls

Protection of social capital: By **sanctions** in case of **misuse of trust**

- Sanctions can be imposed by contracting party or third parties
- Due to implicit nature of contracts: sanctions of informal nature, such as damage to reputation, public disregard or social exclusion

➤ Even in globalized world, moral misconduct becomes risk factor for businesses (e.g. legal consequences of bribery)



CSR as Business Strategy: Social Capital

Corporate social responsibility manifesting in relations of trust between corporations and citizens

Theoretical positions described in this lecture describe different manners in which to strengthen trust between firms and citizens, either

- 1) Strengthen business and free market economy (Friedman)
- 2) Focus on the interests of stakeholders
- 3) Accept responsibility for finding solution to social problem (Shared Values)

Next Lecture: Legislation and practical aspects of sustainability reporting as the openness and transparency required for safeguarding public trust in the corporations



Corporate Social Responsibility

Theoretical mile stones after Milton Friedman's article

1979: Archie B Carroll: Pyramid

1984: R. Edward Freeman's Stakeholder Theory

2011: Michael E. Porter and Mark R Kramer: Creating Shared Value

1979: Archie B Carroll

Different levels of responsibility

Economic and legal responsibilities as fundamental and preconditioning other responsibilities

Ethical standards: Expectation exceeding Legal requirements

Philanthropic responsibilities: Active commitments to promoting the common good





The different levels of responsibility in more detail

Economic responsibility is fundamental because society expects of companies that they are capable of sustaining themselves. Lack of profitability would drive the firm out of business.

Legal responsibilities: Ground rules as codified ethics. Compliance as condition for license to operate and for an effective economic system. Corruption and mistrust undermines effective business practices.

Ethical responsibility: Living up to normative expectations of society which are not codified in legislation. For example: Global corporations' conduct in countries with more lax regulations

Philanthropic responsibilities: Active commitment to promote good. Example: Encourage employees to participate in charity work



Challenge of Carroll's pyramid

Ethics and philanthropy is conditioned by profitability

=> Identifying the level at which a corporation has satisfied its economic responsibility

Significant difference between **the level of profitability at which the public believes** that a corporation has satisfied its economic responsibility

and

The **level of profitability at which the company believes** the economic responsibility is satisfied

From the perspective of company profits should be retained for consolidation

The public would expect higher commitment to ethical responsibility and philanthropy on the basis of lower profits

Stakeholder Theory (1/5)

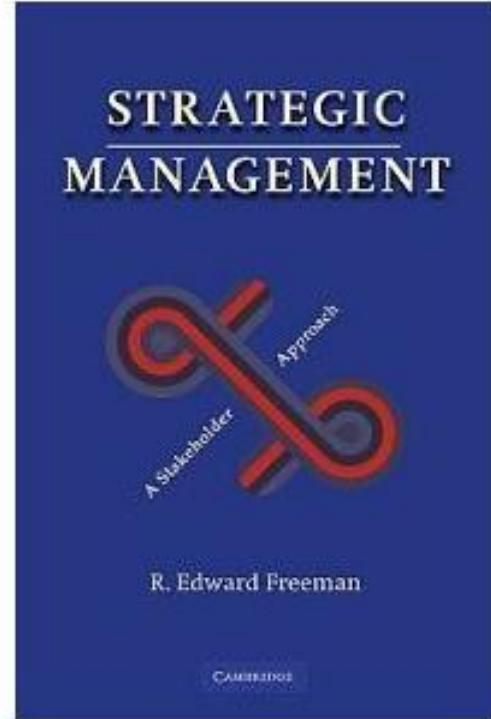
Expression used by Stanford academics since the early 1960s

Most importantly in 1984 by:

R. Edward Freeman:

Strategic Management. A Stakeholder Approach

Stakeholder: Person or group of persons with an interest
in the company.



Stakeholder Theory (2/5)

Stakeholder theory emphasises the common interest of the firm and all the stakeholders

Friedman: Management of firms are obliged towards all their shareholders

Freeman's stakeholder theory encourages firms to take into account all stakeholder concerns





Stakeholder Theory (3/5)

Task of management. To balance a multiplicity of interests of sometimes conflicting interests of stakeholders.

Strategies for balancing interests of stakeholders:

- 1) Specific stakeholder strategy: Maximise benefit for what is believed to be the most important stakeholder(s).
- 2) Utilitarian strategy: Maximise benefits to all stakeholders (within means)
- 3) Rawlsian strategy: Raise the level of the worst off stakeholder

Employees may require higher wages and shareholders investment in production

Conflict between consumers desire for cheap products and their requirement for a cheap environment

Essential claim of Stakeholder Theory: Firms benefit from taking the interests of stakeholder into account.
If the can affect the firm, the firm should deal with them.



Challenge of Stakeholder Theory (4/5)

The increasingly critical civil society has often blamed firms for using stakeholder management in particular and CSR in general strategically. Accordingly it is not real CSR if it benefits the firm.

This creates the following dilemma for businesses

- 1) As moral obligation: Stakeholder theory as requirement for moral surplus => untenable in competitive market economy
- 2) Stakeholder theory as empirical claim: Considering the interests of stakeholders beyond legal obligations increases profit – controversial claim

Claim valid in societies with strong civic society and for corporations with high public exposure and replaceable products (VW, H&M, Shell)



Challenge of Stakeholder Theory (5/5)

Dilemma: If stakeholder management is purely strategic, i.e. only caring about stakeholders because it increases profit, there is no difference between Friedman's shareholder focus and Freeman's stakeholder management.

Freeman in interview: "I actually think if Milton **Friedman** were alive today, I think he'd be a **stakeholder theorist**. He would understand that the only way to create value for shareholders in today's world is to pay attention to customers, suppliers, employees, communities and shareholders at the same time."

If Friedman and Freeman are coherent: Then the theory is in no need of moral surplus.

