

Introduction to Business Ethics

WI001058

Structure

0. Introduction
1. Basic Concepts
2. Historical-economic background: Premodern and modern
3. Foundations and tools of business ethics
4. Recent problems: Ethics of digitalization
5. Corporate ethics

Exam

18.02.2021

50 single-choice questions

10 of these are part of the sample questions of the lecture

0. Introduction

Main concern in Business Ethics

How to act ethically correct in various cases?

- Withdraw of Siemens from Ryadh conference due to Khashoggi's death in a broken state
- Should Western pharmaceutical companies supply Africa with antiretroviral HIV medication?
- Corporate Social Responsibility made American Express donate 2 cents for every credit card transaction which increased the overall amount of transaction
→ Can an ethical action also pay off and become a business case?

General perception of Business Ethics

Public perception is coined by Aristotle's virtue ethics

- **Greed** → main cause of economic misconduct
- **Distrust** of certain population groups such as bankers
- **Criticism** targets the **people involved** and not the structures

Germany's view on Entrepreneurs

Critical view on the engagement of corporations in social issues

- Corporations do not support social welfare
- Social commitment of corporations has decreased
- High corporation profits are morally questionable
- Society does not benefit from high profits of corporations

CSR (= Corporate Social Responsibility) Reporting Development

- Increase in awareness
- 35% in 1999 to 95% in 2011

Ford Pinto Case

- Problem: Fuel tank behind the rear wheel held the danger of explosion at collision
- Management decided not to change due to higher risk
- Result: Many lethal accidents and injuries → lawsuits and withdraw from the market
- This case introduced CSR and the question if long-term ethics and commercial success are compatible

Value of Life

- National highway traffic safety administration NHTSA evaluated value of life in terms of liabilities (costs, loss for society)
 - in 1972: 200.725\$
 - in 2017: 1.175.471\$
- Market value of chemical components of body
 - in 1972: 1.022€
 - in 2017: 1.037€
- Value of body parts
 - in 2008: 1.672.349€
 - in 2017: 1.856.307€
- Value of life in KZ Buchenwald in 1941
 - in 1941: 1.261 RM

1. Basic Concepts

1.1 Problems in Business Ethics as interaction problems

1. Crusoe and Friday

- Business Ethical Problem
 - involves at least 2 individuals
 - Environment of scarcity → leads to conflict
- "Robinson Economics"
 - Business Ethics begins when Friday comes to the island
 - Individual problem of scarcity → becomes social problem
 - Focus lies on the interaction
- Possible reactions to conflicts
 - **Combat** = fight
 - **Altruism** = give to others
 - **Cooperation** = mutual benefit

2. Cooperation as solution to scarcity problems

Distributive Justice	Allocative Justice
How should a given cake be split?	How can we improve the supply of goods quantitatively or qualitatively to satisfy more demand than before?
<ul style="list-style-type: none">– Existing quantity of goods is given– Distribution based on rules– Criterion is usually to get a result as equitable as possible	<ul style="list-style-type: none">– Best possible allocation of scarce production factors (labor, raw materials, capital, etc.)– Determine which scarce production factors should be allocated and used to satisfy which needs
Distributional issues treated in isolation Problem of scarcity itself is not addressed and persists	Gains from cooperation Problem of scarcity should be mitigated (= abgeschwächt)

Distribution = Verteilung = In how many pieces do we have to divide the whole?

Allocation = Zuteilung = Who gets which amount of the whole?

Allocation Problems in Economics

- **Connection to economics**
 - Interdependence of production and distribution have to be discussed simultaneously
→ different distribution of product 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
- **Example for Economic Policy**
 - Governments redistribute wealth and income by levying taxes and social security contributions including the payment of social benefits
 - Which criteria (equity, equality) 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

3. Limits of individual moral actions

Decoupling (= entkoppeln) of motive and result

→ Morality is interpreted as an **unintended result of intentional action**

Example: The virtue-ethical question of "What should I do?" makes Robinson give up half of his stocks to Friday → resulting in both not getting enough to eat

Adam Smith: Everyone is entitled to have own interest e.g., baker, butcher

4. Outcome for business ethics

→ Business Ethics should be based on the conditions under which they are carried out (and not based on actions and their motives), because:

- Individual virtues cannot solve **structural problems**
- Problems in Business Ethics are by nature **interaction and interdependence problems**
- **Complex conditions of the modern world**
 - Rising degree of complexity in economic relations
 - Prevalence of mutual interdependences between individuals, firms and nation states

1.2 Ethics and Economics

1. Classification of Philosophy

Theoretical Philosophy	Ontology	What does exist?
	Metaphysics	What is the order of the world?
	Epistemology, Philosophy of Science	What can I know?
	Philosophy of Language	What is the relation of language and reality?
Practical Philosophy	Ethics	What should I do?
	Economics	What is the best means to achieve an end?
	Political Philosophy	What is the best order of society?
History of Philosophy		

2. Ethics and Ethos

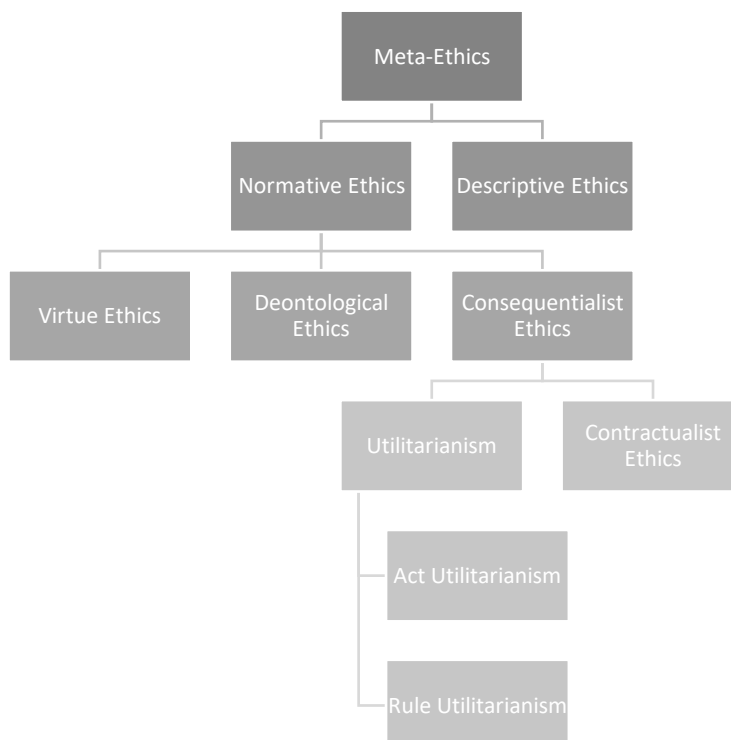
Ethos = space of living, habit, custom, tradition, character

Aristotle: Triad of politics, ethics, and economics

3. Ethics and Morality

Morality = complex of rules and norms that (should) determine people's actions

Ethics = theory of/ reflecting on morality



4. Overview on Ethics

Meta Ethics	<ul style="list-style-type: none"> – Focuses on nature of morality, often relies on semantic analysis of moral judgments – Difference between cognitivism and non-cognitivism – Not directly related to content of rules or norms – Meta-Ethical Questions: according to Richard Garner and Bernard Rosen 	
	Moral Semantics	What is the meaning of moral terms or judgments?
	Moral Ontology	What is the nature of moral judgments?
	Moral Epistemology	How may moral judgments be supported or defended?
Descriptive Ethics	Description, systematization, and explanation of normative systems → Ethnology, moral psychology, evolutionary biology, behavioral economics	
Normative Ethics	<ul style="list-style-type: none"> – Conditions for approval and compliance – Evaluation of an economic order as "just" or "unjust" – Contains many empirical constituent parts – Different from psychology and humanities – Ethics is the analysis of human conduct from the perspective of "good" and "bad" respectively "morally right" and "morally wrong" – Different types of normative ethics based on: <ul style="list-style-type: none"> – Action as such – Purpose of action – Rationale behind action (mens rea) – Consequences of action – Utility of action 	
	Virtue Ethics	<ul style="list-style-type: none"> – Virtuous life = good and happy life – Goal: enhancement of certain values – Virtues: wisdom, justice, courage, moderation
	Deontological Ethics	<ul style="list-style-type: none"> – Based on whether an action itself is good or bad – Kant: Categorical Imperative – Grounded in nature – Ethics of conviction <ul style="list-style-type: none"> – Motives as criterion – Quasi-deontological: To act out of duty and not in accordance with duty (Companies act with profit interests) – Problems of Deontological Ethics: <ul style="list-style-type: none"> – Clash of different moral norms if consequences are not considered (Not lying to a murderer) – Implementation issue/ exploitation risk – Issue of value pluralism
	Consequentialism	<ul style="list-style-type: none"> – Consequences of actions are crucial to distinguish between good and bad actions – Consideration of purpose and means – Long term vs. short term consequences – Consider (unintended) side effects

	Utilitarianism	<ul style="list-style-type: none"> – Jeremy Bentham: happiness of greatest number – Utility is crucial to distinguish between good and bad actions – Utility of the greatest number, not individual <ul style="list-style-type: none"> – Act Utilitarianism: – Rule Utilitarianism: Utility of the rule – Problems of Utilitarianism: John Rawls <ul style="list-style-type: none"> – How should utility be calculated? – Individual and its rights are less important than society – Utility of majority can be raised at the expense of a (small) minority
	Liberalism	<ul style="list-style-type: none"> – John Stuart Mill: Power can only be exercised over people to prevent harm to others – Freedom of speech, to pursue tastes and unite (as long as it does not cause harm on others)
	Contractualism	<ul style="list-style-type: none"> – John Rawls: Consent of all people to a rule – Individual is taken into consideration – No maximization disregarding the individual interest – Social contract theory: Buchanan and Hobbes

Example: Different Levels of Ethics

"Human dignity is inviolable"

Descriptive	According to the German Constitutional Law human dignity is inviolable
Normative	No one, not even public authorities, ought to compromise human dignity
Meta-Ethical	What does "is" mean? Does the statement imply a normative meaning? Is an embryo a "human"? What does "dignity" mean?

