Ethical Frameworks that Work

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First things first…

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I do not represent anyone else's views

Although I have been teaching Business Ethics at OBU for the past twelve years, my views are not necessarily representative of anyone else's.

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- Ethics/Codes of Conduct (slides 15 – 28)
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So, just what is a “framework?”

It seems to me that it’s much easier to beg that question and rely instead on *examples* of alternative frameworks.

Common types of frameworks

- Building framework
- Conceptual framework
- Cultural framework
- Legal framework

Building framework

- Physical
- Concrete
- Materialist

Building framework

- Matters of Engineering
  - Lots of ways to classify
  - Traditional construction
    - Steel
    - Wood - Primarily platform framing
  - Nontraditional construction
    - Adobe, hay, straw

Conceptual framework

Sir Isaiah Berlin: there are ***two types of conceptual frameworks***

- **Foxes** – *literati*, like Shakespeare
- **Hedgehogs** – build silos to classify and organize ideas

“Hedgehogs”

- Philosophers
  - Theoretical models
  - Organizing principles

Philosophy

- Metaphysical
- Abstract
- Idealist

Berlin was himself a “hedgehog.”

A leading intellectual historian, Berlin liked to ‘get into the weeds.”

Organizing Principles of …

- Bureaucracy
  - administrative convenience ("efficiency")
- Economics
  - market mechanisms, constrained optimization
- Marxism
  - class struggle

Bureaucracy

- Standardizable
- Great for repetitive, low-cognitive tasks
- Ease of administration
- Takes on a life of its own, with little regard for market dynamics

Economics

- Is now required for CPA in many places
- Mathematically rigorous
- May be too esoteric
- Supports those **!@Q>*** economists!

Marxism

- Not very stable, unless economic activity is moribund.
- Often results in mass executions.

Cultural framework –
Traditions, Values, and Myths

Accounting - GAAP

Subject to interpretation
Different for each person

*True **intersectionality** may be a lofty goal, but it is very hard to achieve.*

Legal framework –
Governmental Standards

Constitutions

Contracts

Pure democracy - mob rule

Watch out for the fox!

Constitutions

- Are designed to be difficult to amend
- Represent the perspectives of people without a stake in the fight (dead folks)

Contracts

- Are usually designed to be shorter-term than constitutions
- Are *supposed* to be voluntary for all parties

Pure Democracy

- According to Schumpeter, always devolves into Socialism and dictatorship

Any framework

Always has to start with foundation.

Advantages/Disadvantages of Alternative Frameworks?

Conflicts between

rules vs. norms

No two people are just alike.

Ethics – the slippery subject

Aspects of Conceptual Framework
Aspects of Cultural Framework
Aspects of Legal Framework

Must have foundation
Must minimize contradictions (sustainability)

It is <u>hard</u> to think of every contingency.

Ethics/Codes of Conduct

”To the greatest extent possible … selected moral standards should retain their significance despite differences in culture, religion, time, and circumstance.”

Ethics/Codes of Conduct

”The standards should be accepted by a large and diversified number of individuals and social groups as being of fundamental importance in guiding or evaluating behavior, actions, or policies.”

Ethics/Codes of Conduct

Well, that's a big help! (not)

Schwartz, Mark S. (2002) "A Code of Ethics for Corporate Code of Ethics," *Journal of Business Ethics* 41: 27-43.

Ethics/Codes of Conduct

"How much significance should the 'selected moral standards' have?"

Schwartz begs the most important issue:

"***Which*** groups of individuals and social groups?"

Ethics/Codes of Conduct

Almost as important is another unanswered question:

"Just what constitutes acceptance or *consent*?"

Ethics/Codes of Conduct

Is forced consent '***consent***'?

Is mere acquiescence '***consent***'?

Ethics/Codes of Conduct

If members of some groups start chanting the Code of Ethics as their life philosophy and others go along merely to get along, has there been **consent**?

Yet another wrinkle…

Once a person has given her/his consent, *does it last for all time*?

What if his/her preferences change?

Should a person be locked into one viewpoint for all time thereafter?

This becomes important when discussing things like **intergenerational equity**.

The Arrow Impossibility Theorem

Unfortunately, we cannot consistently apply utility maximization methods to Social Welfare Maximization.

Kenneth Arrow demonstrated this with his 1951 "Impossibility Theorem."