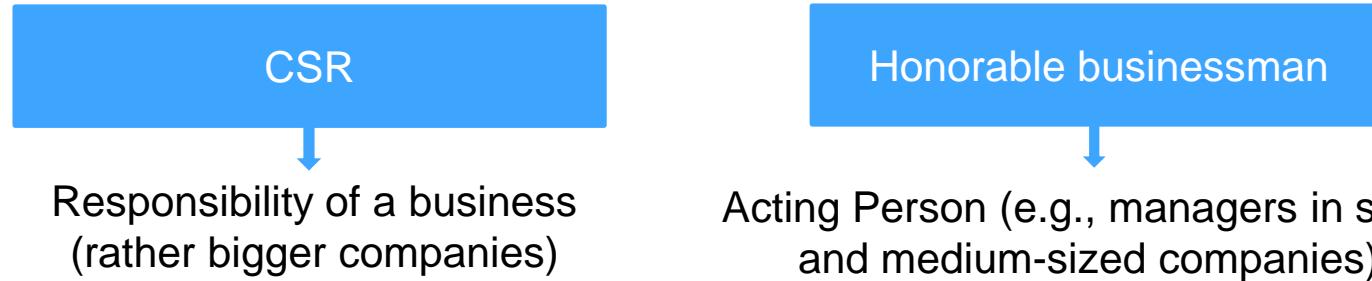
If stakeholder management is meant as a moral obligation to take the interests of stakeholders into consideration, Freeman is asking for "Moral Surplus"

Source: <https://www.derby.ac.uk/online/course-taster/business-and-management-bsc-hons-online/the-instrumental-perspective-of-csr/shareholders-vs-stakeholders---friedman-vs-freeman-debate.php>



The challenge of moral surplus

CSR as Moral Obligation: The Honorable Businessman



- Promotion of ethical behavior of legal person (in form of enterprise)
 - character of entrepreneur
- Individual ethical concept (moral demands on individual)
- Virtue-ethical approach (strong connection to individual character traits and virtues)



CSR as incorporating the honorable businessperson

- Many professional groups have guiding principles, e.g. doctors, lawyers, etc.

Statute on the Provisional Regulation of Law of Chambers of Commerce and Industry

§ 1

"... It is incumbent on them in particular to support and advise authorities through proposals, expert opinions, and reports and to work for the preservation of the decency and customs of the honorable businessman."

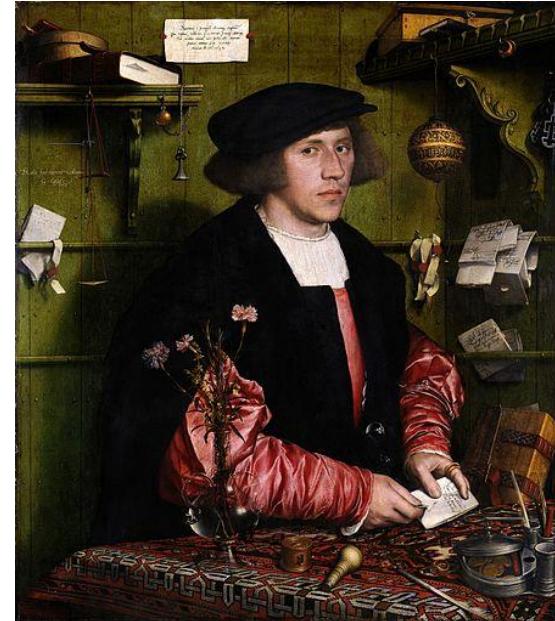
There are numerous models in various organizations and associations that define virtues of honorable merchant, but:

→ Principles derived from these virtues are indeterminate and abstract

Concept of Honorable Businessman

Lack of a unified basis of concept → **historical and conceptual approximation necessary**

Businessman (m/w) refers to **economic subject** who conducts any kind of **commerce** (purchasing and reselling/production and distribution) with degree of **autonomy**

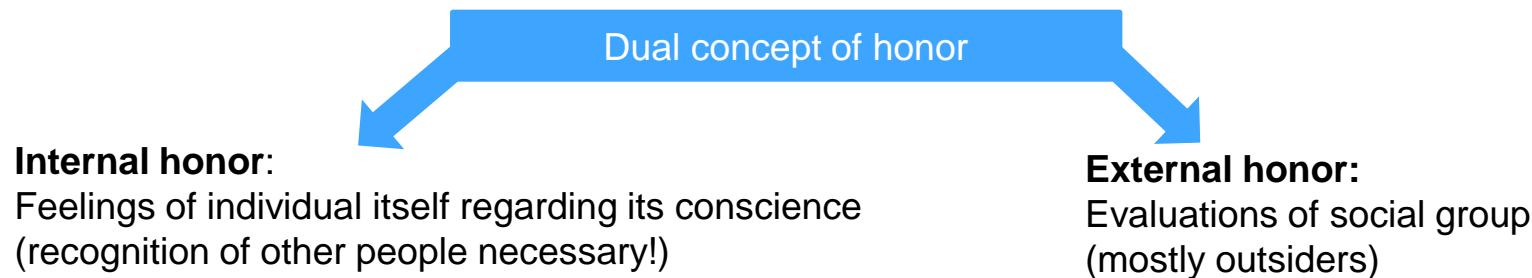


Quelle: IHK Nürnberg

Concept of Honor

- Interpretation of term only possible within **social context**
→ Which actions are considered "honorable", "venerable", etc.?
- Term consists of Old High German root *êre* and the Greek term for "good reputation" (emphasizes social character of term)

→ An action is honorable if it is assessed positively by society (e.g. if it meets/exceeds norms)

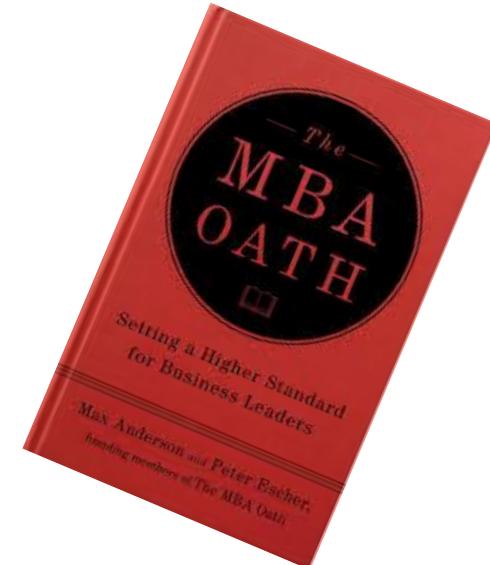


Concept of Honorable Businessman Today

- Harvard Business School has issued MBA Oath for graduates to ensure "**ethical conduct**" in business-related decisions (voluntary signing!)