5. Economy and Economics

Economy

= Household = Domain of the discipline economics

Economics

- deals with the explanation and design of the conditions and consequences of interactions on the basis of individual cost-benefit calculations
- was traditionally the science of the domain of economy, meanwhile also comprises culture, political offices, elections, education, family

6. Two concepts of Business Ethics

Hyphenated Ethics	Ethics with Economic method
<ul style="list-style-type: none">– Ethics for the economy– Analogous to medical ethics/ bioethics	<ul style="list-style-type: none">– Implementing norms → transferring rules into the social world– Morality is reconstructed by economic means

Business Ethics = a discipline of practical philosophy that explores which norms can be constituted and implemented under conditions of modern society

1.3 Situating Business Ethics in Philosophy

Two Options for Theory in Business Ethics: Dualism vs. Monism

Dualism

= Gegensätzlichkeit, Zweiheit, Polarität

- Calls for decision on one position or at least "mediation" between both positions
- How can the postulated goals be implemented?
- Final aim: Domestication of economy
- Proximity to everyday intuitions of many if not most people
- 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
- Examples:
 - Morality **or** Economy
 - Altruism **or** Egoism
 - Solidarity **or** Competition
 - Ecology **or** Economy
 - Common Welfare **or** Self-interest
 - Common Welfare **or** Efficiency
- Real-life Examples:
 - Karl Kraus
 - Ulrich Döring
 - Erich Fromm

Limit of Dualistic Approach: Problem of Implementation

Competing actors do not necessarily agree with the postulations established by other actors

→ Actors who do follow can therefore suffer from exploitation and competitive disadvantages

→ Example: Environmental protection

Monism

- Economics as a continuation of ethics by other means
- Normative criterion: mutual improvement → all parties can agree on certain rules
- Ethics cannot make individuals work constantly against their own interest
- Ethics has to show that acting according to moral rules is in the aggregate more advantageous than breaking these rules
- David Hume's: all demands of ethics are in the interest of the individual
- Only with general advantages can people be expected to act according to norms
- Iceberg metaphor: Morality is the surface and advantages are hidden underneath

Morality and Economics as two sides of the same coin

Example of universal health insurance in the USA

- **Ethical argument:** Right to primary healthcare regardless of income
- **Economic argument:** Bad health conditions are detrimental (= nachteilig) to economy by creating high opportunity costs

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

Ideal: Perfect economic framework (all actions fixed in details)

→ business ethics systematically relevant

Real: Complete framework is practically impossible due to dynamic nature of global markets

→ Corporate ethics is complementary to business ethics

Theory of incomplete contracts

Starting Point: assumes that human interactions are governed by contracts, formal (codified laws) and informal (promises)

Problem: These contracts are incomplete in a number of ways

→ e.g., performance and consideration are not precisely defined

→ incomplete contracts thus increase uncertainty

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

Parallelism of Corporate Ethics and Business Ethics

- Business Ethics (level of regulation) and Corporate Ethics (level of action) must not be in conflict with each other
- Dualism vs. Monism: What is the relationship between profits and morality?

Risk of a Dualistic Corporate Ethic

- Klaus Steilmann was pressured to lower prices of his products due to globalization
- Risked bankruptcy in order to keep his more expensive German workers and was bought up

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

Reputation

- Goal is to represent yourself as reliable product/ trading partner
- Signal reliability through collective or individual action
- Establish customer loyalty despite the 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)
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

2. Historical-economic background - Premodern and Modern

2.1 Ethics of Actions and Ethics of Conditions

Economic conditions and moral norms

- Validity of moral norms in business ethics depends on the prevailing economic conditions
- Strong change in the economic conditions and structures
→ Paradigm shift in the pre-modern and modern worlds
- Ethical concepts from philosophies of the past century are not easily transferable
- Reason: Earlier ethical concepts were not wrong in themselves, but moral thinking could not catch up with developments in other human domains

Historical background of pre-modern societies

- Small communities with only a few isolated cities
- Predetermined order and leadership → Called from heaven
- Low interregional communication options → interaction mostly among individuals
- Strong importance of agriculture
- Economy: a private affair of self-sufficiency, subsistence, and risk aversion
- Clear notions of hierarchy of professions or castes

Social classes in Antiquity

- Ranking of professions
- Exclusion of particular groups from political participation
- Differences of human beings by nature

Changed structures of the Modern World

- I. **Multitude of different goals and beliefs**
 - People can influence their behavioral actions (political participation)
 - Limited degree of predetermined order
 - Lack of universally recognized external authority
- II. **Establishment of Multiculturalism and Pluralism**
 - Increase in individual mobility in geographic, social, cultural, and professional dimension
- III. **Increase of material wealth of humanity** since the industrial revolution
- IV. **Easy escape of direct moral control** due to lack of enforcing social norms
- V. **Erosion of traditional "Moral Monopolies"** such as the church

Pre-modern Ethics	Modern Ethics
Ethics of Action = quest for individual character improvement	Ethics of conditions or order

Economy and growth in Antiquity

Zero-sum game

- hardly any growth in Antiquity
- Static income distribution ("the profit of one is the loss of another")
- Political consequence → distribution struggles and political instability
- Winners of income distributions are either poor or rich

Causes of Economic Growth in Modern Age

- Technological progress and gain of scientific knowledge
- Increasing economics of scale by implementing new technologies
- Introduction of competition and international trade (vs. face-to-face trade)
- Modern societies have centers with high production levels

Ethics of Actions

- Economic conditions: subsistence economy that should ensure survival
- Traditional ethics:
 - Perception of society as a zero-sum game
Giovanni Ruccelai: *"By being rich, I make others poor I may not even know"*
 - Virtue of moderation in consumption
 - Risk aversion
- **Cato:**
- Example of St. Martin
 - sliced his coat into two and gave the other half to a freezing beggar
 - This altruistic act is considered to be the epitome of a good deed
 - Two angles on this act:
 - Unselfish act 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

Solidarity and Competition

- Competition **enables growth** → which increases "size of the cake" (e.g., industrial revolution)
- Competition **promotes solidarity** more than sharing
- Homann *"Social interaction for the benefit of all, including the disadvantaged"*

Economic Order

- Competition is **not "war of all against all"**
- Conditions and rules of competition
 - Enabling competition that enhances **prosperity**
 - **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
- Focus is on **conditions of actions** (process) and **not the motivation** (why it is done)

Causes of re-evaluation of competition and individual striving

- **Elimination of Social Control**
 - Pre-modern: 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 → competitive disadvantages**
- **Self-interest as a "modern form of charity"**
 - **Suitable framework** crucial for prosperity and production of goods that benefit fellow human beings
 - **Prevention of self-interested action** at the expense of others
 - Preferences do not only refer to monetary or material advantages

- Modern ethics of investment instead of pre-modern ethic of moderation
- Conflict between good, altruistic behavior and bad egoistic behavior is no longer valid

Ethical Quality of Competition

if competition takes place in an appropriate regulatory framework

- **Self-interest benefiting** fellow human beings and society
- **Prevention of exploitation** by rules
- **Avoidance of forcing ethical values outside of framework**
- Recognizing the **complexity of contemporary socio-economic systems**
- **Competitive market economy** as systematic approach of business ethics

Example of shortcomings of traditional ethics of action

- In 2016 105 tons of confiscated ivory were burnt to fight illegal poaching
 - Burning this high amount reduced supply of ivory, which increased the prices
 - Demands stayed constant, price of ivory increased → higher profits attract poaching
- Overlooking of systematic connections → unforeseen and unwanted consequences

2.2 The Benefits of the Market and Competition

Competition

- = state of competitive striving
- = *"a metaphor to call competition competitive war or simply war. The function of battle is destruction; the function of competition is construction"* - Mises
- Important distinction between competition and struggle
 - Struggle = natural and without rules
 - Competition = without a suitable set of rules, competition can quickly lead to ruinous competition - Hobbes
- **Conceptual history and linguistic usage**
 - Latin: competere vs. concurrere
 - English: Competition vs. rivalry
 - German: Wettbewerb in many different contexts

Six interpretations of "Market" that lead to its success story

Market as a...

- (1) instrument for the **use of distributed and local knowledge**
- (2) method of **discovery**
- (3) engine of **innovation**
- (4) **control mechanism**
- (5) instrument of **disempowerment**
- (6) instrument of **self-discipline**

(1) The Market as a Method for the Use of Knowledge

"Economic relations and human needs as a complex and spontaneous order" - Friedrich A. Hayek

Planned Economy (= Command Economy)

- **Central authority** (government) makes economic decisions
- **Price loses** its function as a **scarcity indicator**
- General **production quotas and prices are set**

Market Economy

- **Constant change** of human **needs** and **conditions**
- **Price changed** by **knowledge of all individuals**

Example: Decreasing supply and increasing price of copper due to fire in African copper mine

→ German companies substitute copper with other precious metal

→ Price as an indicator of the shortage of a good without understanding nature of price change

(2) The Market as a Method of Discovery

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

- **Input:** Swarm Intelligence = Knowledge of Millions of people
- **Output:** Unimagined market solutions
- **Competition:** constant exchange of information and pressure of competitors
- Creation of not sensibly controlled goods, concepts, services, and convictions
- Findings affect products and services, but also spheres of human existence in general

Examples:

- **Joseph Schumpeter**
 - Dynamic entrepreneurial type and genius cult of the 19th century
 - Process of creative destruction → improvement and new development of products
- **William Baumol**
 - Rule-based market economy with competition promotes entrepreneurship
 - Pre-modern: competition was suppressed and obstructed (guilds)
 - Innovations and competition results lead to feedback effect

(3) The Market as a Control Mechanism

- **Pre-Modern Period**
 - Face-to-face control
 - Social control in small communities
- **Modern Period**
 - Control function of the market
- Cost and duration weaken the effectiveness of legal processes
- Instead: Companies are subjected to **control from outside and inside**
 - **Externally:** control over stakeholder relations and discipline of the market
 - **Internally:** Shareholders control mechanism (e.g., via supervisory board)

(4) The Market as an Instrument of Disempowerment

- **Impartiality** (= Unparteilichkeit)
- **Reward** of what **meets demands**
- Automatic **limitation of power** through threat of **competition**
- **No abuse of power**

Example:

Microsoft had a large market share and thus power position but had to fear future competition

(4) The Market as an Instrument of Self-Discipline

- **Success** possible through **cooperation** with others
- Business transactions when both parties **believe in its benefit** for them

Example: Ultimatum Game: Does competition generate fairness?

