The Real Business of Real Business

Corporate trust and integrity

Gordon Pearson

Gordon Pearson

The Real Business of Real Business

Corporate trust and integrity

The Real Business of Real Business: Corporate trust and integrity
1st edition

ISBN 978-87-403-1133-4

Contents

	Preface	**12**
1	**The Interdependent Business Context**	**16**
1.1	Introduction	16
1.2	Business Legal Background	17
1.3	Management Revolution	21
1.4	Environmental Context	23
1.5	An Economic Theory of Business	24
1.6	The New Financial Context	28
1.7	Conclusion	30
2	**The Friedmanite Neoclassical Economic Belief System (FNEBS)**	**31**
2.1	Introduction	31
2.2	Evolution of Economic Analysis	31
2.3	The FNEBS' Impacts	38
2.4	A Footnote on Friedman	39

3	**Business Evolution**	**44**
3.1	Introduction	44
3.2	Evolutionary Stages	45
3.3	Evolution and Ethical Rules	48
3.4	Evolution of Culture and Psychological Contract	57
3.5	Industry Evolution and Competition	58
3.6	Conclusion	61
4	**The Business Ethics Movement**	**63**
4.1	Introduction	63
4.2	The Business Ethics Approach	64
4.3	Normative Ethical Theories	67
4.4	Application to Business	75
4.5	Conclusions	78
5	**Interdependence and Business Integrity**	**80**
5.1	Introduction	80
5.2	Ethical Performance	81
5.3	Trust and Business Integrity	83
5.4	Enlightened Self-interest	87

5.5	Collaborations, Alliances, Networks and Teams	91
5.6	Moral Development	98
5.7	Conclusion	101
6	**Business Perspectives**	**103**
6.1	Introduction	103
6.2	Business Strategy	104
6.3	Business Objectives	109
6.4	Strategic Health and Performance	115
6.5	Conclusions	116
7	**Objectives and Responsibilities**	**118**
7.1	Introduction	118
7.2	Survival	120
7.3	Satisfying Stakeholders	122
7.4	Pleasing Customers	136
7.5	Beating Competitors	141
7.6	Conclusion	147

8	**Business Integrity**	**149**
8.1	Introduction	149
8.2	Enlightened Self-Interest Revisited	150
8.3	Perception or Reality	151
8.4	Characteristic or Style	153
8.5	Calculation or Value	154
8.6	Transcultural Integrity	155
8.7	Levels of Integrity	157
8.8	Conclusion	159
9	**Action on Trust and Integrity**	**161**
9.1	Introduction	161
9.2	A Culture of Openness	165
9.3	Corporate Governance	168
9.4	Internal Codes of Ethical Practice	174
9.5	Making Integrity Explicit	177
9.6	Conclusion	182

10	**Alternative Economic Systems**	**183**
10.1	Introduction	183
10.2	Welfare Economics	183
10.3	Social Balance	185
10.4	Behavioural Economics	187
10.5	The New Economics	189
10.6	What They Don't Tell You About Economics	191
10.7	Conclusion	193
	Bibliography	**195**
	Endnotes	**202**

List of Figures

Figure 3.1 – Industry Phase Changes 59
Figure 6.1 – Hierarchy of Business Objectives 111
Figure 7.1 – Objectives and Transactions 119
Figure 7.2 – Product Attributes 138

List of Tables

Table 3.1 – Systematic Business Evolution 45
Table 3.2 – Phases of Ownership and Control 49
Table 3.3 – Control and the Psychological Contract 58
Table 3.4 – Control and Organisational Culture 58
Table 3.5 – Industry Progression and Competition 60

List of Boxes

Box 3.1 – Start-Up 50
Box 3.2 – Entrepreneurial Phase 51
Box 3.3 – Family Business 52
Box 3.4 – Family Management 53
Box 3.5 – Quoted Company 55
Box 3.6 – Internal Dealings 56
Box 9.1 – "Still no Oscar for Sugihara's List" 163
Box 9.2 – Whistleblowing at S.T.P. 167
Box 9.3 – Cadbury Report on Corporate Governance – Code of Best Practice 169
Box 9.4 – Non-execs fail to learn the facts of company life 173

Preface

The title of this book requires some explanation. It is a heavily revised edition of a book entitled Integrity in Organizations: An Alternative Business Ethic, published by McGraw-Hill in 1995. The focus of the text has not changed; it remains oriented to the business practitioner's perspective and is written specifically for students of management. What has changed is the depth of understanding of the business context and the extent to which the dominant economic orthodoxy is in collision with the many and various imperatives of a fragile and barely sustainable world[1]. Hence this revised text and new title requiring explanation.

The sub-title, *Corporate Trust and Integrity*, is probably clear enough. In this ever increasingly interdependent globalised world, it is vital for organisations that they are welcomed into the myriad of mutually beneficial interactions. To achieve this they need to be trusted. The only exception to that is if the organisation has become so powerful that interaction with it is unavoidable. Even then, if the powerful organisation is not trusted, one way or another, it will pay for that lack of trust. In the end, its power, even its autonomy, may be threatened. So trust is crucial to the long term success of any organisation and businesses are no exception. So the question is how do companies ensure they are trusted? The answer is to ensure they always behave with integrity. That is to make absolutely certain they are trustworthy. Clever PR and promotion are irrelevant. Unless an organisation behaves with integrity it will not be trusted. So that is what the subtitle is about.