Commitment to:

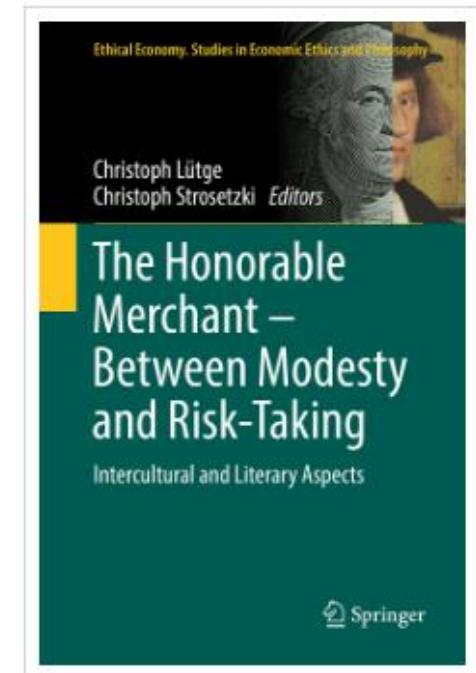
- Not promoting their own interest at expense of their company or society
- Rejecting corruption and avoiding business practices that harm society
- Supporting management profession as whole, acting ethically and create sustainable prosperity
- Reinforcing integrity and confidence in oneself through one's own behavior





Book recommendation

The Honorable Merchant – Between Modesty and Risk-Taking
(Lütge & Strosetzki, 2019)





Criticism on Individual Ethics (1/4)

External concept of honor:

intercultural differences and historical fluctuations in meaning

- Different markets require different behaviors in order to get **social recognition** of respective society
- Concept of honorable businessman is **not stable!**
- How can ethical model be implemented against background of **value pluralism**?
- Divergences in **evaluation of actions** even within cultural circle

Concept of honorable businessman **can not act as guideline!**

Criticism on Individual Ethics (2/4)

Free market economy: Demand for honorable businessman can become superfluous, since companies have vested interest in being **perceived as "honorable"** and respectful

Is **inner motivation** to act with great honor relevant?

- Businessman would not be honorable if he or she did not act out of intrinsic motivation, but do purely instrumentally what is expected from him or her

Trust: trust-based relationships are very important in business ethics

Criticism on Individual Ethics (3/4)

Concept of honorable businessman has fallen out of time:

- Concept comes from time, in which economic system was much simpler than today (Late Middle Ages: no large organizations with complex chains of action and responsibility)

Modern world: individual ethics meaningful on conditional level!

- Need to implement ethical values in form of institutions and rules



Source: IHK Nürnberg

Plea to individuals to behave ethically are unenforceable unless competitors behave "honorably" as well



Criticism on Individual Ethics (4/4)

Confidence-inducing performance of businesses essential, but mainly for purpose of creating reputation (investment in future)

→ **Concept of honor seems unnecessary**, even threatening

Concept depicts company's untimely normative ideal

Honorable businessman suggests a "trustworthy, proper official"

But: Dynamics and entrepreneurship should not be in the background!

Ethics necessary for a modern, dynamic society!



Creating Shared Value (CSV) (1)

Harvard Business Review 2011:

Creating Shared Value. How to reinvent capitalism and unleash a wave of innovation and growth

Claim: “The capitalist system is under siege. In recent years business increasingly has been viewed as a major cause of social, environmental, and economic problems. Companies are widely perceived to be prospering at the expense of the broader community.”

Solution: Creating economic value by addressing needs and challenges of society => company success connected to social progress

(Lütge & Uhl, p. 266)



Creating Shared Value (CSV) (2)

CSV as enhancement of existing ideas within the field of corporate social responsibility

Question of Stakeholder Management: Where do corporations harm society and where are they obliged to give back to society

Question of CSV: How can corporations become part of the solution to the societal challenges by actively searching for win-win opportunities

CSV encourages business to actively seek out areas of business where they can make profit by contributing to social and societal solutions

For mature business the idea is useful as basis for supplementary projects, for start-ups with shared value as foundation CSV is an optimal alignment of interests



Creating Shared Value (CSV) (3)

Examples:

Novartis’ “Access” programme: A cooperation between Novartis, governments of emerging economies and NGOs to deliver affordable treatments, including innovative medicines against chronic diseases, to the poorest people in the world.

Increasing access for the poorest and building foundations for future markets



CSR as mitigating reputational risk



Immoral Behavior as Business Risk? (1/2)

Beginning of Business Ethics!

Critical Public:
Demands Responsible Business Conduct



From then on, companies had to deal with
the new factor "reputation"

Cases like Ford Pinto, Brent Spar and IHC Caland : Immoral behavior can lead to business risk

There are hardly any large companies that do business without corporate ethics activities

Economic Perspective: Why do Companies practice business ethics?



Immoral Behavior as Business Risk? (2/2)

Also: fundamental objection to Friedman's point of view → every company has the inherent duty to assume social responsibility

Stakeholder theories:

- Corporate Responsibility: In case of doubt, also against economic interests of company
- Question: How can demands be realized under permanently competitive conditions?



Business Ethics as Business Strategy: Reputation (1/2)

Theoretical core of economic and business ethics: **monism**
Problems characterized by conflicts of interest

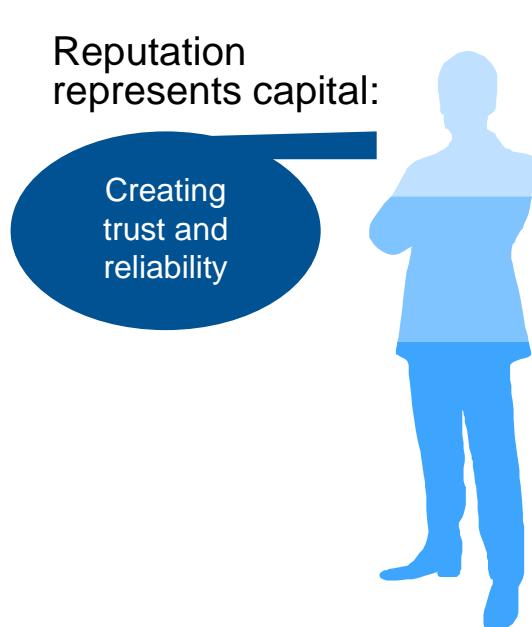
Aim:

Win-Win-Situation

- Non-anticipated **interaction uncertainties**: situation in which neither contracts nor laws govern the rights and obligations of contractors
 - **Mistrust**: Does the other side use the loopholes for their own benefit?
→ Can lead to preventive counterfeiting
- Actors can counteract this with help of confidence-building measures and build reputation!