- Player A distributes 10€ to himself and Player B
- If Player B rejects the distribution because it seems unfair (9:1), no one receives any money
- Empirically fair distributions (5:5) were especially common under participants coming from cultures of competition → used to interacting with strangers and building a reputation

2.3 The Fair Price

Antiquity

Objective Valuation is typical for Antiquity

(1) Platonic Philosophy

- Main objective: state sponsored **pursuit of virtue**
- **Reject of profit** and **utility maximization**
- Can call for **upper limit on ownership**
- Special **regulations** for **economic transactions**
 - Fixed daily price per good
 - Profit only in modest margins
 - Sellers know the value of goods, no need to charge premium

(2) 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 housekeeping) within clear limits → morally permissible
 - Chrematistic (= Study of wealth) as enrichment at the expense of others is immoral → zero-sum-game

(3) Cicero's View

During a famine a Trader possesses grain from another location and is unsure of how to act

- Sell at highest possible price → Freedom of action and ownership
- Share information on location → Community forbids exploiting such knowledge

Middle Age

(1) Old and New Testament

- Moses and Matthew: No one should take advantage of a brother
- Last Judgment: Do not endanger security through wealth
- A priori suspicion: It is hard to keep away from doing wrong and sin

(2) Augustine

- De Civitate Dei: Theory and ranking of values
 - Purchase price based on human needs
 - Ranking of human needs from experience → Objective value theory
 - Trading gains are not necessarily bad despite moral dangers

2.4 The Prohibition of Interest and Usury (= Wucher)

(1) Antiquity

- Clear **prohibition of interest**
- **Duty to help** among **relatives**
- Not applied to behavior among outsiders
- Moses: *Offer help to friends or strangers in need without speculating on interest*
- Deuteronomy: *Only charge interest to a foreigner*
- These moral rules can be maintained in **small groups or face-to-face societies only**

(2) Ancient Greece/ Plato

- **State** is the **highest moral good**
- **Plato's Nomoi:**
 - **Rejects lending money for interest** → since it can **destroy social order**
 - Contrast between state and capital (analogy to Karl Marx)
- **Plato's Politeia:**
 - **Interest is evil**
 - **Credit trade** increases number of **poor people** in the state

(3) Ancient Greece/ Aristotle

- Generating profit through interest is unnatural since it does not come from work but from money itself

(4) Christian Doctrine

- Council of Nicaea
 - **Ban on money lending against interest**
 - Trading loans against interest was **punished with infamy**
 - Constantine established **laws for these rules**
- Other **councils also emphasizing the prohibition of interest**
 - Lateran Council 1139
 - Council of Lyons 1274
 - Council of Vienne 1311
- 1830 lift of this ban by Pope Pius VIII

(5) Islam

- Interest is **prohibited** and **non-Muslim** due to acquisition **without achievement**
- Interest a premium for which there is no consideration
- The waiver (= Verzicht) of consumption is not recognized as consideration
- **Islamic Banking** as an alternative
 - **Lender participates in the profit and loss** of a credit financed company
 - Profit only if **risk of loss is borne** (= getragen)
 - Problems:
 - **No distinction between equity and debt**
 - **Borrowing** is usually **less risky** and therefore **important for companies**
 - Many **social policy instruments rely on interest**
 - **Insurance policies are rejected** in Islam according to the traditional understanding if they are not based on donations

3. Foundations and Tools of Business Ethics

3.1 Philosophical Principles and Tools

View of Ethics on CSR

- Companies improve social and environmental image of company to **maximize profit**
→ this goal **corrupts ethical goals** from a deontological point of view
- Deontological ethics does not only look at results of making ethical judgments but also at **certain characteristics of the behavior**
- **Consequentialists** look at consequences of an action, not the reasons for it
→ CSR has positive effects on humans, animals, or nature

3 Aspects of characteristics of behavior

- **Strict and not-strict deontological ethics:**
 - Is ethical correctness of an act or even a law really independent of result of an action?
 - Fundamentally less sensitive to empirical conditions
- **Situational independence**
→ lying is fundamentally wrong regardless of the situation
- **Goal of deontological ethics**
 - Respecting/ protecting values of action
 - Basic Mode: principles are more important than consequences

Deontology by Immanuel Kant

- 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?
 - Do we want lying to become a generally morally permissible act?
 - Not even a criminal wants to live in a world where people constantly lie
→ Lying is morally unacceptable
- Today: Norman E. Bowie pursues a Kantian approach

Example: Launch (= abschießen) of a hijacked aircraft

- **Legal basis:** Right to life and physical integrity → Art. 2 Basic Law
- **Case:** Kidnapped plane flying towards a football stadium
- Is it ethically justifiable to shoot down plane?
 - **NO - Deontological**
→ Art. 2 GG must not be violated, no matter how high the damage may be
 - **YES - Consequentialism**
→ Minimize harm, life must be balanced against each other

Consequentialist Ethics

- John saves child from well → bumble bee flies out of well and stings driver who drives into crowd of people
→ John's behavior not immoral due to unforeseen circumstances
- Target of Consequentialism and Utilitarianism is Maximization of happiness
 - John Stuart Mill = different qualities of happiness
 - Peter Singer = achieving certain goals, not cognitive happiness

- Other theories = Openness of concept of preference
- Intergenerational justice = Maximization of favorable consequences for current and future generations
- Object of consequentialist calculus are actions, rules of action, and institutions

Weakness of Act Utilitarianism

- Very **demanding for individual**
 - One should maximize benefit for all
 - Every single decision becomes a moral issue
 - Difficult to determine how a sequence of action determines sequence of happiness
- **Happiness of the individual could be sacrificed** for happiness of the mass

Reflective Equilibrium

Vertical Norm Conflict	Horizontal Norm Conflict
= Clash between norms and individual cases <ul style="list-style-type: none"> – Norm = certain ethical paradigm that dictates the maxim of action – Individual case judgment = value judgment in a real action situation independent of an ethical paradigm → Trolley problem 	= Opposing Norms <ul style="list-style-type: none"> – Example: violation of prohibition of bribery vs corporate code (e.g., secure jobs)

Trolley Dilemma

- Tram will override five people; you could switch to another track where only one person stands
- **General Norm:** Maximize happiness of all by sacrificing one person
- **Individual case decision:** Do not reroute the train and consciously decide against person
- Before 2006 it was legal to weigh lives against each other in the Hijacked Aircraft Dilemma, but this has since been overruled since it is not compatible with a human's right to life and dignity
- MIT is working on a platform called Moral Machine that identifies a broad view on how machines (autonomous driving cars) should solve moral dilemmas and the public can discuss ethically problematic scenarios

Advantages of autonomous driving cars

- **Avoidance of accidents** (90-95% of car accidents are due to human errors)
- **Reduction of physical and mental stress**
- **Time saving + convenience**
- **But:** Automated driving **needs rules** (Uber accident in Arizona in 2018)

Levels of autonomous cars

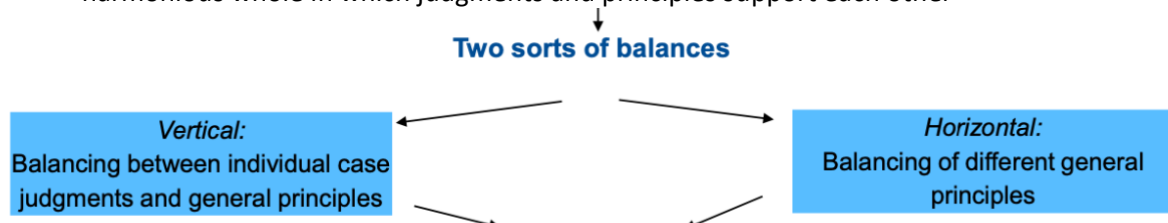
Stage 0	Stage 1	Stage 2	Stage 3	Stage 4	Stage 5
Driver Only	Assisted	Partially automated	Highly automated	Completely automated	Driverless
driver executes longitudinal and lateral guidance on a permanent basis	driver executes longitudinal or lateral guidance on a permanent basis	driver must permanently monitor system	driver must not permanently monitor system	no driver required in the specific case of application	no driver required from start to finish
no intervening vehicle system active	system takes over the other function	System executes longitudinal and lateral guidance in specific cases	driver must be potentially able to take over	system can automatically cope with all situations in specific applications	the system performs the driving task completely for all road types. Speed ranges and environmental conditions

20 Ethical Guidelines for Autonomous Driving

- Avoiding personal injury > damaged property
- Qualification according to personal characteristics (age, sex, physical or mental constitution) is strictly forbidden
- Liability passes from user/ owner to manufacturer and software operator
- General programming to reduce total number of personal injuries permissible

Process of Mutual Adjustment Rawls 1979

- Coherence between intuitions, case-by-case judgments, norms, supreme principles and harmonious whole in which judgments and principles support each other



Weaknesses

- Problem of operationalization
- Coherence \neq Moral truth
- Coherent system of case-by-case judgments, intuitions, rules, and general principles do not need to be right
 - Coherence criterion alone is not enough
 - Danger of ethical relativism (Norms and values are time-bound)

Two Types of Dissent in Modern and Pluralistic Societies

What is a good life?	What is morally imperative?
<ul style="list-style-type: none">– People live together in a small space– Different backgrounds, languages, hobbies, and lifestyles– No more consensus on how to live life	<ul style="list-style-type: none">– Controversies especially in ethical and economic issues– Markets for blood, organs, sex? Freedom vs. exploitation
→ Dissent does not lead to problems	→ Dissent leads to problems

Three rules 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

- **Ability to consent** instead of actual consent
 - Consent can be expected on the basis of interests and preferences
- **Hypothetical contracts** instead of de facto contracts
 - Large number of hypothetical contract participants

→ Understand contract-theoretical logic as kind of thought experiment

Contractarianism vs. Contractualism

	Contractarianism	Contractualism
traditionally by	Thomas Hobbes	Immanuel Kant
contracting parties	maximizer of one's own utility	morally motivated agents
conditions of use	divergent interests + little moral common ground	Similar interest + common moral basis
	For pluralistic societies with cultural differences	For communities with a strong cultural foundation

Democratic Majority Principle

Idea: Dissent votes on moral questions → majority opinion as a tool for establishing standards

Serious problems: Discrimination against minorities possible → Majority prohibits e.g., Catholicism...
→ Additional normative regulations (such as fundamental rights) to avoid suppression

Discourse Ethics - Consensus as a Goal

Essential Principles

- Equal participation
- Rule-free
- Better argument counts
- Put yourself in position of opponent

→ Aim of discourses is to find a consensus

Three difficulties for reaching a consensus

- **Principal reasons:** people affected by a moral norm are often excluded from discourse
- **Pragmatic reasons:** Number of people affected is too big to involve everyone
- **Motivational reasons:** Some participants are unwilling to search for viable solution

Ulrich: Discourse ethics as Business Ethics

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

3.2 Economic and socio-scientific fundamentals and tools

Rationality

= Calculation, Reason

Two Distinctions by Max Weber

Purposive, Instrumental Rationality	Value Rationality
= Relationship between a goal and the means	= Reasonableness of a certain goal
Goal-Means-Relationship <ul style="list-style-type: none">– Goal is exogenous– Hypothetical Imperative: "If objective A is to be achieved, then means B fulfills this purpose" Efficiency <ul style="list-style-type: none">– Things are done right in relation to a certain predetermined goal	Reasonableness of a certain goal <ul style="list-style-type: none">– Goals have to be justified– Correctness of the goal dependent on e.g., moral, religious, or aesthetic beliefs Effectiveness <ul style="list-style-type: none">– Right things are done– Correctness dependent on criteria
Individual Rationality vs.	Assessment of social conditions

Interdependency between Goals and Means

→ No strict separation between instrumental and value rationality

Homann: *No consideration in isolation possible*

Open Concept of Advantage in Economics

Stigler, Becker: *Matters of taste cannot be disputed* → Individual know what they want

What should be the subject of scientific research?