Kenneth Arrow
(1921 - 2017)
Nobel Laureate, 1972

The Arrow Impossibility Theorem

This result has been interpreted as

"No voting method is fair", or

"The only voting method that isn't flawed is a dictatorship".

These statements are not quite accurate.

The Arrow Impossibility Theorem

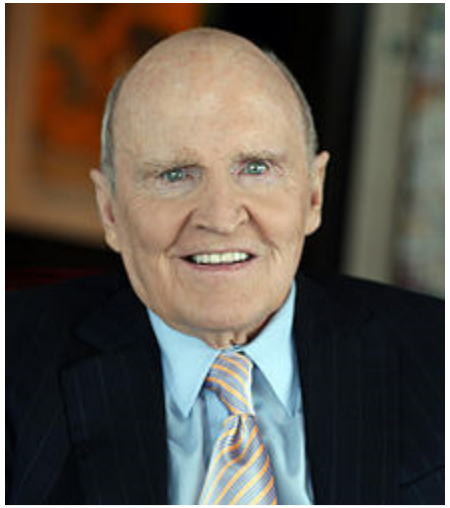
Instead, a better version would be:

"No voting procedure (or Social Welfare Function) that yields a unique and complete ranking of choices and is consistent with individual utility maximization is attainable without a (benevolent) dictator."

The Arrow Impossibility Theorem

Sometimes, that dictator gets rid of half of the people in the room.

Jack Welch at GE?



In memory of
Jack Welch
(1935 –
2020)

Ethics/Codes of Conduct

Sooner or later, when the going gets tough, there will be dissatisfaction, claims of disenfranchisement, and things will be back where they started (or worse).

Ethics/Codes of Conduct

Impossibility Theorems, like Arrow's famous result in 1951, demonstrate that there is no single magic bullet policy or set of laws in which everybody is happy (unless they all think, feel, and act exactly alike).

Ethics/Codes of Conduct

Perhaps a better goal is stability or **sustainability** of enterprise.

As tough-to-run as mission-oriented organizations can be, at least they have widely publicized sets of shared values that stakeholders can **see** before they apply.

Hooker's Criteria

- According to Professor John Hooker of Carnegie-Mellon U., a rational choice will pass three tests:
  - The Generalization test
  - The Utilitarian test
  - The Virtue test

John Hooker
T. Jerome Holleran Professor of Business Ethics and Social Responsibility; Professor of Operations Research Carnegie-Mellon University

The Generalization Test

"The reasons for any action should be consistent with the assumption that *everyone who has the same reasons acts the same way."*

The Generalization Test

An action is unethical if its general adoption would undermine a practice it presupposes.

The Utilitarian Test

"A rational choice must maximize utility, subject to the other conditions of rationality."

The Virtue Test

"Integrity requires self-consistency."

But everyone is different.

"A rational choice must be consistent with who you are and why you are here."

*Here, we **punt**.*

So, it helps to be *mission-based*.

Otherwise, you're still left with Hooker's last gem:

"A rational choice must be consistent with who you are and why you are here."

Ethics/Codes of Conduct

Secular societies/companies are at a distinct <u>disadvantage</u>

- *Brainstorming* to provide ethical baselines?
- Risky, particularly in *Wokeplaces*
- Must come with immunities (a big "King's X) to avoid truncations of preferences

Ethics/Codes of Conduct

Whether or not they have given their approval in advance, have all stakeholders been reasonably informed of the expected behaviors?

What is the Corporate Culture of your Company/Organization?

Compliance Orientation?

Values Orientation??

Something else????

Compliance Orientation …

tries to adhere to the letter of the laws, rules, and conventions that society imposes on itself.

Compliance Orientation …

"What could possibly go wrong with that???"

Compliance Orientation …

Besides running the risk of having no viable intersections, this approach limits upside potential from other risks that shouldn't be categorically ruled out.

Values Orientation …

tries to inculcate values that fulfill the ***spirit*** of the law.

Codes with Values Orientation

Secular societies are at a distinct <u>disadvantage</u>

- Brainstorming to provide ethical baselines?
- Risky, particularly in *Wokeplaces*
- Must be with some immunity (a big "King's X) to avoid masking or truncation of preferences

Codes with Values Orientation

Nobody can think of all possible contingencies.

That's why ***examples*** are essential for Codes of Conduct.