The Real Business of Real Business warrants a bit more explanation. Let's take the second *Real Business* first. Governments often talk about how important it is to be business friendly, completely failing to recognise that business is not a single coherent entity. There are start-ups, fast growing hi-tec businesses, mature low-tec plodders and businesses which appear to be in terminal decline. They all have different objectives and different needs. Even more important, today there are businesses which operate in the traditional frame, producing goods and services which the general population need or want. These are the producers. There are also other businesses whose role used to be to provide the financial support needed by the producers in order to invest sufficiently in R&D, production facilities, people development and working capital. However, over the past few decades, a large proportion of these financial businesses have changed their effective roles so that rather than supporting the financial needs of the producers, they are extracting value from them. So the second Real Business in the title makes the distinction between the producers of goods and services and these ambiguous financial businesses. The second Real Business refers to the producers.

Now, the first Real Business refers to what those producers do. Neoclassical economists would have you believe that they exist to maximise profits. Or the Friedmanite strand of neoclassical economists would suggest they exist to maximise shareholder wealth. But the first Real Business doesn't relate to maximising anything. Instead it refers to the strategic objectives of the producer business which would involve satisfying customers better than competitors, through any one of several identified means to do with the product, the service, the technology, delivery and so one, all of which must be known and understood by customers.

So The Real Business (satisfying customer needs or wants better than competitors) of Real Business (i.e. the producers rather than the financial parasites) is achieved by behaving with sufficient corporate integrity to be trusted by all stakeholders including customers.

The aim of the text is to assist organisational management students and practitioners. The focus is on business, because business is still, as Chandler described in 1977, the most powerful institution in the economy. Its managers are probably no longer the most influential group of economic decision makers, having been overtaken by the financial sector which now and for the time being dominates governments as well as industry. Businesses operate subject to the sometimes apparently competing demands of financial performance and integrity. Clearly, good business not only **can** be both efficient and trustworthy, but in order to survive long term, **must** be both.

The aim is to provide a realistic guide, in this fast changing, globalised world, as to how management practitioners might achieve excellent performance while contributing to, rather than undermining, the common good.

It is based mainly on Anglo-American analysis, but also draws on data from other industrial and industrialising economies. Practitioners must necessarily make use of their own experience and judgement in managing integrity. They may need to adapt concepts to their own organisation's particular circumstances. In some cases they will have to take unique initiatives and adopt distinctive responses. Moreover, whatever action they take will not remain valid for ever. The business of ethical business is a live and evolving concern; which is what makes it interesting to work with and, hopefully, to read about and in which to develop professional expertise.

The importance of trust and integrity for the real business of real business is continually being emphasised by the daily news. As this is written, on the 23rd September, 2015, the two lead items in the day's Financial Times were:

1. "Martin Winterkorn, VW chief executive, vowed to fight on, saying in a video statement that he was "endlessly sorry" that the carmaker had betrayed customers' trust, but would do everything in his power to restore faith in one of Germany's proudest industrial brands.… He was speaking four days after US regulators revealed that VW had used "defeat devices" to cheat US emissions tests for its diesel cars, opening itself to multibillion dollar fines and possible criminal charges."
2. "Google has been charging marketers for advertisements on YouTube even when the video platform's fraud-detection systems identify that a "viewer" is a robot rather than a human being.… When the researchers sent the bots to visit two particular videos 150 times, YouTube's public view counter identified only 25 of the views as real. However, Adwords, Google's service for advertisers, charged for 91 of the bot visits."

"Something is profoundly wrong with the way we live today. For thirty years we have made a virtue out of the pursuit of material self interest; indeed this very pursuit now constitutes whatever remains of our sense of collective purpose."[2]

Plan of book

The opening chapter provides an overview of the business context, its legal historical background, its role with regard to sustainability in terms of the environment and the collision between these various contextual issues and the economic theory which is currently still dominant.

The second chapter examines further, and provides some critique of, the dominant economic belief system which is wholly accepted by the industrial, financial, media, academic and political establishment. As such it is hugely influential over all forms of business, directing progress to an unsustainable future. This chapter provides an additional assessment of the position and together with the final chapter provides a picture of the theoretical economic options.

Chapter 3 provides some insight into the ethical ambiguities inherent in business. From start-up to maturity and decline, business is necessarily managed at the boundaries of ethical acceptability. Not surprisingly, people in business cross those boundaries from time to time. The inherent conflict between business and ethics needs to be understood if any approach to business ethics is to be of practical value.

Chapter 4 outlines the business ethics orthodoxy and examines why it fails to work and why, therefore, there is a need for this alternative approach.

Chapter 5 provides the basic outline of the alternative, values free, business driven model and sets it in the present context of interdependent organisation.

Chapter 6 develops the strategic perspective of business, emphasising the dominance of strategic and business objectives and how these relate to the internal and external relations of the business organisation.

Chapter 7 examines the implications of the model for its transactions with each category of stakeholder and in pursuit of each of its business objectives. The examination further elaborates the business perspective and provides a number of actual examples of integrity in transactions with stakeholders.