Business Ethics as Business Strategy: Reputation (2/2)

Reputation represents capital:



Establishes **business relations** and thereby saves transaction costs

Accumulating reputation by engaging in moral principles such as **integrity and fairness**

Under conditions of globalization: reputation as important **prerequisite for successful entrepreneurship**

Premodern: trade limited to few actors, "face-to-face control"; immoral behavior was punished with ostracism

In globalized world: this type of control is systematically eliminated (trade worldwide) → **Mistrust and risk of preventive deception is growing**



CSR as incorporated in legislation

Implicit versus explicit CSR (Lütge & Uhl, p. 253)

Implicit: European Union. Social welfare is the responsibility of the state => corporations practice CSR by complying with legislation and codified

Explicit CSR: Strongly represented in the United States. Social welfare the responsibility of citizens. Tradition for engaging in charity projects



Organisational information

- On the 8th of February, we will have an exam preparation session.
- Amongst other, we would like to recap the content that you are still unclear about.
- Therefore, please use **Tweedback** to indicate the content that you have questions about (please always state the date/session & slide number you are referring to).
 - Here you can **paste your questions**: <https://tweedback.de/ze14/chatwall>
 - You can also upvote questions of your fellows. This way, we get a feeling of most pressing questions.
- The deadline for pasting questions is on the **6th of February**.



Thank you for your attention!

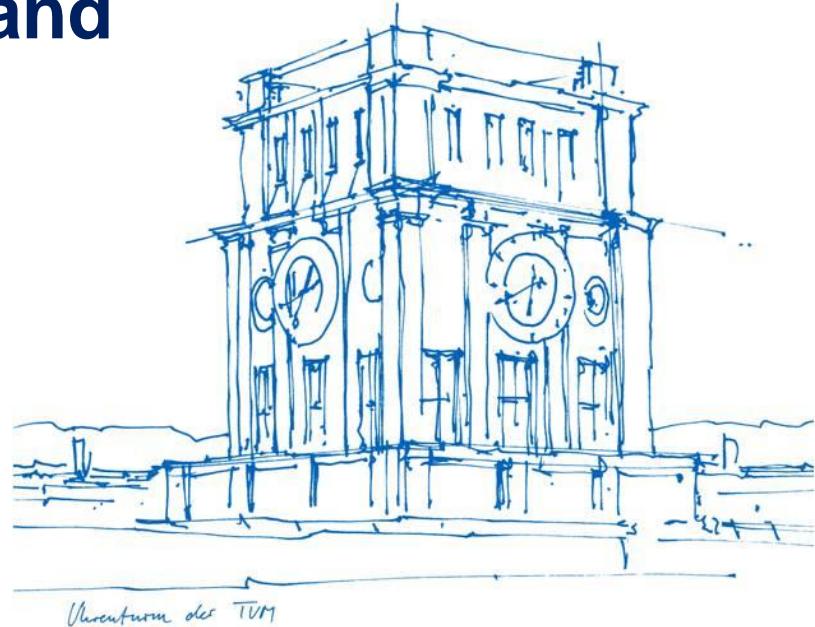


Introduction to Business Ethics: Sustainability Reporting and ESG Rating

01. February 2023

Dr. Marianne Thejls Ziegler

Peter Löscher Chair of Business Ethics
Technische Universität München





CSR, Sustainability Reporting and ESG Rating



Agenda:

Legislation on sustainability reporting in EU

Frameworks of sustainability reporting: Global Reporting Initiative (GRI)

ESG rating of corporations (ESG = Economic, Social and Governance)



Slido 2490883

Would any of you be interested in working with sustainability reporting?



Frameworks for sustainability reporting

United Nations

EU legislation

Global Reporting Initiative



United Nations

International organisation founded in 1945 for the purpose of securing international peace,

193 nation states as members

Forum for communication between nations

Security, peace, humanitarian aid, upholding international law .. and sustainable development.

Subdivisions: World Bank Group, World Health Organisation (WHO), World Food program,
UNESCO and UNICEF



United Nations Global Compact



The image shows a vast array of solar panels installed in a large, organized field, symbolizing renewable energy and environmental action.

United Nations Global Compact

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UN Global Compact at COP 27

Driving Ambitious Corporate Action on Climate Change

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World Economic Forum and Global Compact

Initiated by Kofi Annan, General Secretary of the United Nations 1997 – 2006

In 1999 Kofi Annan gave a speech at the World Economic Forum in Davos:
Protagonists of business, politics and academia meet once a year for discussions.

World Economic Forum: NGO for corporations

Founded in early 1971 by a the then 32 year old German business professor Klaus Schwab – the actual inventor of the concept of Stakeholders and stakeholder capitalism

Around 1000 member companies with more than \$5 bn turnover.

Annual meeting in Davos: Business leaders and heads of state. Speakers: Greta Thunberg, Elton John, Prince William etc.



Kofi Annan speech:

Kofi Annan suggested to the business leader, that they should join forces and create a global compact for the purpose of protecting human rights, working conditions and environment. In 2004 they added anti-corruption.

“The spread of markets outpaces the ability of societies and their political systems to adjust to them, let alone to guide the course they take. History teaches us that such an imbalance between the economic, social and political realms can never be sustained for very long”



United Nations Global Compact, the largest voluntary CSR initiative world wide. 21.000+ members in 160 countries.

Basic idea: Business should cooperate with NGOs, labor organisations and governments in order to advance the broader goals of the united nations.

Basic requirements manifest in 10 Principles: Respect Human Rights, freedom of association, eliminate forced labour and child labour, address environmental challenges and work against corruption in all its forms.

Recommendations and values

Year 2000: United Nations Millennium Development Goals



2015: Sustainable Development Goals (SDGs)





SDGs as language for sustainability

Enable corporations to describe the areas where they are making a contribution to sustainability

Either via their products and according to shared values principles. Example:

Novartis's Access Programs: Are delivering medicine in emerging economies sometimes at cost price developing markets in emerging economies.

Contributes to SDG 3: Good health and well-being.

In parallel they develop brand reputation in future markets

Or as description of projects and initiatives which are not part of core business



SDG in Business: BMW SDG 11

MOVEMENT^{BMW}

October 1, 2018

The BMW Group is Working to Achieve Sustainable Development Goals

SUSTAIN



MOVEMENT^{BMW}

HOME SUSTAIN IN

SDG 11 – Sustainable Cities and Communities: with our integrated mobility services and innovative approaches, we want to change mobility patterns in selected metropolitan areas in a sustainable way. These include our car-sharing services DriveNow and ReachNow, which increasingly offer electric vehicles, as well as the electric scooter specially designed for commuter traffic in cities. With the Urban Mobility competence center created in 2015, the BMW Group supports the paradigm shift from cities suitable for cars to cities suitable for people. The center acts as a platform through which the BMW Group works with cities and other partners to develop new concepts for future urban mobility with a view to making cities even more attractive to live in.