Values Orientation

The trouble is that EVERYBODY *claims* to have a "Values Orientation."

OUR VALUES

RESPECT: We treat others as we would like to be treated ourselves. We do not tolerate abusive or disrespectful treatment. Ruthlessness, callousness, and arrogance don’t belong here.

OUR VALUES

INTEGRITY: We work with customers and prospects openly, honestly, and sincerely. When we say we will do something, we will do it; when we say we cannot or will not do something, then we won't do it.

OUR VALUES

COMMUNICATION: We have an obligation to communicate. Here, we take the time to talk with one another … and to listen. We believe that information is meant to move and that information moves people.

OUR VALUES

EXCELLENCE: We are satisfied with nothing less than the very best in everything we do. We will continue to raise the bar for everyone. The great fun here will be for all of us to discover just how good we can really be.

Name that company…

Can anyone name the company for whom the previous four statements comprise their ‘values?’

These statements are all from *Enron*'s 1998 Annual Report

Born 1985
Died 2001

Source for Enron's 1998 Annual Report: McLean, Bethany and Peter Elkind (2004) *The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron*. New York: Penguin Books.

Yes, even Enron claimed a "values orientation.

Unfortunately, they were Ken Lay's values.

Since Ken Lay was a snake,

No one except those in his inner circle knew for certain that Enron's "Values" were just window-dressing.

Accounting – 1990s or NOW?

Does a *clean* set of books mean ‘no fraud’?

Accounting – 1990s or NOW?

"Does a clean set of books mean 'no fraud'?"

- Of course not!
- GAAP

It is impossible to consider all contingencies, but it's a start.

- AICPA and other groups take years to iron out interpretations

Very **co$tly** and **expen$ive**

SOX, FSGO, and Dodd-Frank

Probably all are job-killers

Start-ups and IPOs took a nosedive after SOX (December, 2008)

Fast-forward to, um, 2008

Wirecard hires Ernst & Young, *at the behest of shareholders*, to investigate treaments of customer deposits. EY becomes Wirecard's auditor.

June 2020 Wirecard Dead

A special audit by KPMG turns up **fraud**.

EY is completely blindsided.

Maybe SOX didn't go far enough?

A successful values orientation -

Has to go beyond the legal staff and organization architects. They can only think of so much…

A successful values orientation -

*Little wonder that one of the best ways to **kill** your Code of Ethics is to use legal boiler-plate and/or technical jargon.*

A successful values orientation -

Requires participation of everyone in the firm, like TQM.

What does this further require?

A successful values orientation -

It requires incurring some ***unconventional*** *risks.*

A successful values orientation -

But the risks of business-as-usual are probably far greater…

A successful values orientation -

is **always** going to be risky. *You cannot avoid all risk, or even most risk...*

nor should you necessarily try to do so.

A successful values orientation -

The best you can hope for is **managing risk**, by insisting that you are paid enough to cover the risks you are taking, seen or not.

Soft Law evolves outside of statutes -

- and has resulted in *ex post* re-interpretation and enforcement of laws.

Soft Law evolves outside of statutes

The 2009 re-interpretation of the 1977 U.S. Foreign Corrupt Practices Act led to the *destruction* of General Cable.

The FCPA of 1977 excluded "grease payments"

In 2009-2010, companies who had been given a clean bill of health by previous DOJs were charged with violations of FCPA (*ex post* prosecution).

The FCPA of 1977 excluded "grease payments"

Most of the new prosecutions (including General Cable) were because the new DOJ unilaterally decided that "grease payments" were bribery.

General Cable self-reported its behavior.

By self-disclosing the behavior of agents in other countries, GC sealed its fate.

So much for **sunlight** and soft law.

Soft Law evolves outside of statutes

In 2009 federal prosecutions of fraud multiplied under conditions of users' having violated social media terms of **private** service agreements.

Soft Law evolves outside of statutes

Such ‘back-door’ prosecutions cause distortions in behavior of firms and in openness to stakeholders.

Soft Law evolves outside of statutes

Q: How can your company's staff lawyers see the next re-interpretation of laws and rules coming?

Soft Law evolves outside of statutes

A: ***They can't.***

That's why you need <u>all</u> your employees' input.

It's tough for staff lawyers to think outside the box.

Questions to Ponder…

Why do offices have water coolers and coffee pots?

