Advanced Corporate Governance

Business Ethics

Univ.-Prof. Dr. Marc Eulerich ▪ Lehrstuhl Interne Revision ▪ WS 2019/20
Literatur


Agenda

1. Business Ethics
2. Board Diversity
3. Board Dynamics
4. Board Compensation
5. Codetermination
6. International Corporate Governance Systems
Required Readings

Required Reading Business Ethics:

Required Reading Board Diversity:

Required Reading Board Dynamics:

Required Reading Board Compensation:

Required Reading Codetermination:

Required Reading International Corporate Governance Systems:
1 Business Ethics
**Introduction**

**Ethics** refers to accepted principles of right or wrong that govern the conduct of a person, the members of a profession, or the actions of an organization.

**Business ethics** are the accepted principles of right or wrong governing the conduct of business people.

**Ethical strategy** is a strategy, or course of action, that does not violate these accepted principles.
The most common ethical issues in business involve:

- employment practices
- human rights
- environmental regulations
- corruption
- the moral obligation of multinational companies.
Employment Practices

If work conditions in a host nation are clearly inferior to those in a multinational’s home nation, should companies apply:

- home country standards
- host country standards
- something in between.
Firms should:

- establish minimal acceptable standards that safeguard the basic rights and dignity of employees
- audit foreign subsidiaries and subcontractors regularly to ensure they are meeting the standards
- take corrective action if necessary.
Human Rights

In developed countries, basic human rights such as freedom of association, freedom of speech, freedom of assembly, and freedom of movement, are taken for granted.

In other countries, these rights may not exist.
Environmental Pollution

Ethical issues arise when environmental regulations in host nations are far inferior to those in the home nation.

Environmental questions take on added importance because some parts of the environment are a public good that no one owns, but anyone can despoil.

The tragedy of the commons occurs when a resource held in common by all, but owned by no one, is overused by individuals, resulting in its degradation.
Corruption

The U.S. **Foreign Corrupt Practices Act** outlawed the practice of paying bribes to foreign government officials in order to gain business.

The **Convention on Combating Bribery of Foreign Public Officials in International Business Transactions** adopted by the Organization for Economic Cooperation and Development (OECD), obliges member states to make the bribery of foreign public officials a criminal offense.
Corruption

Some economists believe that in a country where preexisting political structures distort or limit the workings of the market mechanism, corruption in the form of black-marketeering, smuggling, and side payments to government bureaucrats to “speed up” approval for business investments may actually enhance welfare.

Other economists have argued that corruption reduces the returns on business investment and leads to low economic growth.
Moral Obligations

Social responsibility refers to the idea that business people should take the social consequences of economic actions into account when making business decisions, and that there should be a presumption in favor of decisions that have both good economic and good social consequences.

Social responsibility can be supported for its own sake simply because it is the right way for a business to behave.

Advocates argue that businesses need to recognize their noblesse oblige (honorable and benevolent behavior that is the responsibility of successful companies) and give something back to the societies that have made their success possible.
Corporate Social Responsibility (CSR)

The case for CSR:

- is in the company’s long-term interest
- enhances company’s reputation
- retention of good quality staff
- better risk management
- facilitate brand differentiation
- avoid government and regulatory intervention by demonstrating the capacity of the company to observe the norms of good practice
- divert attention from negative aspects of the company’s business as a matter of public relations.

The case against CSR:

- Confused objectives make it more difficult to monitor management performance
- Social issues are not the concern of business people but of the government, companies are not equipped to handle social activities
- Companies already have too much power
- Costs and disadvantages in terms of international competitiveness.
Ethical dilemmas are situations in which none of the available alternatives seems ethically acceptable.

The ethical obligations of a multinational corporation toward employment conditions, human rights, corruption, environmental pollution, and the use of power are not always clear cut.
Ethical Dilemmas – The Trolley Problem

- A driverless trolley is heading down the railway tracks.
- You are the man in blue and have two options:
  - Do nothing, and the trolley kills the five people on the main track.
  - Pull the lever, actively diverting the trolley onto the side track where it will kill one person.
- Which is the most ethical choice?
The Roots Of Unethical Behavior

There is no clear cut reason why managers behave unethically.