Chapter 8 sets out a number of essential linking concepts in the model.

Chapter 9 highlights the practical implications of the whole model and how managements may use it to define an approach relevant to their own particular organisation.

The closing chapter briefly reports alternative economic perspectives which may at last be gathering some momentum.

1 The Interdependent Business Context

Learning Objectives:

To gain a broad understanding of the business context, including the historical origins of business, the legal origins of the public limited company, the developing role of management, the unsustainable environmental context and the incompatible economic theory which has come to dominate management education and consequently financial and business management practice.

1.1 Introduction

Business is the label most often attached to that part of the economy which generates income and wealth, which pays the taxes which pay for the population's health, education and social wellbeing, as well as its defence against external threat. Business is therefore a Good Thing. An alternative view is that business is that part of the economy that sets out to take advantage of all other parts, by fair means or foul, simply in order to maximise its own benefit, quite irrespective of the damage it does to others and to the future of the planet. Business is therefore an extremely Bad Thing.

Business is clearly an ambiguous concept. It includes a wide set of sub-species, from sole trader to global corporate, from hedge fund speculator to mass employment widget manufacturer, from young, high tec, high growth innovator to mature, low tec, low growth plodder. They are all businesses. Referring to and treating business as though it were a coherent singularity is clearly not logical. Different categories of business may serve quite different purposes and have totally different aims and needs.

However, there is a common historic background to the emergence of modern business, a shared legal background to the different forms of business, a common though changing necessity for financial viability, as well as some responsibility for maintaining the sustainability of life on earth. These commonalities were addressed by the management revolution which took place in mid twentieth century, but was subsequently overtaken by the economic theoretical perspective which now shapes how these various contextual dimensions are addressed.

Most businesses share one further common feature: a basic interdependence. This is obvious to every new start-up business, whose dealing with customers and suppliers is a perpetual reminder of their own mortality. Businesses also depend on successful interactions with various other individuals and organisations, both internally and externally. These include, as well as customers and suppliers, relationships with their own people who work and develop operations, functions and specialisms, and important relationships with providers of both short and long term finance.

Businesses also necessarily interact with local communities and with the whole population in their treatment of the environment. General understanding has increased substantially in recent years, of the environmental challenges caused by the exploding human population and its demand for ever increasing affluence seemingly dependent on economic growth. This is the ultimate interdependence: between business and planet earth.

This opening chapter provides a broad overview of the business context from outside, looking at aspects of its past development, its legal, financial and environmental contexts and the development of those theoretical ideas which now shape the political and economic regulation and control of business operations.

These are necessarily abbreviated snapshots of the interdependent business context. The aim is to highlight issues which may be critical to the development of long term business success. Effective management decision-making must necessarily take account of that interdependence and the consequent existential need to be recognised as trustworthy, and therefore the essential need for integrity in business operations.

1.2 Business Legal Background

The earliest UK businesses were formed as companies, either by royal charter or act of parliament which granted monopolies to trade in certain geographic regions or in certain commodities. They were set up as joint stock companies, initially with stockholders acquiring a share of the financial responsibility and profits of individual expeditions.

The agent – principal relationship was first established in English law to facilitate these expeditions. The ship's captain was legally empowered to act as the agent of those who had financed the venture, usually the ship's owners, who were legally established as the principals. That legal relationship enabled the captain, while away from base and unable to communicate with the owners, to enter legally binding agreements on their behalf. At the same time, the captain as agent, was required at all times to act professionally in the best interests of the principals.

Expeditions were risky projects. Many were unprofitable and in some cases the ships simply did not return. So the owners stood to lose all they had invested not just in the expedition but in the related hardware, and in some cases were required to compensate others, including families of crew members whose lives might be lost on the expedition.

In due course, capital was raised on a permanent basis, rather than for individual expeditions, so trading companies were created which owned the ships and other assets, employing people on a permanent basis and retaining a proportion of the proceeds from their expeditions and trading. That enabled the owners' risk to be spread over multiple expeditions and activities. However, the agency relationship remained fundamental to the company's governance, empowering the captain to act on behalf of the owners so long as he always represented their best interests.

With industrialisation in the 18th century there came the need for massive cash investment on a scale that was completely unprecedented. Wealth had been mainly held in the form of land and property rather than liquid resources ready to be invested. Initially money was needed to build the transport infrastructure, the canals and turnpike road system to open up the country to large scale manufacture. Building a canal was hugely expensive. It involved petitioning for an Act of Parliament to approve the project, probably bribing objectors to the proposal, compensating private land owners through whose territory the canal would go, and then paying the wages of those working on the project. As well as pick and shovel labourers ('navvies') there were large numbers of brick makers, quarrymen, bricklayers, miners and tunnellers as well as different groups of skilled artisans and engineers plus the need to acquire specialized tools and equipment.[3] From start to finish it typically took seven years before a canal could start earning any return.

That huge investment was way beyond the ability of the landed gentry to fund. Money had to be raised from many dispersed sources. This was the impetus which brought the financial sector into being with the creation of banks and stock markets to handle the issue and resale of company loan stock and shares.