Preferences	Situative Restrictions
<ul style="list-style-type: none">– Actions can be explained by changing preferences– Lack of theory on development of these preferences– Preferences are subjective– consider preferences as exogenous (= beeinflusst von außen) and stable	<ul style="list-style-type: none">– Objectively observable across individuals– Allow an interpretation of corresponding behavioral conditions– methodologically meaningful subject of investigation

Methodological Individualism

How can social phenomena be explained?

- Every analysis of society begins with the individuum
- It is not Ontological individualism, which is a statement about true nature of man/ concrete form of human behavior
- 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 cannot be explained by individual behavior
- *Example:* System Theory of Luhmann (Welt besteht aus autopoietischen Systemen)

Subjective Concept of Advantage

Subjective Concept of Advantage	Goosen's First Law
<ul style="list-style-type: none">– Value of good depends on individual advantage it brings to the respective customer	<ul style="list-style-type: none">– The marginal benefit of a good decreases with increasing consumption

John Law: Value depends on the utility and the quantity compared to the demand of a good

→ Water is of little value, despite its great utility, the quantity is huge

→ Diamonds are of great value, despite the low utility, the demand compared to the quantity is low

Classical Paradox of Value

Why is a diamond more expensive than water?

Adam Smith saw no connection of both value concepts

	Exchange Value	Value of Utility
Water	↓	↑
Diamond	↑	↓

Labor Theory of Value	Marginalism
<ul style="list-style-type: none">– Objective value theory– Value of a good can be explained by amount of working time spent on it– unable to solve the classical value paradox	<ul style="list-style-type: none">– Subjective value theory– Individual use of a good is directly dependent on its available quantity– solves the paradox

* Value of water in areas with low quantity such as desert higher than in e.g., cities

Theory of Revealed Preferences

- A person prefers good A over good B and good B over good C
→ $A > B$ and $B > C$
- **Criterion of Transitivity:** $A > C$
- **Utility Function:** Formulation of consistent individual choices
→ Success of a Utility Function depends on success of prediction
- **Ordinal Utility Function:**
 - You need Transitivity and completeness
 - Any pair of goods X and Y can be compared
 - You either prefer a good or are indifferent between the goods
 - Result: Ordinal order of goods = alternatives can be ranked from best to worst
- **Concept of Indifference:**
 - A good X is liked as much as good Y
 - **Indecisiveness** = Time is needed to evaluate respective benefits

- **Indifference** = No time for reflection necessary; both alternatives have same value
- **Irrelevance of third alternatives:** If good X is preferred to good Y, this preference does not necessarily have to change if good Z is offered as an alternative

Homo Economicus

- Does not necessarily describe human as selfish
- More so as a very rational and consistent decision maker
- What constitutes a benefit to the individual is up to him
→ Mother Theresa very selfless, but consistent in her decision making = homo economicus
- **Homo-economicus Approach** opens fundamental possibility of modeling human behavior under conditions of scarcity
- **"Anything goes" Approach** allows idiosyncratic behavior, prohibits any abstraction from contingent circumstances and therefore prevents modeling

Economics as Situation Theory

- Actors situationally account for actions of others in their decision
- Situation, not behavioral theory → reality and world view of people are hidden, true motivations of actors are irrelevant
- Modeling of interaction processes that forces individual actors to adapt behavior based on situational incentive structure

Economics and Economic Policy

Economics ask for...	Economic Policy asks for...
<ul style="list-style-type: none"> – 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 	<ul style="list-style-type: none"> – Institutions to implement the answers – Regulatory policy/ economic framework – Process policy to influence process of economic activity

→ Social condition of **open concept of utility** is desirable

Distributive Justice

How can different social conditions be compared?

- Value judgments must be traced back to judgments of individuals
- Individual value judgments can be described as revealed preferences about utility functions
- Cardinal scale level is necessary to compare utility levels intersubjectively
- Comparison of different benefit levels through welfare functions

Hayek: Distributive vs. Procedural Justice

Distributive Justice	Procedural Justice
<ul style="list-style-type: none">– Utilitarianism<ul style="list-style-type: none">– Social interpretation of happiness– Fair means greatest happiness of greatest number of people– Pareto-Criterion <p>→ Focus on outcome → <i>Workers get paid the same amount of money for the same amount of work</i></p>	<ul style="list-style-type: none">– idea of fairness in the process (not the result) of the processes that resolve disputes or allocate resources– Robert Nozick: Entitlement Theory– Friedrich Hayek: Market as a place of spontaneous order <p>→ Focus on process → <i>Team loses a football match where referees ensure a fair game</i></p>

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**
= All superordinate social values can be attributed to value judgments of individuals

Utility Function

= Individual objectives can be indirectly derived from choice actions

- Describes revealed preferences
- Individuals do not have a utility function, but behave as if they maximize it

Cardinal Utility Scale

How can individual benefits be aggregated or compared?

- Cardinal Scale level, such as temperature or time
- Allows a meaningful interpretation and comparison of distances between utility values

Utilitarian Welfare Function

= social welfare as the weighted sum of the individual utilities of individuals

Formula:

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

W^U : Utilitarian welfare function

u_i : utility for individual i

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

x : state of society

Nash Welfare Function

= sensitive to variations of individual utility

Formula:

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

W^N : Nash welfare function

u_i : utility for individual i

α_i : weighting factor for individual i

x : state of society

Rawlsian Welfare Function

= Operationalization of maximum criterion

→ W^M at maximum when worst off individual realizes the maximum benefit

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 individual i

x : state of society

Problem with previous Welfare Functions

→ Cardinal utility concept is mostly rejected

→ Mostly ordinal interpretation statements, such as "better" or "worse"

Pareto-Criterion

- Social conditions can only be judged from individual point of view
- **Pareto-Efficiency** = State A is pareto-superior to State B, if in State A at least one individual is better off and no other individual is worse off
- This criterion helps with classifying social conditions
- Compared to Welfare Functions Pareto normatively more appealing
- **Strong Pareto Criterion:** At least one individual is better off, no one is worse off
- **Weak Pareto Criterion:** All individuals are better off → empirically more difficult to realize

Buchanan's Critique of Distributive Justice Approaches

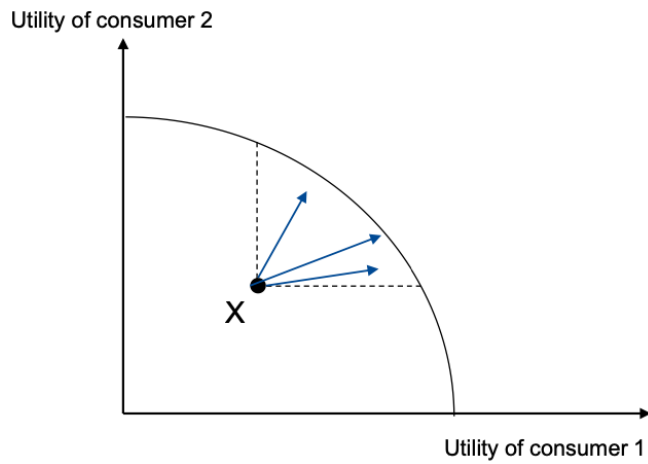
- Inferences from individual to society are often problematic
- Wrong to leap from maximizing individual utility to maximizing society's utility
- Example: Robinson Crusoe
- Economics is essentially interaction problem

Buchanan's Critique of Welfare Economics

- **Welfare economics tends towards intervention science**
 - Criteria of outcome justice requires orientation toward theoretical ideal
 - Tendency for state interventions if the ideal is not achieved
- **Efficiency Criterion is unrealistic**
 - 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 and should be reconnected and upgraded in the public discourse
- **Efficiency ideal regardless of wishes of individuals**
 - Pareto optimum is determined independently of market process and individual desires
 - Deviation of status quo from Pareto optimum = market failure
 - Welfare economics raises efficiency to a normative requirement
 - Welfare economics does not take actual desires of those affected into account

Buchanan's Criterion of Consensus

- His 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
- Three key findings
 - A heuristic that changes from external perspective of efficiency to internal perspective of political processes (mutual consent)
 - Market as an interaction process for reciprocal improvement through exchange acts, rather than measuring the performance of an algorithm against the efficiency ideal
 - Move away from pareto optimum as distribution criterion and return to pareto improvement as process criterion referring to rules and not individual actions



Consensual Rule

- Rule must be derived from metarules (= rules of higher order)
- These metarules must be sufficiently general to be unanimously approved
- Examples: Establishment of a state with a monopoly on the use of force
→ this ended Hobbes's theory of "war of all against all" → generated universal peace

Dilemma Structures vs. Pure Coordination Games

Pure Coordination Games

- No divergent interests between individuals
- Requirement of well-known rule for coordination with each other

Example: **left or right-hand drive**

- **Assumptions:**
 - No driver has preferences for driving on the left or right side
 - All have preferences for everyone driving on the same side
- **Coordination:**
 - No individual has incentive to deviate from the rules
 - Equilibrium is self-enforcing
 - Rule violations do not have to be sanctioned