The causes of unethical behavior are complex and reflect:

• Personal ethics
• Decision-making processes
• Leadership
• Unrealistic performance expectations
• Organizational culture
• Societal culture
The Roots Of Unethical Behavior

Determinants of Ethical Behavior

- Personal Ethics
- Organization Culture
- Societal Culture
- Leadership
- Decision-Making Process
- Unrealistic Performance Goals

Ethical Behaviors
Personal Ethics

Personal ethics (the generally accepted principles of right and wrong governing the conduct of individuals) influence business ethics.

Expatriates may face pressure to violate their personal ethics because they are away from their ordinary social context and supporting culture, and they are psychologically and geographically distant from the parent company.
Decision Making Processes

People may behave unethically because they rely on economic analysis when making decisions and fail to ask the relevant question:

Is this decision or action ethical?
Organizational Culture

Organization culture refers to the values and norms that are shared among employees of an organization.

In firms with an organization culture that does not emphasize business culture, unethical behavior may exist.
Unrealistic Performance Expectations

When the parent company sets unrealistic performance goals, managers may cut corners or act in an unethical manner.

Organizational culture can legitimize unethical behavior or reinforce the need for ethical behavior.
Leaders help to establish the culture of an organization, and set the example that others follow.

When leaders act unethically, subordinates may act unethically, too.
Societal Culture

E.g., firms headquartered in cultures where individualism and uncertainty avoidance are strong are more likely to stress ethical behavior than firms headquartered in cultures where masculinity and power distance rank high.
Philosophical Approaches To Ethics

There are several different approaches to business ethics.

Some approaches deny the value of business ethics or apply the concept in an unsatisfactory way.

Others are favored by moral philosophers and are the basis for current models of ethical behavior.
Straw men approaches offer inappropriate guidelines for ethical decision making in a multinational enterprise.

There are four common straw men approaches:

- The *Friedman doctrine* suggests that the only social responsibility of business is to increase profits, so long as the company stays within the rules of law.
- *Cultural relativism* argues that ethics are culturally determined and that firms should adopt the ethics of the cultures in which they operate, or in other words, “when in Rome, do as the Romans do”.
- The *righteous moralist* approach claims that a multinational’s home country standards of ethics should be followed in foreign countries.
- The *naïve immoralist* asserts that if a manager of a multinational sees that firms from other nations are not following ethical norms in a host nation, that manager should not either.
Utilitarian approaches to ethics hold that the moral worth of actions or practices is determined by their consequences.

Actions are desirable if they lead to the best possible balance of good consequences over bad consequences.

Problems with utilitarianism include measuring the benefits, costs, and risks of an action, and the fact that the approach fails to consider justice.

Kantian ethics are based on the philosophy of Immanuel Kant who argued that people should be treated as ends and never purely as means to the ends of others; people have dignity and need to be respected.
Rights theories recognize that human beings have fundamental rights and privileges which transcend national boundaries and cultures.

Rights theories establish a minimum level of morally acceptable behavior. Morality theorists argue that fundamental human rights form the basis for the moral compass that managers should navigate by when making decisions which have an ethical component.
The *Universal Declaration of Human Rights* specifies the basic principles that should always be adhered to irrespective of the culture in which one is doing business. The declaration was prompted by the idea that some fundamental rights transcend national borders and cultures.
Justice theories focus on the attainment of a just distribution of economic goods and services

A **just distribution** is one that is considered fair and equitable

One theory of justice that is particularly important was proposed by John Rawls who argued that all economic goods and services should be distributed equally except when an unequal distribution would work to everyone’s advantage.
Justice Theories

According to Rawls, impartiality is guaranteed by the veil of ignorance (everyone is imagined to be ignorant of all his or her particular characteristics).

When these conditions exist:

- each person is permitted the maximum amount of basic liberty compatible with a similar liberty for others
- once equal basic liberty is assured, inequality in basic goods and/or social goods are to be allowed only if they benefit everyone.
Ethical Decision Making

To ensure ethical issues are considered in business decisions, firms should:

• favor hiring and promoting people with a well grounded sense of personal ethics
• build an organizational culture that places a high value on ethical behavior
• makes sure that leaders within the business not only articulate the rhetoric of ethical behavior, but also act in manner that is consistent with that rhetoric
• put decision making processes in place that require people to consider the ethical dimension of business decisions
• develop moral courage.
Hiring And Promotion

Businesses should strive to identify and hire people with a strong sense of personal ethics.