The system was essentially dependent on a huge number of small investors, but from the beginning, fears were expressed that the best interests of the company might be subjugated to those of a few major shareholders. Initially those suspicions were eased by the adoption of democratic voting, one-member-one-vote, irrespective of the number of shares held. As early as 1766, an Act of Parliament had explained the purpose of such practical limitations on the power of large share owners as to protect *"the permanent welfare of companies"* from being *"sacrificed to the partial and interested views of the few."*[4]

Company formation was streamlined by the Joint Stock Companies Act 1844 which introduced a relatively simple process of company registration to replace the need for an act of parliament. That was followed a decade later by the grant of shareholders' limited liability. That changed the nature of ownership so that shareholders no longer had any liability for company's actions, or results therefrom, beyond their initial investment.

Under the 1844 Act, registration of a company established it as a separate legal entity with some of the same legal rights and responsibilities as a person, such as the right to sue and be sued in its own right, and the capability of entering legal contractual arrangements. Of course, the company is not a person and so requires a human being, or human beings, to represent it and act on its behalf. The legal solution was, and is, for the company's directors to act as agents, legally empowered to act on behalf of the company and legally required to act in the company's best interests at all times. This has been the legal position in successive Companies Acts right down to the present.

Company shareholders' contract with a limited liability company relates to their purchase of share certificates which entitle them to a potential receipt of dividends and capital growth, both being at risk. Beyond that they were established with the right to appoint directors (or confirm or reject their previous appointment) at a company general meeting and were also able to vote for resolutions raised at general meetings. Votes were commonly taken on the democratic basis of a show of hands.

The shareholders owed no duty to the company or its employees, having discharged it in full when they paid for their share certificates, which they were free to sell at any time.

A similar process evolved in the United States, where democratic voting was said to be justified by the *'American fear of unbridled power, as possessed by large landholders and dynastic wealth, as well as by government.'*[5]

A German commentator in 1837 suggested the democratic approach had a profound impact on the way the corporation was managed, compared to the plutocratic (one-share-one-vote) system which favoured those with large holdings.[6] The democratic approach treated customers, employees and others interacting with the company with fairness and justice. But that profound impact was greatly reduced as protections against the unbridled power of *'the few'* were gradually removed. By late nineteenth century one-share-one-vote had become almost universal in both Britain and the United States, potentially allowing '*the permanent welfare of companies to be sacrificed to the partial and interested views of the few*'. The only protection against that was in the hands of the directors of the company whose duty it was to ensure the company was not sacrificed to those partial interests.

That protection was always limited by a constitutional flaw in company status that has never really been overtly addressed or even acknowledged. The real status of a public limited company effectively changes from being an independent legal entity to an item of private property, when a shareholding of over 50% is achieved. At that stage, though the legal position doesn't, on the face of it, change, the practical power of the majority shareholder is unassailable.

The company's legal entity status had been initially protected from the unbridled power of the wealthy few by the democratic voting system. When democratic voting gave way to one-share-one-vote, other means of protection were exercised. Some companies issued non-voting equity, retaining the original ownership control. European companies adopted two tier boards of directors with employees represented on the supervisory board which took decisions on matters affecting the company's external relations. Formation as a co-operative excluding external shareholders, also provided a corporate entity with protection from external attack.

In UK, public limited companies have made limited use of these protections and so have remained vulnerable to the *'unbridled power'* driven by the '*partial and interested views of the few.*'

1.3 Management Revolution

Even in Adam Smith's time, hired managers were starting to gain power. Smith expressed his suspicion of their role and effectiveness:

> *'The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own.… Negligence and profusion therefore must always prevail, more or less, in the management of the affairs of such a company.'*[7]

Management, though clearly apparent as a practice, was not formally recognized till around a century after Arkwright's first cotton spinning mill and Smith's 'Wealth of Nations'. By then the size of companies had grown substantially and their ownership was becoming more fragmented among large numbers of shareholders.

Smith, of course, had no concept of what in the twentieth century, Peter Drucker referred to as the 'management revolution' when management became professionalised and autonomous.

During the mid-19th century, the centre of gravity of management practice and theory started to move across the Atlantic to the United States. There the world's biggest and most successful corporations prospered in the freely competitive domestic markets which were bigger than any in the old world. Not only did they enjoy economies of scale, but more importantly from the business perspective, the United States markets were growing more rapidly than those of the old world. The greater scale and more rapid growth of markets justified substantially greater investment in new capacities, technologies and methods. So the United States became the world's leading industrial producer, and led the way to establishing effective management skills, training and education.

The president of Harvard University reported that by 1900 more than half of new graduates were being employed by businesses. The need for Harvard to provide suitable management education had become pressing.

The first businesses schools pioneered education for the new, big business management. Their aim was to instill in their students a sense of social obligation, typical of the accepted professions of the day. This may well have been in reaction against the worst excesses of the 'robber barons' who had grown up with their new industries, as exploitative of their workers as the worst kind of British mill owners recorded by Engels, though some famously later turned philanthropist, financing private business school education.