Why do managers sometimes encourage employees going to Happy Hour *without* the **boss**?

Informal Markets

Is it to foment gossip?

Is it to let associates let off steam?

Is it to allow for a ‘grapevine’ to provide much-needed information?

Informal Markets

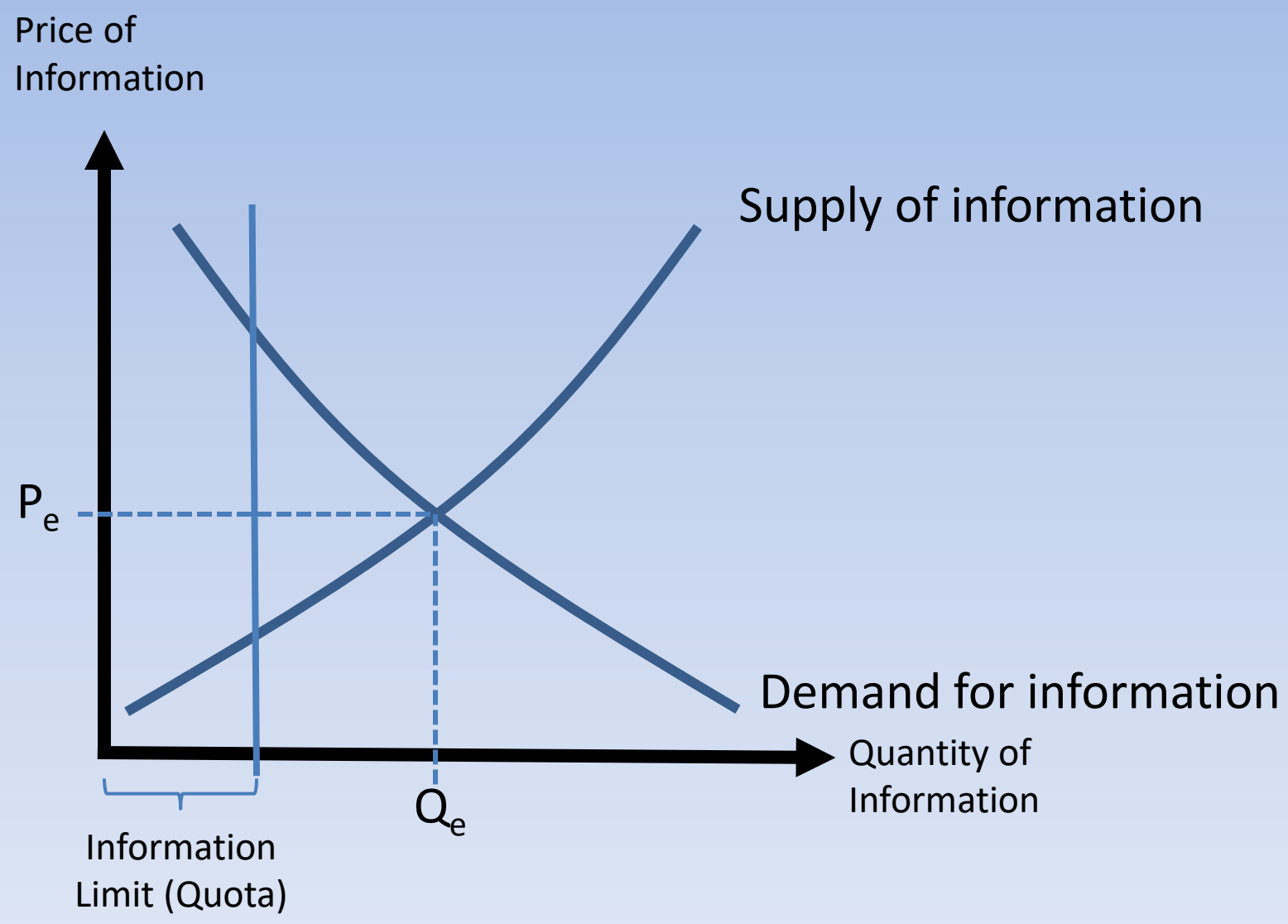
Fomenting gossip is probably a very bad idea.