Companies should refrain from promoting individuals who have acted unethically.

Prospective employees should find out as much as they can about the ethical climate in an organization prior to taking a position.
To foster ethical behavior, businesses need to build an organization culture where:

- the business explicitly articulates values that place a strong emphasis on ethical behavior, perhaps using a **code of ethics** (a formal statement of the ethical priorities a business adheres to),
- leaders in the business give life and meaning to the code of ethics by repeatedly emphasizing their importance, and then acting on them,
- the business puts in place a system of incentives and rewards that recognize people who engage in ethical behavior and sanction those who do not.
A code of ethics typically includes:

- A general statement of the values of the organization and its guiding principles
- Definitions of what constitutes both ethical and corrupt conduct in the organization
- Competence requirements and professional standards
- Directives on personal and professional behavior
- Affirmations of fairness, equity, equal opportunity, and affirmative action
- Rules on gifts and conflicts of interest
- Restrictions on use of the company’s facilities for private purposes
- Guidelines on confidentiality, public comment, whistleblowing, and use of company information
- Identification of different stakeholders and other interested parties, and their rights
- Commitment to occupational health and safety
- Commitment to the environment and social responsibility
- Mechanisms for enforcing the code, including sanctions for violations
- Advice on interpreting and implementing the code.
To determine if a decision is ethical, managers can ask:

- Does my decision fall within the accepted values of standards that typically apply in the organizational environment?
- Am I willing to see the decision communicated to all stakeholders affected by it?
- Would the people with whom I have significant personal relationships approve of the decision?
Managers can also use a five step process to think through ethical problems:

**Step 1:**
Managers identify which stakeholders (the individuals or groups who have an interest, stake, or claim in the actions and overall performance of a company) a decision would affect and in what ways:

- **Internal stakeholders** are people who work for or who own the business such as employees, the board of directors, and stockholders.
- **External stakeholders** are the individuals or groups who have some claim on a firm such as customers, suppliers, and unions.

**Step 2:**
Managers determine whether a proposed decision would violate the fundamental rights of any stakeholders.
Decision-Making Process

Step 3:
Managers establish *moral intent* (the business must place moral concerns ahead of other concerns in cases where either the fundamental rights of stakeholders or key moral principles have been violated).

Step 4:
The company engages in ethical behavior.

Step 5:
The business audits its decisions, reviewing them to make sure that they were consistent with ethical principles.
To ensure ethical behavior in a business, a number of firms now have ethics officers.

**Ethics officers ensure:**
- all employees are trained in ethics
- ethics is considered in the decision-making process
- the company’s code of conduct is followed.
Moral Courage

Moral courage:

• enables managers to walk away from a decision that is profitable, but unethical
• gives an employee the strength to say no to a superior who instructs her to pursue actions that are unethical
• gives employees the integrity to go public to the media and blow the whistle on persistent unethical behavior in a company
• does not come easily and employees have lost their jobs when acting on this courage.
## Intra-company measures to support business ethics

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<td><strong>Goal</strong></td>
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<td>Expectations for corporate members have to be clear, allowed/encouraged &amp; forbidden/unwanted actions have to be clear.</td>
<td>Corporate members have to be willing to act in the desired manner.</td>
<td>Taking their skills, abilities, and knowledge into account, corporate members have to be able to act in the desired manner.</td>
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### Means
- Corporate mission statement
- Corporate culture
- Personnel selection
- Personnel assessment and appreciation
- Control systems
- Personnel development
- Organizational structure
- Information systems

Source: Göbel (2013, p. 198)
Societal measures to support business ethics

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<td>Expectations for companies have to be clear, allowed/encouraged &amp; forbidden/unwanted actions have to be clear.</td>
<td>Companies have to be motivated to act in the desired manner.</td>
<td>It needs to be made easy for companies to act in the desired manner.</td>
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**Means**

- Laws and regulations
- Codes and conventions
- Monitoring
- Incentives
- Business ethics taught in schools/universities
- Consumer information and education

Source: Göbel (2013, p. 260)
Companies that operate internationally can face additional challenges.