The leading university academics together with the industrialists who provided much of the funding, shared a view as to the values which they thought industry should espouse. They included a belief in scientific rationality, an acceptance of the puritan work ethic, a politically liberal perspective, a view of education as formative of character as well as technical competence, and an avowed commitment to meritocracy and integrity.

By 1914, there were twenty five United States business schools teaching what was referred to as the science of management, an approach which was analytical, avowedly objective and where possible quantitative. These characteristics were common to all the subject areas over which the study of management was divided.

Adam Smith had denied the feasibility of business improvement by management without ownership. In this he was challenging his own division of labour argument demonstrated by his pin factory and was quite clearly mistaken. In point of fact, management without ownership achieved massive improvement, ownership having no more to do with the processes of professional management, than it has to do with professional processes of medicine or the law.

The 20th century saw management firmly established as a professional endeavour, with a growing body of knowledge and understanding based on the study of real people in real business settings. Names such as Argyris, Herzberg, Jacques, Likert, March, Mayo, McGregor, McLelland, Simon, Trist, and many, many more, contributed a complex and rich understanding of business and human behaviour and human frailties in different business settings. This is the understanding which drives management across all its responsibilities in operations, marketing, finance and technical areas, focusing on ever better use of resources so as to ensure the company's survival and long term prosperity. Management was seen as a continuously innovative process of improvement, to find ever better methods of manufacture (i.e. to reduce costs, improve yields or improve quality of production), or to improve the products (i.e. by either lowering their cost, improving their quality or performance or adding more features), and so giving the customer better value.

Drucker's 'management revolution'[8] had dramatic impacts in terms of the living standards of the general population. The development of management expertise was led by practitioners, observers and researchers, rather than pure theoreticians. Under their guidance, management developed through various phases of increasing understanding and enlightenment. That professional expertise was clearly independent of ownership and was accepted as such, until it was overcome by the adoption of a particular strand of economic theory which became accepted as the academic foundation of management education and subsequently of the practice of management.

1.4 Environmental Context

Keynes envisaged that within his lifetime it should be possible '*to perform all the operations of agriculture, mining and manufacture with a quarter of the human effort*' then required. In other words, '*mankind is solving its economic problem.*'[9] By 2020, he anticipated, mankind would be freed to address better and more fulfilling aims in life than simply improving the standard of living or the manic pursuit of money. In this he was clearly wrong. By 2015, the pursuit of money, which Keynes thought of as '*a somewhat disgusting morbidity*',[10] had produced massive inequality as well as dire threats to the environment.

The pursuit of money is never ending for those consumed by it. As well as producing more wealth for the wealthy few, it creates the poverty of unemployment for a far greater number.

Since Keynes time, human population has grown from 2.5bn to over 7bn today and is predicted to top 9.5bn by 2050 with no generally accepted benign limitation on further growth. Consequently, the human demands on earth's finite resources keep increasing without any effective limitation.

The scientific consensus is that environmental impacts from human activity are unsustainable. Burning fossil fuels for energy produces land, sea and air pollution, ecosystem damage and climate change by releasing multiple pollutants into the atmosphere, contaminating soils and oceans, contributing to the phenomenon of acid rain, and average temperature rises across the globe resulting in ice-cap and glacial melt, thermal expansion and warming oceans which is predicted to cause significant sea-level rise by the end of the 21st century, flooding low-lying areas.

Governments, appearing to retain their commitment to economic growth, have so far been unwilling, or unable, to limit, let alone reverse, these catastrophic impacts which are caused by human activity largely under the control of businesses. But as the situation becomes more urgent, it appears inevitable that responsibility for avoiding these many and various impacts will eventually be recognised as a prime responsibility of business management. Also that avoiding, or externalising these costs to the general tax payer, will increasingly be understood as acts of corporate criminality for which companies and responsible individuals will be made to pay the price.

1.5 An Economic Theory of Business

A complex mix of influences has been identified so far. The public limited company, or corporation, was established as a legal entity having most of the rights and privileges of a real person, but with some fears expressed that it was vulnerable to being overtaken by the unbridled power of the wealthy few. Management developed a practice and theory, based on empirical research, practical experience and common sense, which incorporated some professional ideals intended to lead business in a direction which would serve the common good. The population explosion multiplied the environmental unsustainabilities such as pollution, resource depletion and climate change, adding to earth's increasingly apparent fragility.

Business played a primary role in these various developments. And 21st century business is now required to play a leading role in their resolution. Economic theory, which has overtaken management theory and practice, should indicate the way forward.

The theory originated with Adam Smith outlining what is now called classical economics, which emerged with the industrial revolution. Smith's Wealth of Nations was published in the early days of industrialization, in 1776, five years after Richard Arkwright opened his first cotton spinning mill. Smith exampled his explanation with the pin factory which achieved tremendous economic gains by specializing the production tasks – one man making pins from beginning to end might make one a day and certainly no more than 20, whereas by specializing ten men could make upwards of 48,000 a day. Comparable gains had been noted by Defoe in his 1722 *Tour through England and Wales*.