DriveNow => ShareNow=> Sold to Stellantis



From Computacenter – technological infrastructure

SUSTAINABLE DEVELOPMENT GOALS

UN Sustainable Development Goals

We are focused on where we can take meaningful action aligned to nine of the UN Sustainable Development Goals.



Ensure healthy lives and promote wellbeing for all at all ages

We will support the mental and physical wellbeing of our employees by ensuring that our people have quality working lives and feel safe and protected.



Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all

We will work to remove barriers that exist in our local societies, creating employment, training and educational opportunities.



Achieve gender equality and empower all women and girls

We will continue to work towards achieving a balanced gender mix in a male-dominated industry.



Promote sustained, inclusive, and sustainable economic growth, full and productive employment, and decent work for all

We will maintain high standards of employment for our people and will work with our supply chain to build resilience and decent work.



Build resilient infrastructure, promote inclusive and sustainable industrialisation, and foster innovation

We will be responsible as a business to make a positive impact in our industry and wider communities.



Reduce inequality within and among countries

We will continue to foster an environment which enables employees to speak openly and ensure they have the knowledge they need to promote a positive and inclusive environment for all.



Ensure sustainable consumption and production patterns

We will work with our technology partners and customers to promote sustainable technology sourcing, supported by our own Circular Services solutions.



Take urgent action to combat climate change and its impacts

We will continue to take action to reduce our climate impacts both direct and indirect, aligned to science based targets.



Promote peaceful and inclusive societies for sustainable development, provide access to justice for all, and build effective, accountable, and inclusive institutions at all levels

We will continue to be an ethical business while being mindful of the



Conflicts between SDGs

Some of the SDGs are conflicting

Nr. 1: “No Poverty” will be difficult to achieve without weakening SDG nr. 8: “12: “Decent Work and Economic Growth” and nr. 12: Sustainable Consumption and Production.”

SDG 7: Affordable and Clean Energy ... momentarily either affordable or clean

Disadvantage is cherry picking: Which SDGs would suit the profile of the corporation

SDG 2 Zero Hunger => <= SDG 14: Life Below Water and SDG 15: Life on Land



Sustainability Reporting



Legislation on sustainability reporting

Europe: Regulation since 2017: Companies of public interest (around 12.000 companies in EU) with more than 500 employees are obliged to disclose non-financial information. Sustainability with regard to environmental, social and governmental risks

From 2024 (for 2023) new Corporate Sustainability Reporting Directive (CSRD): Companies are obliged to disclose information when they have more than 250 employees and a turnover of more than 40 Million Euros.

Non-European companies are to disclose information if they have more than € 150 million turnover in Europe => 50.000 companies in the EU



CSRD part of European Green Deal

Initiative aiming at climate neutrality in 2050

Part of an overall European industrial strategy => twin transition to green and digital economy

Expectation from citizens that corporations understand their positive and negative impacts on society and environment and that they mitigate this risk

Corporations need to disclose information on economic, social and governmental aspects for directing financial and capital flows to sustainable investments

Information on sustainability => investors know where to invest



Future sustainability reporting

Transparency and accountability towards investors, NGOs and the general public

Double materiality:

Outside-in risks are the risks of sustainability issues affecting the company

Inside-out risks are the risks of the company negatively affecting society and environment

EU is developing an EU sustainability reporting standard which will make sustainability reports comparable

(According to the directive from 2014, the corporations could choose their own standards; GRI, ISO 26000, OECD guidelines etc.)



Experiences from a smaller company (January 2023)

New legislation still in the process of implementation

Small and medium-sized Enterprises (SMEs) are part of supply chain for larger companies; accordingly, they must collect sustainability data as well because the larger corporations are required to screen their supply chain

Cases of SMEs being ahead of legislation in preparation for future requirements

“Tick the box” but also a driver of value and increasing awareness. Measuring electricity consumption is a prerequisite for reducing electricity consumption



Financial institutions

Investments in companies are increasingly considering ESG issues

Corporations which are carbon intensive, high consumptions of chemicals, plastic industry are not traded as often – irrespective of their profitability

M&A:

Investments in companies are increasingly considering ESG issues

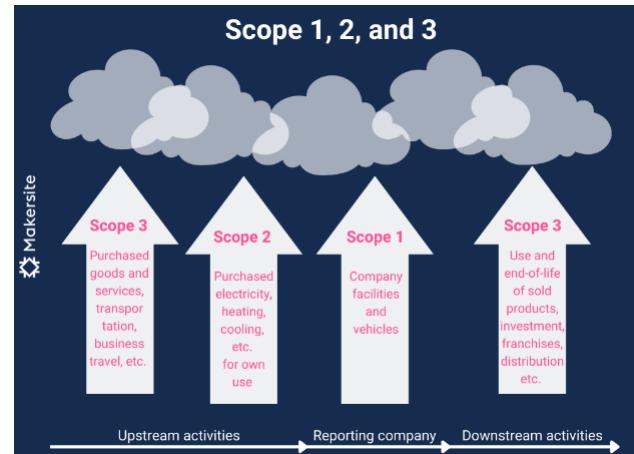
Corporations which are carbon intensive, high consumptions of chemicals, plastic industry are not traded as often – irrespective of their profitability

US legislation on sustainability reporting

No mandatory sustainability reporting

Securities and Exchange Committee (SEC) requires of corporations to disclose environmental, social and governance (ESG) risks which may be material (of decisive importance) to investors

New suggestion: Mandatory disclosure of CO₂ footprint scope 1, 2 and perhaps 3.





How to write a sustainability report

Sustainability reports are written according to standards.

There are several different reporting standards – what should be included, and to what extent –

Most important of them is from Global Reporting Initiative,

GRI is an NGO founded in 1997 Continuous development of sustainability reporting standards in cooperation with United Nations

Momentarily EU is working on developing their own standards.



GRI



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25 years of empowering sustainable decisions

September 2022 marks a quarter of a century since we were founded in 1997. Since then, organizations have relied on GRI as the global leader for sustainability reporting and the catalyst for transparency.

While we can look back with pride on our achievements, our focus is on what's to come. Deepening accountability for impacts, across all countries and sectors, is our continuing mission for the next 25 years.

Join us in celebrating our 25th anniversary →

Figure 1. GRI Standards: Universal, Sector and Topic Standards



Apply all three Universal Standards to your reporting

Use the Sector Standards that apply to your sectors

Select Topic Standards to report specific information on your material topics



Apply all three Universal Standards to your reporting

Purpose: Identify the business' effect on economy, environment and people with regard to sustainability. Describe how the organisation, identifies and prevents negative effects also on human rights.