**Commonly perceived problems in international business dealings:**

- Differing systems (built on trust, e.g. China, Japan or competition, e.g. USA, UK, Australia)
- Cultural differences
- Large-scale bribery
- Involvement in political affairs
- Pricing practices
- Illegal or immoral activities in a host country
- Questionable commissions
- Gifts or favors
- Tax evasion
- Inappropriate use of products
- Traditional small-scale bribery.
In the end, there are clearly things that a business should do, and there are things that a business should not do.

But, not all ethical dilemmas have a clean and obvious solution.
Offen im Denken
Disclosure of Steve Jobs’s Health as Apple CEO: A Public or Private Matter?

An important issue within the scope of corporate governance is whether a company should disclose the health problems of its CEO and how much information should be disclosed. The sensitivity of this issue is exemplified at Apple Inc., where CEO Steve Jobs faced numerous questions regarding his health and the impact that this sudden departure would have on the company.

In October 2003, Jobs was diagnosed with pancreatic cancer. No public announcement was made, although the board of directors was notified of his condition. The specific form of cancer was rare but considered treatable, with the majority of patients who undergo surgery experiencing a survival rate of more than 10 years. On July 31, 2004 Jobs entered Stanford Hospital for treatment.

The following day, Jobs send an email to Apple employees stating, “This weekend I underwent a successful surgery to remove a cancerous tumor from my pancreas…. I will be recuperating during the month of August, and expect to return to work in September. While I’m out, I’m asked Tim Cook [executive vice president of sales and operations] to be responsible for Apple’s day-to-day operations, so we shouldn’t miss a beat.” A copy of the message was distributed to the Associated Press. It was the first public disclosure of his condition. Given Jobs’s strategic and visionary role at Apple, it is perhaps not surprising that when trading resumed the next day, Apple stock fell 2.4 percent almost immediately.

Source: Larcker & Tayan (2011)
Disclosure of Steve Jobs’s Health as Apple CEO: A Public or Private Matter?

The issue of Jobs’s health resurfaced in June 2008, when he appeared noticeably thin at a public appearance. A company spokeswoman responded to inquiries by stating that Jobs had “a common bug…He’s been on antibiotics and getting better day by day and didn’t want to miss [the event]. That all there is to it.” When analysts asked for more information during an earnings conference call, Apple CFO Peter Oppenheimer declined to elaborate: “Steve loves Apple. He serves as the CEO at the pleasure of Apple’s board and has no plans to leave Apple. Steve’s health is a private matter.”

In January 2009, Apple released another letter from jobs in which he explained that his recent weight loss was due to a “hormone imbalance”. According to the letter, “The remedy for this nutritional problem is relatively simple and straight-forward, and I’ve already begun treatment…I will continue as Apple’s CEO during my recovery.” Concurrently, the board of directors issued a statement that “[Jobs] deserves our complete and unwavering support during his recuperation. He most certainly has that from Apple and its Board.”

However, the company announced 10 days later that Jobs would take another leave of absence. According to jobs, “during the past week I have learned my health-related issues are more complex that I originally thought. In order to take myself out of the limelight and focus on my health….I have decided to take a medical leave of absence until the end of June.” No elaboration was offered. Cook, then chief operating officer (COO), would resume leadership of the company. In the two-week period surrounding these announcements, Apple stock fell 17 percent.

Source: Larcker & Tayan (2011)
Disclosure of Steve Jobs’s Health as Apple CEO: A Public or Private Matter?

Jobs returned to work as scheduled six months later. Two weeks prior to his return, however, news leaked that Jobs had received a liver transplant at a Tennessee hospital the previous April. A company spokeswoman declined to comment other than to say, “Steve continues to look forward to returning at the end of June, and there’s nothing further to say.” Doctors unaffiliated with the case explained that tumors associated with the pancreatic cancer that Jobs was originally diagnosed with often metastasize in another organ, commonly the liver. The hospital where Jobs received the transplant stated that his prognosis was “excellent.”

In January 2011, Jobs took a third leave of absence. In an email to employees, he explained that he would “continue as CEO and be involved in major strategic decisions” but that Cook would be responsible for “day-to-day operations.”

Jobs said he would be back with the company as soon as he could. “In the meantime, my family and I would deeply appreciate respect for our privacy.” When asked for additional comment, an Apple spokeswoman replied, “We’ve said all we’re going to say.” Jobs died on October 5 of that year, due to complications from pancreatic cancer that led to respiratory arrest.

Source: Larcker & Tayan (2011)