However, the new quantities of production would be of little use unless they could be sold. So the old ideas of governments deliberately limiting markets with an elaborate system of quotas and tariffs intended to serve the national interest, actually frustrated the new production possibilities. Hence Smith's advocacy of free trade, open access to markets, getting rid of government controls, and leaving regulation to the invisible hand of market forces. Smith exampled the butcher, baker and brewer, who would serve the common good by pursuing their own self-interest. But it is important to note that their self-interest would have been to provide a secure livelihood for themselves and their dependents over their life-time. To achieve this they would need to attract customers, suppliers and employees who would feel benefit from the interactions and therefore remain loyal to the business. There was no suggestion of maximizing self-interest in those various transactions.

Smith's classical economics was fairly common-sense and based on observation of what was happening in the real world as it industrialized. Towards the end of the 19th century, there was an increasing interest in the scientific, or at least quantitative, calculation of economics. Thus the development of what became known as neoclassical economics. It was distinctive from the classical approach by being based on mathematical expression of economic agents and their relationships and transactions. These are modelled according to the dictates of mathematics, rather than from empirical observation of the real world, which led to defining the firm as a profit maximising unit thus enabling the use of calculus. Not only was profit maximizing an impossible unit to model realistically, but it required an array of implausible assumptions to be made in order that the model might be internally consistent.

At the core of neoclassical economics is the necessity to assume humanity is reduced to a single motivation to maximise its own individual self-interest, which for the maths to be applied, had to be expressed quantitatively and therefore only in monetary units. In the real world, human beings regularly demonstrate their unselfishness, generosity and even heroism, while at the same time also showing themselves to be potentially corruptible by the possibility of power and/or money. Such complexity lies beyond mathematical expression.

The neoclassical approach served as a vehicle for teaching the fundamentals of supply and demand, the price mechanism, marginal analysis and the like, and prior to the 1980s was one of several different strands of economic thinking taught in universities and business schools.

Though maximising anything, necessarily involves the impoverishment of alternative quantities, profit being such a diffuse concept, the general idea of its maximization did not necessarily compromise the management revolution. Economists might refer to long term profit maximization, itself an incoherent concept. For management, profit was an essential of long term business survival. It was not a quantity which served as the objectives of business operations. Profit might be retained within the business for its future development and security against risk, or returned to the providers of capital as interest and dividends, or it might be invested directly in further business development. It would necessarily serve an array of purposes.

Through much of the twentieth century the idea of profit as the return to capital, confronted the alternative of state socialism, exemplified by the Soviet communist system. Western economists, in particular the Austrian School, stood for private property and enterprise. Von Mises argued that the programme of liberalism, *'if condensed into a single word, would have to read:* **property**, *that is, private ownership of the means of production.'*[11] Thus, even for the Austrian School's version of laissez faire, government would be required to protect property rights. But, in an ideal world, government would be needed for precious little else.

Hayek defined socialism as not merely *'espousing the ideals of social justice, greater equality and security'* but also encompassing the particular means by which those ideals might be achieved:

> *'…socialism means the abolition of private property, of private ownership of the means of production, and the creation of a system of "planned economy" in which the entrepreneur working for profit is replaced by a central planning body.'*[12]

Friedman's 1962 *'Capitalism and Freedom'* included the following famous injunction:

> *'Few trends could so thoroughly undermine the very foundations of our free society than the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible.'*[13]

The threat of totalitarian communism was still live in 1962, which motivated the neoclassical including Friedman, but it was not until the late 1970s, that the neoclassical strand of economic thinking began to overwhelm all other strands and become the orthodox wisdom with Friedman's ideas gaining traction. And it was not until the 1980s that the idea that business existed to maximize shareholder wealth became the dominant economic belief. The so called profit motive was effectively replaced by the shareholder wealth motive, it being accepted as the **duty** of corporate officials to maximise shareholder wealth.

That orthodox wisdom is referred to in this publication, and in this alone, as the Friedmanite neoclassical economic belief system (FNEBS). It is the foundation of much that is problematic in managing the real economy. Friedman's assertion was originally made without theoretical or legal support, and with no empirical evidence to suggest it was an effective business focus. Nevertheless it achieved and has retained its power as the orthodox wisdom – the following chapter provides some further explanation.

JK Galbraith expressed such orthodoxy as an '*institutional truth*' by which he meant not a truth at all, but an untruth to which all associated must subscribe if their careers are to prosper within their chosen institution.

Theoretical support for the FNEBS was later produced by mis-applying the legal agent : principal relationship to that between company directors and shareholders. This legal relationship originally applied on trading expeditions when the ship's captain acted as agent for the ship's owners, but its realignment to company directors is dishonest. Company directors have written contracts with their employing company which identifies their duties and responsibilities and requires them to act in the company's best interests at all times. Directors are clearly the agents of the company not the shareholders with whom they have no direct contractual arrangement.

To suggest directors owe allegiance directly to shareholders requires the legal entity of the company to be ignored or sidestepped in some way. This was the focus of agency theory, which was invented in the 1970s to get round the inconvenient fact of the company's existence as a separate legal entity. The theoretical argument that was raised held that the company was '*a centralised contractual agent in a team productive process*'[14] and a '*legal fiction*'.[15] These weak or false statements of extremely dubious meaning, were used to support Friedman's institutional truth, despite lack of any legal support. A review of the legal position was conducted by Lan & Heracleous,[16] who found that nowhere in the world is there a legal statute which confirms company directors as the agents of shareholders. Only one item of case law was identified, which was in the Supreme Court of Michigan in 1919, and was so weak as to never be used as any precedent.