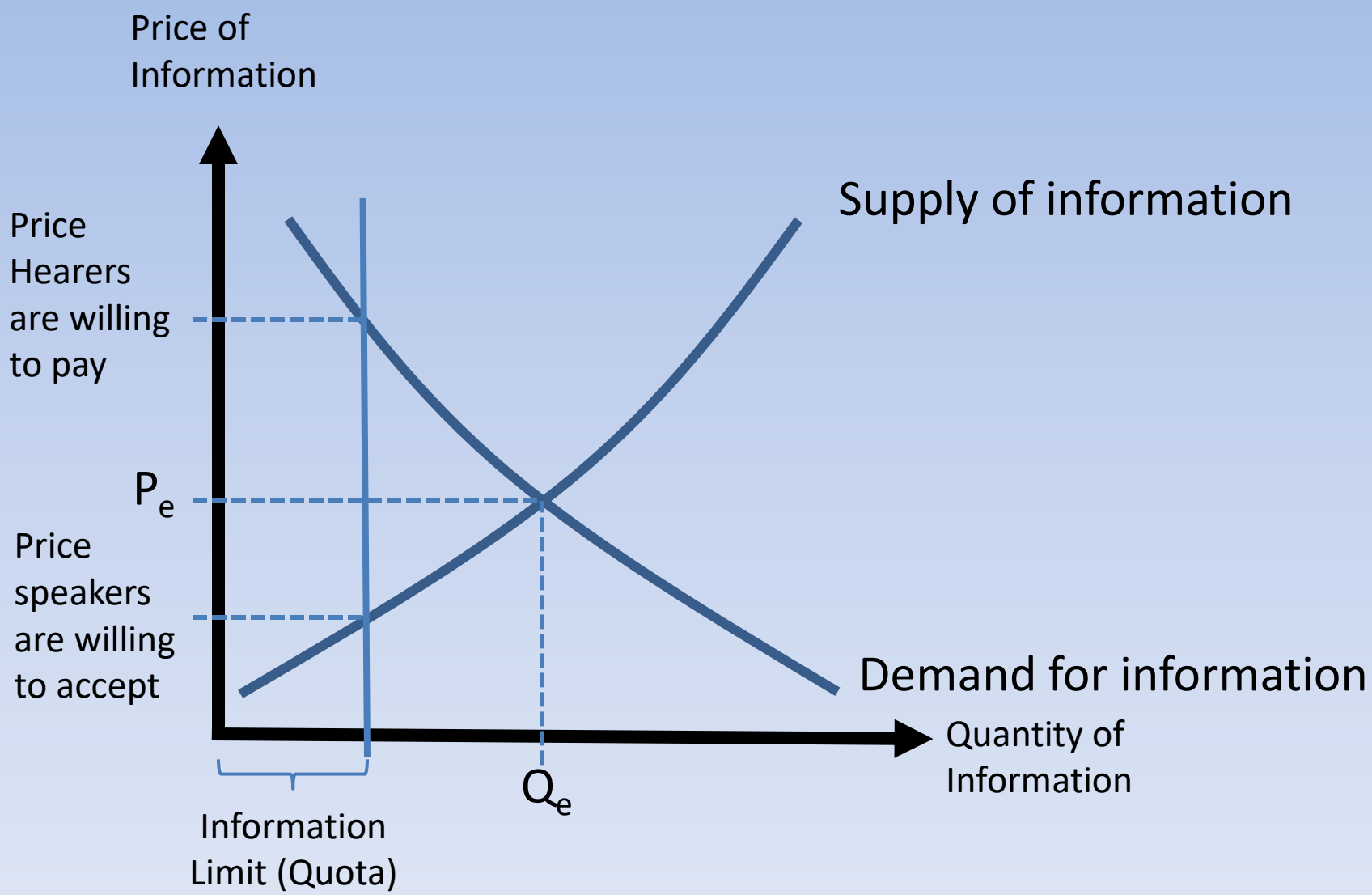
Informal Markets

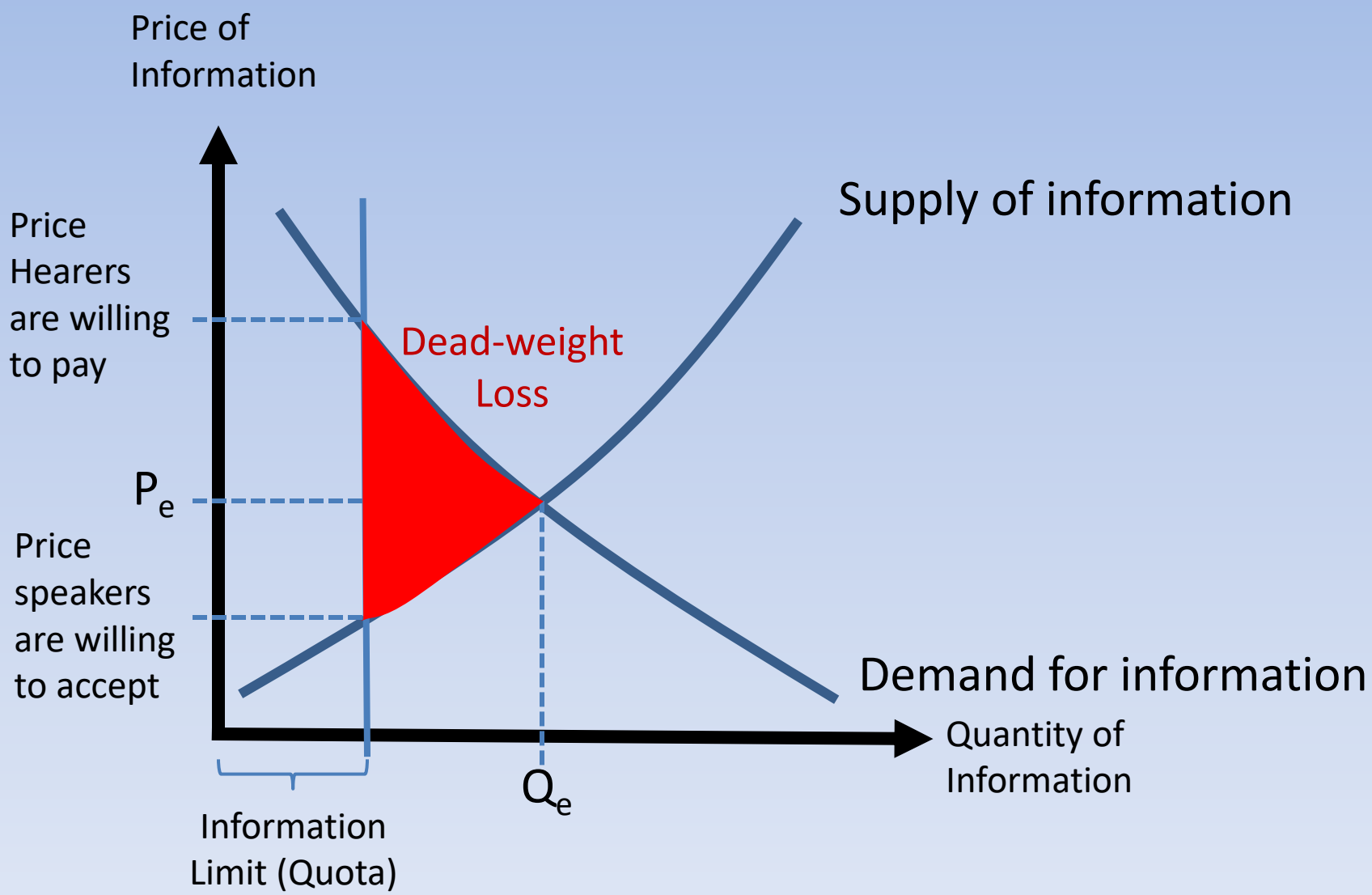
There are probably healthier, safer, (and less costly) alternatives for letting employees blow off steam.

Informal Markets

If all unofficial communication is *discouraged*, then what market phenomenon will occur in the workplace outside of managerial control?


Price of Information
Supply of information
P_e
Demand for information
Quantity of Information
Q_e
Information Limit (Quota)


Price of Information
Supply of information
Price Hearers are willing to pay
P_e
Price speakers are willing to accept
Demand for information
Quantity of Information
Q_e
Information Limit (Quota)


Price of Information
Supply of information
Price Hearers are willing to pay
Dead-weight Loss
P_e
Price speakers are willing to accept
Demand for information
Quantity of Information
Q_e
Information Limit (Quota)

Informal Markets

A quota, or limit on communication, will result in a dead-weight loss to the firm. *Choking off communication also chokes off innovative solutions.*

The inefficiency of ethical systems

In fact, prohibiting other options for the firm, including those that might seem unethical to Mr. Schwartz or others, is also **suboptimal**.