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

- Theoretically possible and mutually desired gains from cooperation cannot be realized
- Behavioral interdependencies
 - 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

- two prisoners are suspected of a joint crime and interrogated in separate rooms
 - **Cooperation** = both are silent
→ one year imprisonment for both
 - **Defection** = both confess
→ two years imprisonment
 - **Cooperation and Defection**
= one is silent, the other confesses
→ no imprisonment for the latter, maximum penalty for the former

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

- **High relevance** of the theory:
 - **Patterns of interaction:**
two people 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:**
In advance, no effective commitment to a strategy
- Relevance by **Ken Binmore**
 - Represents a situation where dice are as loaded against cooperation as possible
 - A paradigmatic case that highlights cooperation problems
- **A Useful Tautology**
 - Criticism: In experiments many people decide to cooperate
→ Prisoner's dilemma as empirically falsifiable assumption or useful tool?
 - Distinction between payoff in units of utility values and units of money necessary
 - Card players do not play Prisoner's dilemma

Ordinal Utility Concept

- Differences between two utilities cannot be meaningfully interpreted
- No specific utilities necessary, rankings in payoff matrix only have to follow a certain sort of inequality to constitute a prisoner's dilemma

Assumption: $a > b > c > d$

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

Stag Hunt

- Two hunters can choose to hunt hares (= Hase) on their own or join forces to kill a stag (= Hirsch) together
- Benefits of split stag > benefit of hare
- Hare can be killed alone, stag only in cooperation
- If a hunter breaks agreement and goes hunting hares alone, other one goes out empty handed
- Generic payoff matrix: $a > b > c$
- **Results:** two possibilities
 - Both hunters stick to agreement and cooperate
 - One player does not trust and fears of going out empty handed
 - goes hunting for hare on his own
 - Slight doubt is enough → Maximin strategy → maximize lowest payout
 - Despite this cooperation dilemma being mutually beneficial and therefore more cooperation-friendly, cooperation may still not be achieved

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

Battle of the Sexes

- A couple wants to spend the evening together but forgot to agree on meeting location
- Woman prefers football stadium, man prefers cinema
- Generic payoff matrix: $a > b > c$
- Results: Two Nash-Equilibria in pure strategies:
 - Quadrant I: If woman goes to stadium, it is also best for man to go there
 - Quadrant IV: If man goes to cinema, it is also best for woman to go there
 - Cooperation fails if both go to their favorite place, or both want to do the other a favor
 - 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

Assumption: $a > b > c$

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

Overcoming Dilemma Structures

- Task of Business Ethics: Identify factors that prevent cooperation for mutual benefit
- Constitutional Perspective of Buchanan: Two essential solutions
 - State: Social institution that comes about through a collective barter (= Tausch)
 - Social cooperation: Individuals refrain from actions due to imminent sanctions

Example: Traffic Offenders

- Quadrant III: Player 1 breaks traffic rules, Player 2 sticks to rules
- Quadrant I: Consistency of behavior of others leads to change in behavior of Player 1
- Consensus of behavioral change fails because traffic offender is better off, if he breaks the rules while everyone else sticks to them
 - Unilateral behavioral changes fail to pass a consensus test
- Instead: Constitutional consensus test asks for ability to approve of rules:
Is a general violation of rules preferred over a general compliance of rules?
- Crucial: Comparison between general defection (status quo minor) and general cooperation (Pareto-better alternative)

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

Assumption: $a > b > c > d$

Experimental Economic Research: Basics

- Idea = Analysis of actual behavior of actors under incentive structures
- Assumption = Economic situations can be investigated in isolated experiments

Two approaches:

Reality test for established theories	Development of more realistic theories
<ul style="list-style-type: none">– Theoretical predictions are checked against behavior of test objects– Distinct behavioral hypotheses can be falsified experimentally	<ul style="list-style-type: none">– Economic situations are constructed– The obtained data might lead to development of consistent theory for observed behavior

Brief History

→ Trend: increasing use of field experiments

1947	Paul Samuelson	Impossibility of experimental economic research <ul style="list-style-type: none">– Ceteris paribus condition cannot be maintained in a social-scientific context– This means: changes in the dependent variable cannot be attributed to changes of the independent variable
1948	Edward Chamberlin	First lecture-hall experiments with students on imperfect competition
2002	Vernon L. Smith	Nobel Prize for his use of laboratory experiments in economics

Experimental Economic Research as a 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

4. Corporate Ethics

Corporate Ethics as Management of Moral Risks

4.1 Compliance as a Minimum Ethical Requirement

The term "Compliance"

- = an organization's **conformity with rules** that are **exogenous**;
rules of CSR are endogenous
- = adherence to **self-imposed principles**
 - collective
 - company-specific and self-binding
- **Minimum**: compliance with **laws and regulation** in the fields of
 - anticorruption
 - competition
 - data protection
 - labor/ employment law
 - foreign trade legislation
 - environmental protection
- **Additionally**: conformity to **self-imposed principles** = code of conduct

Compliance in the 21st Century

- **Loss over company's communication** due to internet, social media, NGOs
- Due to **symmetric communication** misconduct of companies reaches the public much faster
→ **reputational risks**
- Increased needs of **transparency requirements** emerged with **new technologies**

Compliance Risks

= **Violations of law in course of business operation**

Fines Artikel 30, §4 OWiG = *Act on Administrative Offences*

→ **Reputational risks and criminal prosecution**

- Guilt attributed to the authorized representative bodies, signatories, and other representatives by the authorities
- Penalty often skims off the economic advantage from the unlawful act
- **Gross principle of disgorgement** = legal uncertainty regarding the scope of the forfeiture (=Verjährung)

Violation of company's supervisory duty §130 OWiG

= Managers of management and other company representatives may be held criminally liable

- No analysis of compliance risks was applied → §130 OWiG
- Analysis of compliance risks was carried out, but no measure were taken
→ Worst case scenario

Public Procurement Law Article 97 §4 GWB: *Act against Restraints of Competition*

= Öffentliche Auftragsvergabe

- only for **law-abiding** and **trustworthy** companies (esp. in construction and defense industry)
- companies being exempted from public procurement can end up in **vicious circle**
- **re-approval** process requires **comprehensible confidence-building** measures

Reputational Risks

- arise through **disclosed rule violations**
- legal violations tend to receive a lot of national and international **attention from the press**
- **Negative effects:**
 - Less chances of attracting new talents = **social aspects**
 - **Employees' motivation suffers** from criticism of social environment
 - Stigmatized companies are threatened with **sales losses** due to lost trust
 - Compliance-breaches play an important role in (institutional) **investors decisions**

Risks of non-compliance

Types of corporate misconduct

→ important to identify **company-specific compliance risks**

- Corruption
- Antitrust laws
- Data protection/ privacy issues

Corruption

= **abuse of entrusted power** for **private gain** (Transparency International)

- **Forms of corruption**
 - **Bribery** of government officials
 - **Interactions** between **private actors** (purchasing managers)
- **Transparency International:**

German NGO aims to curb corruption and publishes a model code of conduct

 - Corruption Perception Index: Measures perceived corruption in the public sector
→ 100 very clean and 0 highly corrupt
- **Problems with corruption**
 - Difficult to detect
 - Victims often unaware and barely identifiable
 - Aim to provide verifiability and publicity in structures prone to corruption

Corruption Scandal at Siemens

- Greek Summer Olympic bribery scandal in 2004
- Consequences: Trials, discharges, fines, implementation of a comprehensive compliance program monitored by the former Minister of Finance Theo Waigl

Anti-Trust Laws

= serve the purpose to **prevent arrangements** and **bi- or multilateral coordination** between **competing companies** (≠ spontaneous-solidary parallel behavior)

- **Cartel**
 - want same **benefits as monopolists** without giving up legal and economic autonomy
 - Goal: **maximization of collective profits** by **price fixing**
 - Ethical assessment: **competition drives social progress** and is an incentive to **produce better and cheaper products**
 - Adam Smith: *"People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices"*
- **Special anti-trust regulations** apply for companies with **market-dominating positions**

Exclusionary Conduct	Exploitative Abuse
= Behavior that primarily harms competitors of the market-dominating company	= Behavior harming customers and suppliers
Competitive pricing below the prime costs	Inappropriate and enforced business conditions that a company imposes e.g. on its dependent supplier
Aim is to penetrate the market and crowd other companies out	Aim is to exploit dependents

Distinction between different types of illegal agreements

Horizontal Agreement	Vertical Agreement
= Coordination between competitors	= Coordination between suppliers and customers
<ul style="list-style-type: none">– Price fixing– Geographical division of sales markets– Exchange of confidential information	<ul style="list-style-type: none">– Binding independent dealers to minimum resale prices– Reselling certain products only to end customers from a specific EU member state

Gentlemen's Agreement = one- or more-sided coordination of behaviors of competing companies

Example: Lorry Cartel

- Price coordination over 14 years: Daimler, Iveco, Volvo-Renault, DAF, MAN
- Dominated 90% of the market for medium and heavy lorries
- MAN-whistleblower led to them not being fined
- High penalty

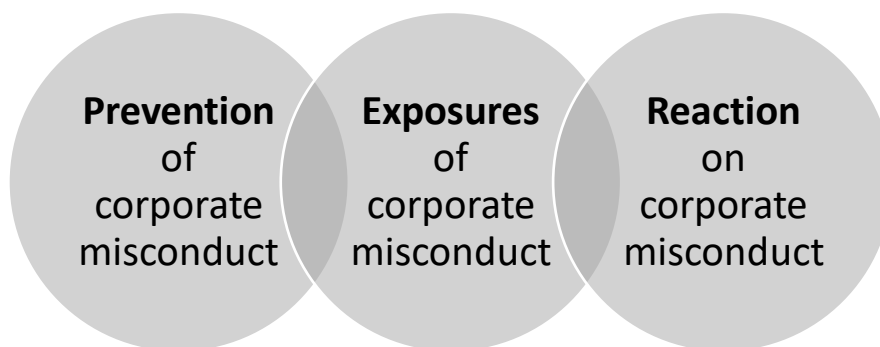
Data Privacy

- Focus on German legal situation
 - **Confidentiality**: Information has to be processed securely
 - Any **use of personalized data** must be **justified**
 - Data has to be **anonymous** or **pseudonymous**
 - Obligation to **report unlawful access to data**
 - Introduction of technical equipment to **monitor the performance of employees** has to be **approved by the works council**
- **Examples**: Food giants and discounters made use of unauthorized video surveillance and other monitoring activities
- Spying scandal at **LIDL**: unauthorized monitoring of employees