Nevertheless, Friedman's institutional truth that business exists to maximize shareholder wealth, is still widely accepted in 2015, having a profound impact on the way business is managed, serving '*the partial and interested views of the few*', rather than being concerned to make any contribution to the common good.

1.6 The New Financial Context

Acceptance of that orthodox wisdom in the 1980s had some important impacts on the financial context. Deregulation of the newly computerised financial sector, enabled the establishment and rapid growth of shadow banking operations which have been thoroughly analysed elsewhere. For the present purpose it is sufficient to note the broad impacts such as the high level of speculative trading which resulted in the 2007–8 crash, the increased level of amoral and criminally fraudulent activities and the financial sector's loss of interest in supporting the real economy.

The original purpose of the financial sector was to make it possible for the real economy to raise the necessary funds to finance the requirements of industrialisation. This was achieved by banks and stock markets providing investment opportunities to many dispersed small scale investors. Investors bought shares or loan stock having no further liability for the company's activities, knowing their investments were at risk but hoping they would produce an attractive return.

Since computerisation and deregulation of stock markets, the originally intended flow of funds from investors into the real industrial economy has been reversed. In the United States, a 'multi-trillion dollar transfer of cash from US corporations to their shareholders over the past ten years' was noted in 2012.[17] A similar process was apparent in UK.

Boots the Chemist, which had accumulated its assets over a century and a half, is one example of how this reversal of funding flow is being achieved. By a somewhat tortuous route, the company was acquired by private equity predators, Kohlberg Kravis Roberts, and incorporated as Alliance Boots Gmbh, in a tax avoiding Swiss canton, loaded with £10.5Bn of debt that had been raised for the company's own acquisition, so that its owners could then go on to repeat similar M&A deals.

If the victim company operates in a sector which is necessarily underwritten by the state, then for the private equity predator, so much the better. Care homes are a prime example. Private equity operator Blackstone extracted £500m from Southern Cross care homes, saddling the company with that debt forcing them into bankruptcy. A similar process is under way in 2015 with Four Seasons which runs 450 care homes and 50 specialist care units. The company was acquired by private equity operator Terra Firma (who had been outbid by Kohlberg Kravis Roberts for Boots), saddled with around £500m of debt, which was over 60% of what Terra Firma paid for its acquisition. Interest on the Four Seasons debt charged at around 10% pa, consumes all Four Seasons gross profit. Bankruptcy appears inevitable. The real victims, as with Southern Cross, will be those patients in care for whom the state is bound, however inadequately, to make provision.

These deals are justified and encouraged by the adoption of the FNEBS orthodoxy. In this revised financial context, the purpose of public limited companies and of the stock exchanges on which their shares are quoted, is effectively subverted so as to provide means for the extraction of shareholder value, rather than its creation.

The world of financial trading was described as '*socially useless,* by Adair Turner, then Chairman of the Financial Services Authority, in his 2009 Mansion House speech. The Economist, referring to the Barclays Bank LIBOR trading scene, described it as exhibiting a *'culture of casual dishonesty'*. Criminal fixing of financial markets, interbank lending, foreign exchange, etc, has become the norm. Between 2009 and 2013, the twelve global bankers paid out £105.4bn worth of fines to European and US regulators for various criminal offences. And at the same time made additional provisions in their accounts for a further £61.23bn of anticipated fines for crimes which presumably they knew all about, but which had not then been uncovered.[18]

Little is left of the financial sector's integrity. It has been hollowed out by a combination of new technology, permissive theory, and corruptible human beings. The imposition of heavy fines, and the identification and punishment of an as yet very small number of individuals, suggests that attention might now be starting to refocus on the rebuilding trust.[19]

1.7 Conclusion

This opening chapter has given a broad overview of aspects of the business context in which management practitioners have to operate. It is hugely ambiguous. Different imperatives appear to contradict each other. The overall impacts currently experienced include the abuse of planet earth which is already threatening many people's survival, an explosion of inequality of wealth and income with the wealthy few taking huge advantage of the rest, and curiously continued acceptance of an economic orthodoxy which argues for the maximisation of shareholder wealth above all else, justifying the business initiatives which are producing the unsustainable impacts of pollution, waste and inequality.

Contextual collisions abound. An employee's contract of employment is likely to require acting in the best long term interests of the company, but the orthodox wisdom is based on the idea that company directors are just the agents of shareholders and must act in their best short term interests, if necessary against the interests of the company and its various stakeholders.

From the outset of industrialisation, there was always the suspicion that unless restrained, the vested interests of the wealthy few, would dominate the world. Over the past three decades or so this appears to have been largely achieved, aided by the new technology which drives the financial sector that was created to provide investment in the real economy but now serves to extract value from the real economy and invest it in speculative high risk high return opaque securities for the benefit of the wealthy few.

This is a 2015 snapshot of a fast moving world. Unsustainable effects will not be sustained. Businesses, acting in accordance with the currently dominant economic orthodoxy have been responsible for much of the damage done. Businesses acting with integrity are the main bodies with sufficient power to effect sustainable change. The rest of this book is about how practitioners might ensure the businesses they work with achieve that integrity.