Overview of the corporation: Names, places, subsidiaries, products, reporting practices and governance structures. How is management organised? How do they secure transparency and avoid conflicts of interest? Who keeps an eye on the management?

Understand organisations context, impact and significance of impact:
Materiality: Review the Sector Standard and determine which topics are material => topics where the information would make a difference to population, investors, NGOs, stakeholders etc.



We are represented around the world and well positioned

The Salzgitter Group comprises over 150 subsidiaries and affiliated companies around the world. We are represented throughout the world through our international facilities which also demonstrate our geographical proximity to our customers.

Managed by Salzgitter AG as the holding company, the Group is divided into five business units: Strip Steel, Plate / Section Steel, Mannesmann, Trading and Technology. It also has stakes in further industrial companies, e.g. Europe's leading copper producer Aurubis AG as well as numerous service companies not assigned to any business unit.

The Strip Steel Business Unit produces, processes and distributes flat steel in a wide variety of metallurgical formulas and sizes. To do so, we operate a modern, environmentally friendly, integrated steel mill at our Salzgitter facility. It produces almost 5 million tons of crude steel and around 3.5 million tons of rolled steel per year. The most important feed materials are iron ore, coke, scrap and alloying agents. Most of the high-quality products are processed by the automotive sector. The pipe sector and industry (e.g. manufacturers of household appliances, mechanical engineering industry) are also among the most important customer segments.

As well as two plate mills, the Plate / Section Steel Business Unit operates an electric steel mill in which around 1 million tons of crude steel are smelted from scrap steel per year. This makes it a significant part of the materials cycle and its products demonstrate that steel can be recycled with no loss of quality. Plate is traditionally used in the metalworking, shipbuilding and mechanical engineering industry. Our mills have also established themselves in recent years as the preferred supplier of steel for the wind turbine industry. Our structural steel is used in the construction sector.

The companies in the Salzgitter Group making steel tubes are combined in the Mannesmann Business Unit. Three product segments offer a wide range of tube products for diverse applications from fuel injection systems, power plants and boilers to large diameter pipelines.

Example



Disclosures about the reporting organization

Sector standards determine materiality (relevance)



Use the Sector Standards that apply to your sectors

GRI 11 = The Oil Industry

Contents

Introduction

Sector this Standard applies to

System of GRI Standards

Using this Standard

1. Sector profile

Sector activities and business relationships

The sector and sustainable development

2. Likely material topics

Topic 11.1 GHG emissions

Topic 11.2 Climate adaptation, resilience, and transition

Topic 11.3 Air emissions

Topic 11.4 Biodiversity

Topic 11.5 Waste

Topic 11.6 Water and effluents

Topic 11.7 Closure and rehabilitation

Topic 11.8 Asset integrity and critical incident management

Topic 11.9 Occupational health and safety

Topic 11.10 Employment practices

Topic 11.11 Non-discrimination and equal opportunity

Topic 11.12 Forced labor and modern slavery

Topic 11.13 Freedom of association and collective bargaining



Alternative to sector standards: SASB Materiality Finder

Dimension	General Issue Category	6 of SASB's 77 industries					
		Health Care Delivery	Non-Alcoholic Beverages	Electric Utilities & Power Generators	Advertising & Marketing	Auto Parts	Metals & Mining
Environment	GHG Emissions						
	Air Quality						
	Energy Management						
	Water & Wastewater Management						
	Waste & Hazardous Materials Management						
	Ecological Impacts						
Social Capital	Human Rights & Community Relations						
	Customer Privacy						
	Data Security						
	Access & Affordability						
	Product Quality & Safety						
	Customer Welfare						
Human Capital	Selling Practices & Product Labeling						
	Labor Practices						
	Employee Health & Safety						
	Employee Engagement, Diversity & Inclusion						
Business Model & Innovation	Product Design & Lifecycle Management						
	Business Model Resilience						
	Supply Chain Management						
	Materials Sourcing & Efficiency						
	Physical Impacts of Climate Change						
Leadership & Governance	Business Ethics						
	Competitive Behavior						
	Management of the Legal & Regulatory Environment						
	Critical Incident Risk Management						
	Systemic Risk Management						

Likely a material issue for companies in the industry

Want to find your industry?

[Search Industry](#)

Access the Materiality Map

[Login](#)

A more basic tool for identifying initial topics relevant (material) for a sustainability report

<https://www.sasb.org/standards/materiality-finder/?lang=de-de30>



Standards for specific topics identified as relevant in the sector standards

For example anti-corruption measures, training and education, specific environmental issues etc.



Example



You do not need
to know the
details for the
exam

201-4 Financial assistance received from government

Reporting requirements

The reporting organization shall report the following information:

- a. Total monetary value of financial assistance received by the organization from any government during the reporting period, including:
 - i. tax relief and tax credits;
 - ii. subsidies;
 - iii. investment grants, research and development grants, and other relevant types of grant;
 - iv. awards;
 - v. royalty holidays;
 - vi. financial assistance from Export Credit Agencies (ECAs);
 - vii. financial incentives;
 - viii. other financial benefits received or receivable from any government for any operation.
- b. The information in 201-4-a by country.
- c. Whether, and the extent to which, any government is present in the shareholding structure.



You do not need
to know the
details for the
exam

8

GRI 402: Labor/Management Relations 2016

2. Topic disclosures

Disclosure 402-1 Minimum notice periods regarding operational changes

REQUIREMENTS

The reporting organization shall report the following information:

- a. Minimum number of weeks' notice typically provided to employees and their representatives prior to the implementation of significant operational changes that could substantially affect them.
- b. For organizations with collective bargaining agreements, report whether the notice period and provisions for consultation and negotiation are specified in collective agreements.



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Would you consider working with sustainability reporting ?



ESG rating

Corporations are rated with regard to Environmental, Social and Governance risks

They measure primarily the outside in risk, i.e. the extent to which the environment may affect the corporation and the way the corporation is prepared for these risks

Good rating: Good for the reputation, for attracting work force, indicates that the company is well managed

Good rating: The company might be included on lists of companies which big pension funds can invest their assets in (good for share price)



ESG ratings (mainly) created by commercial organisations – rating agencies

MSCI: Morgan Stanley

ISS ESG: Institutional Shareholder Service

S&P: Standard and Poor

Sustainalytics

Moody's



MSCI

Used to be “Morgan Stanley Capital International”

MSCI ESG Ratings are created by MSCI ESG Research, one of the largest rating agencies. These ESG ratings are released for 14,000 different equity and fixed income issuers (Corporations).

Ratings measure a company's **management of financially relevant ESG risks**

Create indexes: Lists of corporations representing state of the art – also with regard to ESG, climate etc.