Determination of company-specific compliance risks

- Implementation of a compliance program to prevent systematic misconduct (not necessarily focus on misconduct of single employees)
- Compliance risks are often company-specific → analyze business structure
- Rule of thumb: Corruption in companies in the public sector > private sector
- Keep track of all payment activities: Corruption money flows outside the firm
- Examination of business transactions via third parties: systematic corruption often through use of business intermediaries (= Geschäftsvermittler)

Key Tasks of Compliance *Moosmayer 2012*



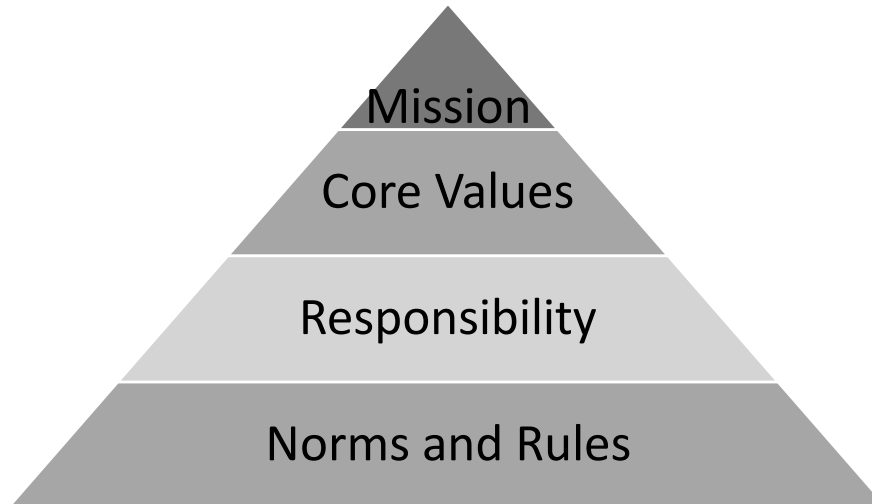
Prevention of Corporate Misconduct

- Ethical code (= corporate integrity)
- Whistleblowing systems
- Compliance training and consultation
- Due diligence of business partners
- Efficacy screening of implemented measures
- **Communication for prevention**
 - Corporate culture that adopts a clear stance when it comes to compliance issues
 - **Tone from the top** = company management
 - **Tone from the middle** = department heads and team leaders

Ethical Codex = central part of compliance programs

- **clearly** and **precisely** formulated
- naming **most important rules** and demands
- content depends on results of **company-specific risk analysis**
- often separate code of ethics for the **finance sector**
- **accessible** via homepage for all employees

Ethical Codex: different levels of information and different characteristics *Kapstein 2014*



Ethical Codex needs to be

Authentic	Code needs to be tailored to the company
Controllable	Neither under- nor over- ambitious No ambiguous statements
Morally justifiable	Viewpoints of the company are subject to strict moral testing (Regular reevaluation according to social changes)

Whistleblowing Systems

- allow employees and suppliers to report misconduct outside of established reporting line
- use comprehensive communication to avoid cultural denunciation
- Knowledge about misconduct and uncertainty on how to behave
→ stress on employee → negative impact on work performance
- **Preconditions of an effective whistleblowing system**
 - **Anonymity** → no personal disadvantage for whistleblowers
 - **Accessibility**
 - **Communication** → Feedback for the whistleblower
 - **No language barrier**
 - **Narrowing of the issues** → only violations of standards can be reported
 - **Documentation**

Correct Application of the Code of Ethics: Training

- **regular participation in trainings** concerning content of the ethical code
- Aim: **Increase awareness** of what is right and wrong and train ability to judge critical situations = **awareness training**
- Different **methods for compliance training**:
 - E-learning module
 - Case study
 - Management workshops for managers
 - Ad-hoc support for field staff per app
- Important: **offer advice** and have effective knowledge management system

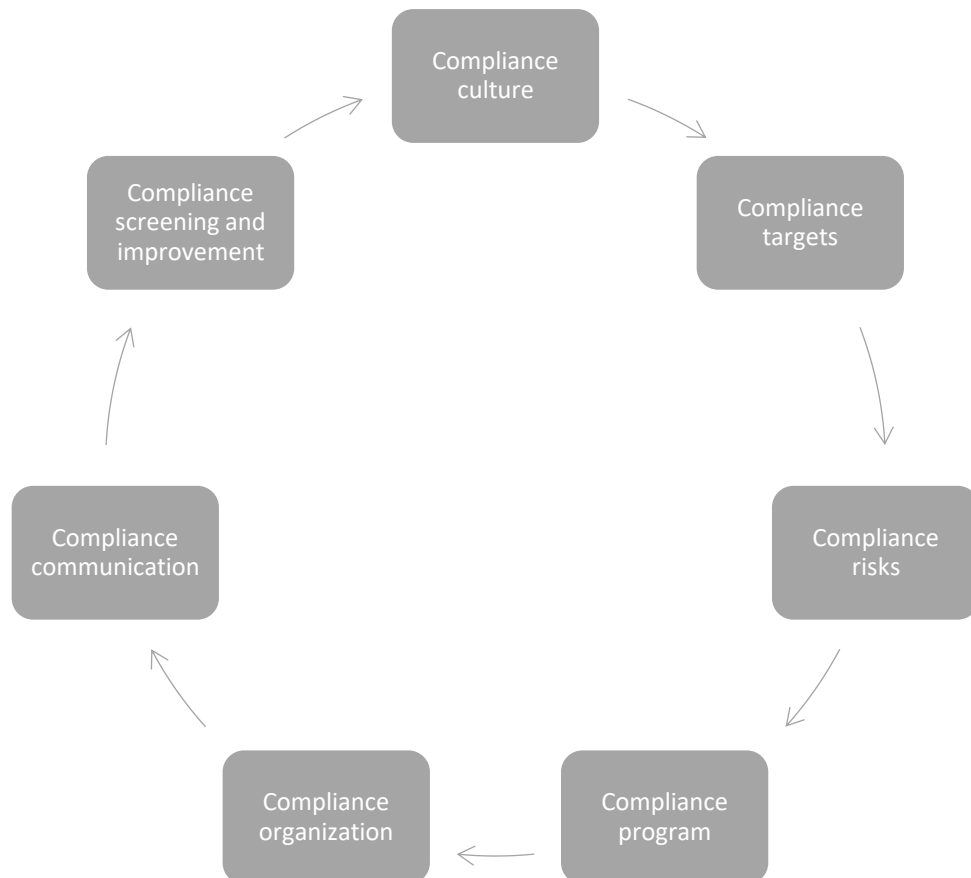
Due Diligence

- **Choice of business partners** is important preventive measure
- Indicators that make specific examination mandatory
 - Potential business partners from **countries** where **corruption is spread**
 - Explicit **request of performance-based remuneration** (=Vergütung) instead of a fixed compensation
 - Dealing with business partners **related to the public sector**
 - Insistence on **unusual payment terms**
- Before carrying out actual due diligence: Development of **risk-adjusted indicator sets for risk analysis of pre-selected third parties** to be investigated

Effectiveness Monitoring of Implemented Measures

Internal Audit	External Audit
Each business unit Compliance department or revision	Experts

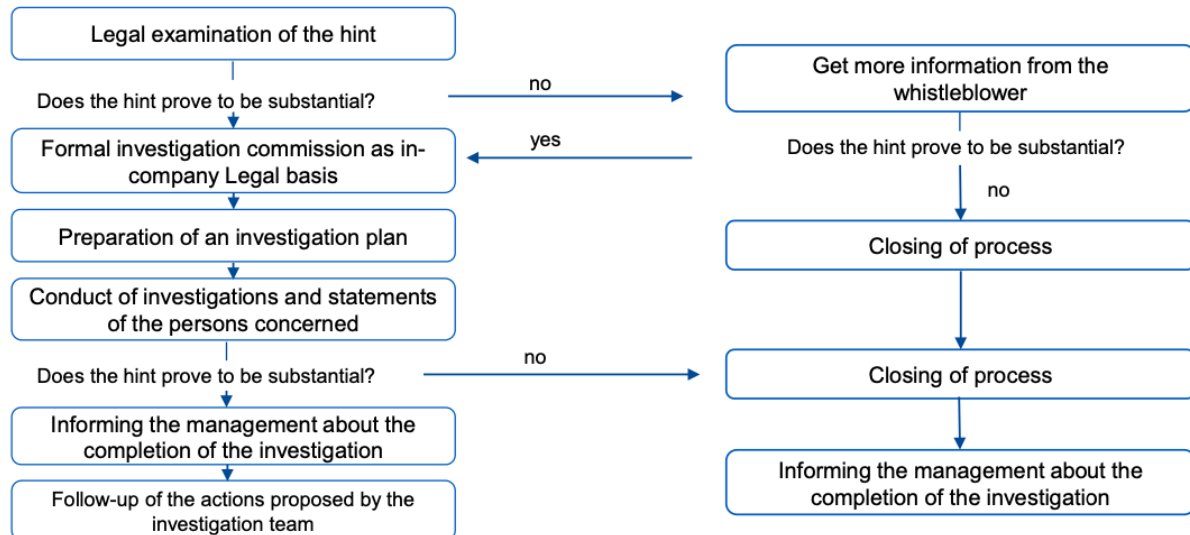
Guidelines in Germany: Principles for the Proper Performance of Reasonable Assurance Engagements relating to Compliance Management Systems



1. Compliance culture	Tone from the top, definition of company values
2. Compliance targets	Definition of the main targets of compliance
3. Compliance risks	Identification of company-specific compliance risks
4. Compliance program	Measures how to cope with risks
5. Compliance organization	Clarification of responsibilities, role-assignment
6. Compliance communication	Communication with employees
7. Compliance screening and improvement	Reporting, documentation, and responsibility

Detection of Misconduct

- Supervisory duty is to follow up on indications of misconduct through internal investigations
 1. Identification of misconduct
 2. Stopping the misconduct
 3. Sanctions
- Identification of weaknesses in compliance frameworks
- Hand over to investigating authority in case of legal difficulties
- Involve employees in internal investigations
 - in some cases: grant amnesty in exchange for cooperation (prisoner's dilemma)