The inefficiency of ethical systems

Now, before everyone reaches for the torches and pitchforks and yells, “That’s terrible!” let me explain.

Recalling Enron (while not forgetting General Cable)

Wasn't the real problem with Enron the ***cloak of secrecy*** *with which executives did exactly the opposite of what they said they were doing?*

Reconsider Enron

*If the Stakeholders **all** had known what was going on (many of them apparently did), who (outside of Lay) would have wept because of Enron's failure?*

A Similar Question

Phrased another way, *Why should everybody else in America absorb the cost of SOX because careless investors expected that Andersen would detect and protect them from fraud?*

Like campaign finance reform…

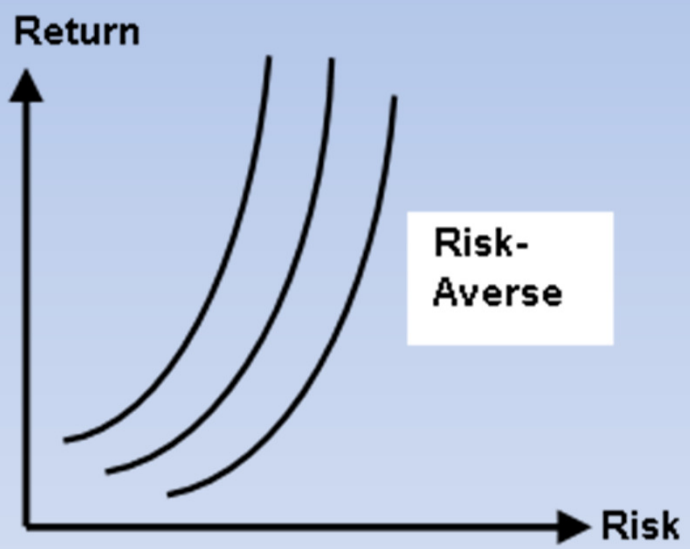
McCain-Feingold was an unworkable intrusion on First Amendment rights.

It was replaced by **sunshine** (at least at first).

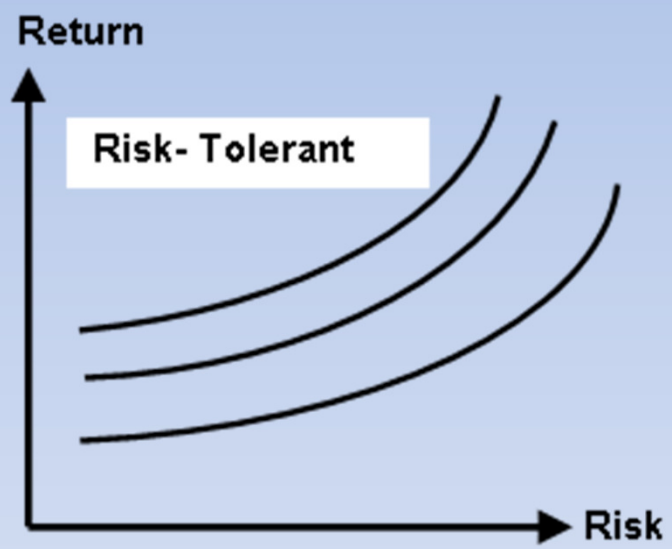
Market ***spansion*** is still needed.

The only long-term way to reduce systematic risk is for a large variety of ***voluntary*** financial agreements, auditing standards, etc., to exist.

Invests in bonds, gold, blue chip stocks



Invests in tech stocks, start-ups



This idea is at the heart of Investments analysis.

But your firm (and client) MUST know its risk/return **preferences**

Are they willing to give up virtually all profit in order to comply with **each new whim** of enforcement?

So, what do we know at this point?

Well, philosophers and economists aren’t much help.

I think we probably already knew that.

But this much seems certain:

You have to rank the importance of your stakeholders and encourage your other stakeholders to fall in line with your most important stakeholders and encourage the others to either get onboard or *get out*.

You can’t be all things to all people, so you ***must*** pick-and-choose.

*Using **Case Studies** isn't cheating*

Anybody, ethicist, philosopher, economist, etc., who comes to you offering a single solution or approach that will solve all your ethical issues is not worth listening to.