MSCI ESG Ratings are generally known to be one of the industry leaders in publishing scores and rating

MSCI rating scale



Das Bewertungssystem von MSCI ESG.

[Übersicht über die wichtigsten ESG-Ratings – und was sie für die Finanzkommunikation bedeuten | NetFed](#)



ISS – partly owned by German “Deutsche Börse Group”

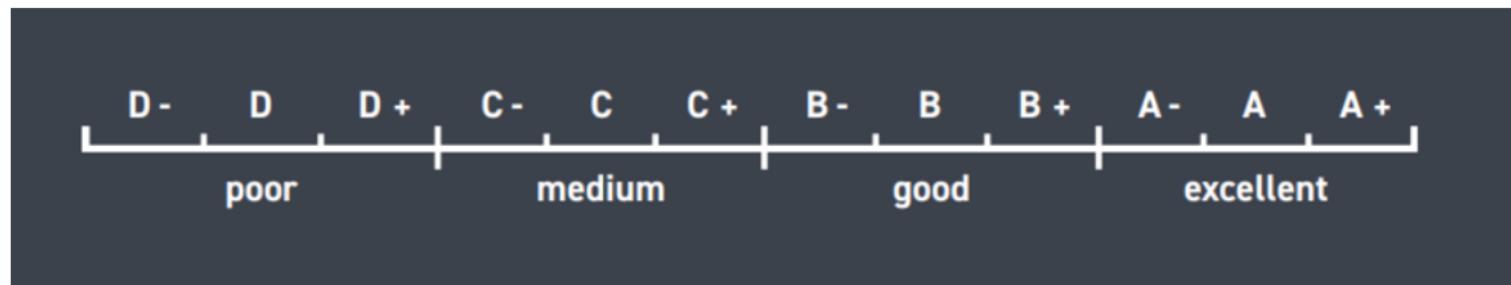
Institutional Shareholder Services Ratings and Rankings

ISS (Institutional Shareholder Services), provides company, country, and fund ratings as well as data and analysis across the full range of [sustainable investment](#) issues, including climate change, human rights, labour standards, corruption, and controversial weapons.

ISS ESG ratings can also help investors in determining compliance with ESGs and proactively address ESGs risks faced by companies.

ISS rating scale

Die Rating-Skala von ISS ESG



ISS ESG



Standard and Poor (S&P Global ESG)

Standard & Poor's Global ESG is one of the largest companies that provide data analytics and reporting related to companies around the world.

S&P Global ESG Scores takes a more analytical look at how well companies perform in areas such as environmental practices and employee relations.

Their reporting allows investors and consumers alike to better understand ESG



S&P rating scale

“Once S&P Global Ratings has determined the company’s ESG Profile score and Preparedness opinion, they are combined to produce a relative overall ESG Evaluation score on a 100-point scale.”



Sustainalytics

Sustainalytics ESG Risk Ratings

Sustainalytics is an ESG rating and data supplier that provides ESG ratings on 20,000 companies and 172 countries. They rate 40,000 companies worldwide. Sustainalytics is a subsidiary of Morningstar, one of the largest stock market data providers in the world.

The ESG ratings from Sustainalytics measure environmental, social and corporate governance performance of companies on a global scale. They cover about 13,000 international equities across all regions worldwide.

Sustainalytics rating scale

Overview of Sustainalytics' ESG Risk Ratings

Sustainalytics' ESG Risk Ratings measure a company's exposure to industry-specific material ESG risks and how well a company is managing those risks. This multi-dimensional way of measuring ESG risk combines the concepts of management and exposure to arrive at an absolute assessment of ESG risk. We identify five categories of ESG risk severity that could impact a company's enterprise value

Negligible	Low	Medium	High	Severe
0 - 10	10 - 20	20 - 30	30 - 40	40+





Moody's

One of the largest credit rating agencies in the world

Rating => investment criteria for investors.

Large pension funds with rules for rating requirements

Rating nations and corporations



Moody's ESG Rating Scale

Score	Definition
E-1 S-1 G-1	<p>Positive</p> <p>Issuers or transactions with a Positive E or S issuer profile score typically have exposures to E or S issues that carry material credit benefits.</p> <p>For G, issuers or transactions typically have exposure to G considerations that, in the context of their sector, positions them strongly, with material credit benefits.</p>
E-2 S-2 G-2	<p>Neutral-to-Low</p> <p>Issuers or transactions with a Neutral-to-Low E or S issuer profile score typically have exposures to E or S issues that are not material in differentiating credit quality. In other words, they could be overall slightly credit-positive, credit-neutral, or slightly credit-negative. An issuer or transaction may have a Neutral-to-Low score because the exposure is not material or because there are mitigants specifically related to any E or S risks that are sufficient to offset those risks.</p> <p>Issuers or transactions with a Neutral-to-Low G issuer profile score typically have exposure to G considerations that, in the context of their sector, positions them as average, and the exposure is overall neither credit-positive nor negative.</p>
E-3 S-3 G-3	<p>Moderately Negative</p> <p>Issuers or transactions with a Moderately Negative E or S issuer profile score typically have exposures to E or S issues that carry moderately negative credit risks. These issuers may demonstrate some mitigants specifically related to the identified E or S risks, but they are not sufficiently material to fully offset the risks.</p> <p>Issuers or transactions with a Moderately Negative G issuer profile score typically have exposure to G considerations that, in the context of the sector, positions them below average and the exposure carries overall moderately negative credit risks.</p>
E-4 S-4 G-4	<p>Highly Negative</p> <p>Issuers or transactions with a Highly Negative E or S issuer profile score typically have exposures to E or S issues that carry high credit risks. These issuers may demonstrate some mitigants specifically tied to the E or S risks identified, but they generally have limited effect on the risks.</p> <p>Issuers or transactions with a Highly Negative G issuer profile score typically have exposure to G considerations that, in the context of their sector, positions them weakly and the exposure carries overall highly negative credit risks.</p>
E-5 S-5 G-5	<p>Very Highly Negative</p> <p>Issuers or transactions with a Very Highly Negative E or S issuer profile score typically have exposures to E or S issues that carry very high credit risks. While these issuers or transactions may demonstrate some mitigants specifically related to the identified E or S risks, they are not meaningful relative to the magnitude of the risks.</p> <p>Issuers or transactions with a Very Highly Negative G issuer profile score typically have exposure to G considerations that, in the context of their sector, positions them very poorly and the exposure carries overall very high credit risks.</p>

Source: Moody's Investors Service

<https://www.ceres.org/news-center/blog/qa-moodys-investors-service>



(Side comment on largest credit rating agencies)

Moody's, Standard & Poor and the Fitch Group

They credit rate 95% of corporations and nations => hidden political power. Downgrade a country => increase the cost of borrowing money.