Reaction to Misconduct

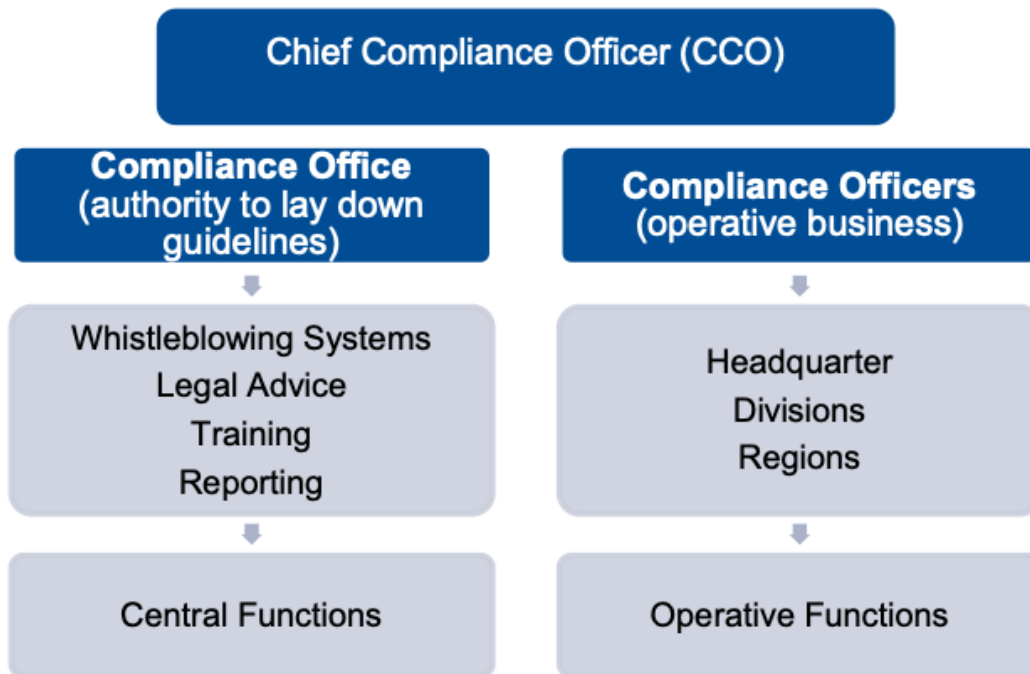
→ Misconduct must have **consequences**, otherwise it becomes a **mere lip service**

- Admonition
- Disciplinary warning letter
- Cutbacks of bonus payments
- Relocation
- Termination of contract
- Additional compliance trainings

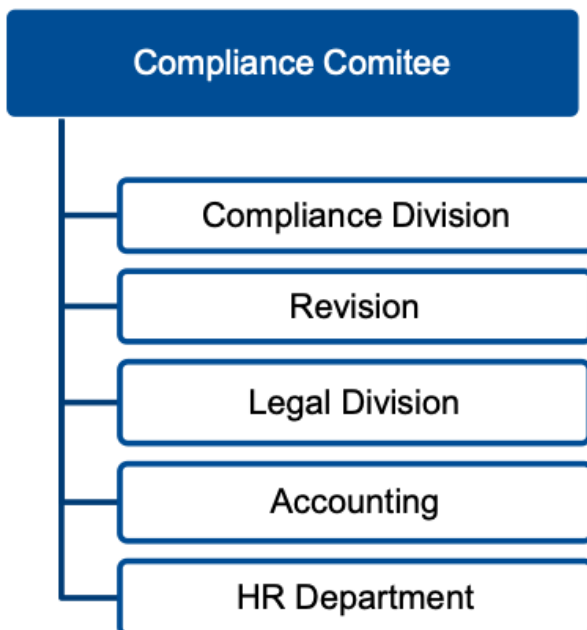
Integration of Compliance into Organization

Autonomous Organization of Compliance

- mostly used by corporations
- Compliance performs each of the basic functions
- Reporting to the COO



Organizational Matrix



- mostly used by medium-sized companies
- Compliance department limited to the function of prevention
- Detection and reveal of misconduct carried out by e.g., HR
- Requires fewer resources but more coordination efforts

Compliance in the Organization

- allows to immediately escalate investigations to the company's management
- Compliance organization reports to company management
- Compliance departments in German companies
 - 82% assess company's compliance risk
 - 67% have internal anti-corruption guidelines
 - 76% have one or more employees in charge of compliance
 - at least 50% have a CCO
 - only 54% of CEOs state compliance a top priority

Limits of Compliance

- Danger that compliance with legal and self-imposed rules will **not be perceived as sufficient by the public**
- **Risk avoidance:** seeing compliance as a learning process and continuously adapting to current developments
- **Effective risk management:** Imposing rules in context of corporate social responsibility before they are codified in written law

Example for limits in compliance: IHC in Burma

- Compliance to legal and self-imposed rules does not guarantee protection from an image loss or boycotts (even in the B2B sector)
- Burma: bad human rights situation in the Mid 90s
 - Clinton issued a ban on investments, many companies followed
- Dutch company IHC Caland made a 15-year contract with Burmese government in 1998
- Worldwide protests these investments
- Dutch banks refused to finance investment, Shareholders sold their shares
- Conclusions:
 - Public can exert considerable pressure on B2B
 - It is in the interest of a company to calculate reputational risks beyond legal framework
 - Compliance alone is not sufficient

4.2 Different Perspectives on Corporate Social Responsibility

Friedman: Profit Maximization as a Corporate Goal

- Milton Friedman: "*The Social Responsibility of Business is to increase its profits*"
- His essay from 1970 is regarded one of the most influential views in Business Ethics
- According to him the main goal for managers should be to maximize the profits for their shareholders and CSR would be use of resources for goals that are not required by shareholders

Background and classification of the theory

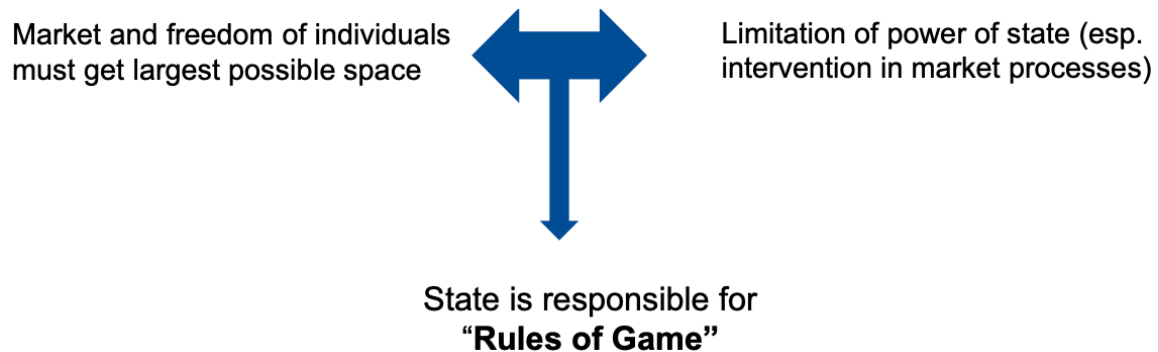
Neoclassical Paradigm Coase 1960	Systematic Perspective
Requirements: <ul style="list-style-type: none">– Clearly defined ownership rights and free exchange of property via efficient markets → optimization of results– Individuals are interest-driven<ul style="list-style-type: none">→ economic freedom→ free decision making	Requirements: <ul style="list-style-type: none">– Justification of property-based free market economy and associated promotion of welfare
Incentive: Profit maximization through efficient use of resources	<ul style="list-style-type: none">– Market participants with limited restrictions by state bodies<ul style="list-style-type: none">→ economic freedom to act as consumer or producer– Political voice of citizens– Exertion of political influence of citizens<ul style="list-style-type: none">→ protection of freedom in economic sphere against state encroachments
Welfare promotion for society through responsible actions of the enterprise, if it achieves maximum profit with resources at its disposal	

Tasks of Managers

- Managers are employed by shareholders for **specific purpose = profit maximization**
- Use for **moral purposes** is perceived as **improper use of resources**
 - Managers don't have the knowledge to use resources outside of business area
 - Allocation of resources has to align with non-democratic decisions of management
 - Costs of this behavior will be allocated to customers or employees (forced tax)
- Managers **undermine ownership rights** → **endangering of liberal economic system**
- **Responsibility for social problems** lies with **state** and not the companies

Society's regulatory framework

- **Friedman**: Irresponsible action would just be an act that violates the law of state
- **Smith's** invisible hand: Profit maximization only permitted within society's regulatory framework for the **benefit of all**
 - Each individual should work on such framework
 - Power of state should be curtailed to not interfere in market processes
- Core task of state: **Establish and maintain regulatory framework**



Goal of companies

- Friedman: Companies emerged from free association of individuals and their property
- Objective and tasks of companies: Determined by the owner or managers
- Friedman: A company cannot 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 → should be responsible for society
- But: How can individual know if particular expenditure of resources serves "social interest" if manager cannot know what "social interest" is?
- **Fiduciary duty** of manager to owner is to maximize profit
 - success can be easily measured by data, compared to social goals
- By complying with legal frameworks and basic moral standards company is already paying attention to other stakeholders
- Friedman's example of misunderstood forms of "social justice"
 - Forego price increase to meet social desire of avoiding inflation
 - Environmental protection beyond legal framework (achievement only by cost factor)
 - Recruitment of long-term unemployed rather than better qualified workers = social integration
- **Criticism:**
 - Managers utilize resources that are entrusted to them for other purposes
 - Risk of shifting decision-making power over social developments
 - undermine central pillar of free society (esp. property)
 - Small group of incompetent managers decides on social investment
 - Incentive problem (no means to audit manager's performance)
 - Investment in social projects diminishes profit = form of enforced taxation
 - taxation is brought about by small group of incompetent managers
 - Implication that profit motive of companies is wrong
 - Assumption that social responsibility compensates for morally dubious profit
 - "Iron fist" by state compulsion for not engaging managers = danger for liberal social order
- Task of state institutions is to account for social responsibility

Necessity of Corporate Ethics

- Friedman did not take **nature of profit maximization** into account
- Starting point for business ethics research

Right Form of profit maximization	Wrong Form of profit maximization
<ul style="list-style-type: none">– Appropriate conditions– Institutional integration in society– Wealth creation	<ul style="list-style-type: none">– Misuse of company's resources– Danger of diminishing perceived legitimacy of market economy and the fundamental order of freedom– If "rules of the game" provide certain latitude: irresponsible exploitation<ul style="list-style-type: none">→ e.g., outsource production to country where child labor is punished

Corporate Ethics as Profit Maximization

- Ability to maximize profits depends heavily on institutional framework, which depends on how companies put their profit motive into practice
- E.g., perception of public that undesirable forms of profit maximization prevail → amendment of legal framework → possibly disadvantageous for companies
- Question of how to implement maximization strategy is essential

Example: "Hit and Run" Strategy Suchanek 2004

- **Short-term profit strategy** with products that are inferior quality and not sustainable
- Usually, these companies will leave the market quickly → no investment in reputation
- Friedman perceives short-term profit as **marginal** by referring to **market forces**
 - Sorting out such behavior by market (not incentive-compatible) by customers, suppliers, and investors
 - National framework applies ("rules of game"), especially for external effects ("neighboring effects"): sanctioning of harmful behavior
- State is the last resort for what the market itself cannot solve

How much power does the state need?