Gave Lehman Brothers an AAA rating => subprime mortgages => bankrupt in 2008 => financial crisis

Euro crisis in 2009????: Agencies downgraded Greece and thereby increased its costs of borrowing, which caused their situation to deteriorate further



ESG: Environmental, Social, Governance

Criteria for screening investments.

Risk profile of the company

Financially (!) material ESG information

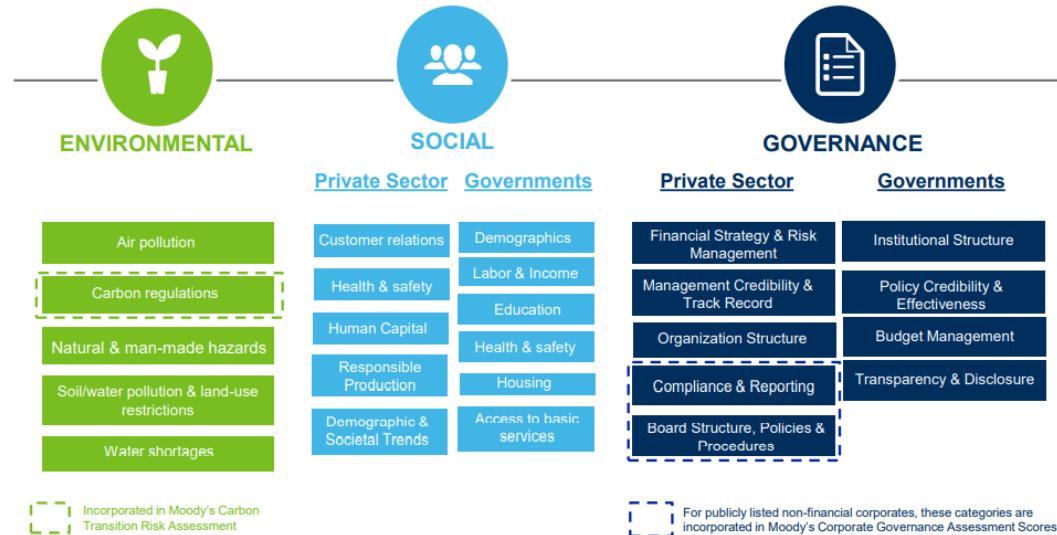
Which ESG risks can damage the profitability of the corporation

It indicates relation to society and environment => low risk = low potential damage to society, but this is secondary to the financial risk

Of relevance to investors => decisive for publicly traded companies
=> Influence their access to investors



Credit relevant ESG “Taxonomy” Created



Example from Moody's Methodology

EXHIBIT 2

Moody's Environmental Risk Categories

Carbon transition



- » Current positioning for carbon transition
- » Technology, market and policy risk
- » Actions to mitigate risk
- » Long-term resilience to risk of accelerated carbon transition

Physical climate risks



- » Current and future effects of climate change
- » Exposure to heat stress, water stress, floods, hurricanes, sea level rise and wildfires

Water management



- » Non-climate-related risks
- » Impact of economic activity
- » Availability, access and consumption
- » Innovations to enhance water use efficiency
- » Risk of pollution-related regulatory violations

Waste and pollution



- » Non-GHG air pollutants
- » Land-based accidents, spills and leaks
- » Hazardous and non-hazardous waste
- » Circular economy

Natural capital



- » Impact on natural systems (soil, biodiversity, forest, land, oceans, etc.)
- » Dependency on goods and services derived from nature (agriculture, fiber, fish, etc.)

Note: Subcategories are representative and not exhaustive.

Source: Moody's Investors Service

Moody's social risk categories

EXHIBIT 4
Moody's Social Risk Categories - Private Sector



Notes: While the categories of risk are reasonably distinct, in some cases there are interrelationships among the categories. Subcategories are representative and not exhaustive.
Source: Moody's Investors Service

Moody's governance risk categories

EXHIBIT 6

Moody's Governance Risk Categories – Private Sector



Notes: While the categories of risk are reasonably distinct, in some cases there are interrelationships among the categories. Subcategories are representative and not exhaustive.
Source: Moody's Investors Service



ESG Rating

Enables investors to evaluate which environmental, social and governance risks the corporation is facing and their severity.

Ratings have decisive influence on the price of capital, i.e., the price of borrowing money. High ESG risk => higher interest rates

Rates the *financial* risk, the risk ESG issues affecting profitability, and NOT the impact of the company.

Challenge: How to compare complex organisations?

Each rating agency has a specific methodology: which aspects contributes how much to the overall rating?



Methodologies

Rating created on the basis of thousands of data points.

Materiality: Which issues are material? Requires understanding the line of business and understanding the particular situation of the corporation. Each methodology (rating agency) has a different understanding of materiality

Data harvesting: More than half of the data are based on qualified guesses, on statistics on what is normal in this line of business – by the specific rating agency. If a corporation has an untypical issue, it is not included in the rating

Scoring: How much weight do you give to each cluster of data points? How important is lack of inclusivity compared to water consumption? This is determined by the individual methodology of the rating agency



Complexity => not possible for investors to understand the differences in detail => Moody's methodology is 69 pages long. If two corporations are rated by different agencies, the investor would have to understand the differences in methodologies *and their consequences for the rating*

Different metrics => data points are – by each rating agency - ascribed different importance relative to the overall score

Example: MSCI upgraded McDonald's rating by claiming climate change posed no risk to the business. (This claim is of course highly controversial since McDonald's is a major buyer of beef)

Adopting policies already integrated in the legislation will increase ESG score (Corporate Governance rules banning bribery)

Reply from MSCI: Ratings are about risks, and not about “goodness”.
(<https://www.greenbiz.com/article/secret-life-esg-ratings>)



Criticism by Aswath Damodaran

Professor of Finance

Who does ESG rating serve?

The Investors? No, higher ESG rating gives them a lower return on their capital.

Only IPOs raise capital => other corporations do not raise capital

Investors in companies accept lower return for a high ESG rating

Individuals have outsourced responsibility

Future: Consultants and bankers will make money on ESG. Society will be worse off



BlackRock asset management company

2020: Announced that they will divest from carbon intensive companies and focus more on ESG

- ⇒ Republican (oil-friendly) are withdrawing from BlackRock because of their commitment to ESG
- ⇒ ESG as political battleground