- State must have regulatory power to prevent unwanted forms of profit maximization
- Friedman: Strong restriction of state activities, esp. against interference in the free market
"If you'd put federal government in charge of the Sahara Desert, in 5 years there's be a shortage of sand"
- Discrepancy: State should be assigned more power and influence regarding regulatory framework and its design → otherwise state framework is inadequate to prevent unwanted profit maximization

Friedman's Two Restrictions within which companies should maximize their profits

1. **Rules of game:** institutional framework, laws, and regulations
2. **Basic moral principles**
 - If neither principle is violated, maximizing profits is sole imperative of enterprise
 - With incomplete regulatory framework: In liberal society task cannot be completely passed onto state actors alone

Co-Responsibility of Companies

- Suchanek: *"Companies have responsibility for ensuring that they also receive 'conditions of decision-making autonomy' in future and if possible, for improving them by seeking to resolve current or potential conflicts of profit and morality or improving (institutional conditions for resolving these conflicts"*
- Companies share responsibility for whether framework is viable
- Companies are interested in minimizing state regulations
- Long-term perspective: Follow rules of regulatory framework
- Society will give companies room to maneuver if they don't feel exploited
→ expensive controls become superfluous (= überflüssig)
- Society trusts companies that don't abuse their liberties
→ society waives (= verzichtet) having detailed and comprehensive regulation
→ Advantage for companies: resulting freedom is often cheaper and preserves flexibility needed for competition

Concept of Honorable Businessman

- Approach was revived due to financial crisis
- Collection of desired behaviors and ethical principles in form of codes
- E.g., Manifesto "Mission Statement for Responsible Business Conduct" was signed by many top executives
- Concept not based on general principle → Normative Model
- Buzzwords: Honesty, moderation, accountability, decency, meticulousness, reliability, sustainability, integrity, role-model function
- Lack of a unified basis of concept → historical and conceptual approximation necessary
- Businessman = economic subject conducting any kind of commerce with degree of autonomy

CSR	Honorable Businessman
Responsibility of a business/ rather larger companies	Acting person → Managers in small and medium-sized firms

- Promotion of ethical behavior of legal person in form of an enterprise
= character of entrepreneur
- Individual ethical concept = Moral demands on individual
- Virtue-ethical approach = Strong connection to individual character traits and virtues

Honorable Businessman as Point of Orientation

- Many professional groups have guiding principles → doctors, lawyers
- 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 honor

- Interpretation of term only possible within social context
→ Which actions are considered honorable or venerable (= ehrwürdig)
- Term consist of German "Ehre" and Greek "Good Reputation"
→ emphasizes social character of the term
- An action is honorable if it is assessed positively by society, meets or exceeds norms

Dual concept of honor

Internal Honor	External Honor
= feelings of individual itself regarding its conscience → recognition of other people necessary	= evaluations of social group (mostly outsiders)

Concept of Honorable Businessman today

- Harvard Business School issued voluntary MBA Oath for graduates on ethical behavior
 - 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 a whole, acting ethically and sustainably
 - Reinforcing integrity and confidence in oneself through one's own behavior

Criticism on Individual Ethics

External concept of honor: intercultural differences and historical fluctuations in meaning

- 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 cannot act as guideline
- Free market economy has made honorable businessman superfluous since companies are investing in being perceived as honorable and respectful
- Inner motivation to act honorable is important: intrinsic motivation > extrinsic forces
- Trust-based relationships are very important in business ethics
- Concept of honorable businessman has fallen out of time because it comes from Middle Ages where there were 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
- Plea to individuals to behave ethically are unenforceable unless competitors behave "honorably" as well
- Confidence-inducing performance of businesses essential, mainly for creating reputation
→ Concept of honor seems unnecessary and 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 are necessary for a modern, dynamic society

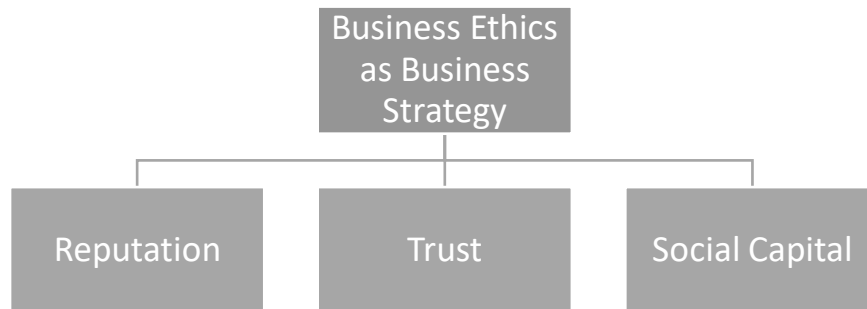
Ford Pinto Case

- Higher accident rate, injuries, and even deaths due to cheaper construction
- Cost accounting of management: Retrofitting cars to avoid the explosions would have been more expensive than the insurance damages caused by the explosions
- Ethical evaluation:
 - No violation of laws or regulations
 - Statistically not less safe than other registered cars
 - Conscious decision against retrofitting cars due to costs
 - Assessment of human life (as also undertaken in economic evaluation of safety measures in road or insurance sector)
- One of the worst scandals in automotive history
- Public rejection of cost-benefit calculation of Ford

Immoral Behavior as Business Risk?

- Critical public demands responsible business conduct → companies had to deal with the factor **reputation** → beginning of business ethics
- **Friedman:** *The social responsibility of business is to increase its profits*
 - Task of social redistribution only by state
 - Unauthorized redistribution through a company as misappropriation of capital
- **Criticism of Friedman's presentation:**
 - Assumption that state is unable to perform tasks such as corrections to externalities or redistributive mechanisms due to
 - State is dominated by interest groups
 - Social problems are outside legislative sphere of influence
 - High transaction costs and inadequate information:
Only with great inefficiency
 - Implies that if state had full capacity to act, nothing could be objected to Friedman's argumentation
 - Every company has the inherent duty to assume social responsibility
- **Stakeholder theories**
 - Corporate responsibility: If in doubt, also against economic interests of company
 - Question: How can demands be realized under permanently competitive conditions?

Business Ethics as Business Strategy



Reputation

Reputation represents capital: Creating trust and reliability

- 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 can lead to preventive counterfeiting
- Actors can counteract this with help of confidence-building measures and build a reputation
- Establish business relations and thereby save transaction costs
- Accumulating reputation by engaging in moral principles like integrity and fairness
- Under conditions of globalization reputation is important prerequisite for successful entrepreneurship
- **Premodern**: trade limited to few actors
 - face-to-face control
 - Immoral behavior was punished with ostracism (= Ächtung)
- **Globalized world**: this type of control not possible due to worldwide trade
 - Mistrust and risk of preventive deception (= Betrug) is growing

Trust

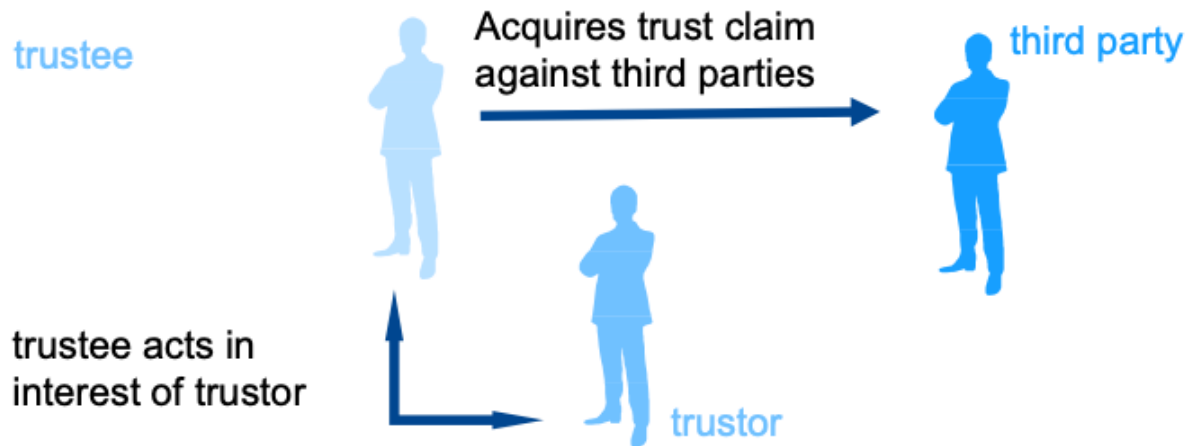
= willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party (Mayer)

- Trust **saves economic transaction costs**
- Core of trust: **Reciprocal Altruism** → performance and consideration are temporarily decoupled and contractually not explicitly secured
- **Trust capital**: Positive impact for individual actors and economy as whole
- Correlation of citizens' trust in country with prosperity indicator
 - Greater confidence in economic area leads to greater prosperity (World value survey)

Social Capital

= Developing a relationship of trust between to actors in multilateral relationship

Trustee acquires claim of trust against third parties within contracting community



→ Social capital with factual, temporal, and personal decoupling of performance and consideration

Example of social capital: Alumni Associations

- Graduates can expect **support** from each other, even if **unknown**
- Social capital **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 a risk factor** for businesses
 - e.g., legal consequences of bribery

Example: Enron - Rise and fall of an energy company

- Early on beginning of bookkeeping tricks like "Market to Market Accounting"
 - = Counting the current value of future long-term revenue as revenue
- Stock price falls, Enron has to file for bankruptcy, Accounting firm collapses, convictions