2 The Friedmanite Neoclassical Economic Belief System (FNEBS)

Learning Objectives:
To understand the origin and nature of the Friedmanite neoclassical economic belief system (FNEBS)

2.1 Introduction

The FNEBS is an open system which impacts industrial, financial, social, political and ecological systems. It is a belief, because it is not a scientific law or coherent, testable theory. Though it has been regularly falsified, it remains the orthodoxy promulgated by those in power. It is a development of neoclassical economics, accepting the key neoclassical concepts relating to the real economy. It is Friedmanite, having adopted Friedman's distinctive twists to neoclassical belief.

The following notes outline the origins, content and impact of the FNEBS. It is viewed from the particular perspective of the real economy which comprises real businesses which employ people providing food, shelter and clothing, as well as the other needs and wants of the general population. It does not include the perspective of those financial institutions which exist primarily now to maximise their owners' wealth without regard to the interests of the real economy or the common good. Being from this particular perspective, the following notes are not intended to provide a comprehensive analysis of the neoclassical strand of economic thinking.

2.2 Evolution of Economic Analysis

2.2.1 Adam Smith's Classical Economics

Adam Smith's approach to economics was based around the tremendous productivity gains from specialisation (division of labour), exampled by his pin factory. From a maximum of 20 pins per person per day, the ten person factory could achieve 48,000 pins a day. Smith attributed that increase in productivity to the increased 'dexterity', reduction of lost time between different functions, and the deployment of specialised machinery. But, as Smith pointed out, such increased productivity would be limited by '*the extent of the market*', i.e. not much use unless it could be sold.

Governments then were concerned that international trade should be managed for the national interest, and used an elaborate system of quotas and tariffs to control imports. The net effect of these mercantilist interventions was to restrict the size of markets and therefore the productivity gains that could be made from specialisation. Adam Smith therefore advocated ending government controls, enabling free trade with open access to markets, leaving regulation to the invisible hand of market forces.

Smith was a political thinker above all else. His first major work, *The Theory of Moral Sentiments*,[20] provided a nuanced assessment of human motivation, with the desire to save as the ultimate human need at the top of a Maslow style hierarchy. By saving, rather than consuming all, a person could accumulate capital in order to 'improve' themselves and their dependents and thus become *'deserving and obtaining this credit and rank among our equals'*. This desire to 'improve' was the self-interest which motivated the artisans: *'It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard for their own self-interest.'*[21] That self-interest was to 'improve' themselves and their dependents over their life time, which would require the attraction and maintenance of loyal customers, suppliers and employees.

At the same time, Smith clearly recognized that most human beings were essentially corruptible: '*people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the publick.'*[22] Similarly he was cynical of management's diligence: *'The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own.… Negligence and profusion therefore must always prevail, more or less, in the management of the affairs of such a company.'*

However, Smith did concern himself with the ill effects of specialisation, warning that it led to the *'mental mutilation'* of workers '*whose whole life is spent in performing a few simple operations…His dexterity at his own particular trade seems, in this manner, to be acquired at the expense of his intellectual, social, and martial virtues. But in every improved and civilised society this is the state into which the labouring poor, that is, the great body of the people, must necessarily fall, unless government takes some pains to prevent it.*'[23] Smith's proposal was to counterbalance these effects of such work by attending to the education of the workers. His concern for aspects of social welfare has largely been forgotten by his Friedmanite successors.

He had previously explained his basic sympathy in the opening of The Theory of Moral Sentiments: *'How SELFISH soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it. Of this kind is pity or compassion, the emotion which we feel for the misery of others, when we either see it, or are made to conceive it in a very lively manner.'*[24]

The conflict of interest between those who accumulated capital and those who were dispossessed of what little they had, was multiplied many times over by the industrialization process. Whilst citing the citizens' self-interest as the foundation of economic progress Smith nevertheless acknowledged, and had sympathy for, all humanity including especially those who were inevitably disadvantaged by industrialization.

While he counselled against governments interfering directly in free markets, he nevertheless advocated a progressive taxation system whereby the rich pay proportionately more of their wealth and income than the less rich, and the taxes be deployed to benefit the poor, for example, through their health, social care and education.

'It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion.'[25]

Thus Adam Smith's classical economics, based on observation of the real world as it industrialized, included considerations of social justice, with the rich paying progressive taxes to provide benefits for the poor. It was not just about free trade, open markets and minimized regulation and taxes, as it has since been misrepresented.

2.2.2 Neoclassical Economics

Neoclassical economics was distinctive from the classical approach by being based on the application of mathematics to model economic structures and processes, rather than observed reality. That necessitated the crude and simplistic assumption of maximisation. Without that assumption, there could be limited application of calculus. Applied to model human beings, maximisation produced the even more crude and simplistic self-interest maximising economic man, frequently referred to as *homo economicus*. The Latin label was presumably applied to add gravitas and mask the essential triviality of the idea, shorn of all Adam Smith's subtlety and depth of understanding. This grotesquely oversimplified model of humanity was the result of the neoclassical need for mathematical expression, which was quite incapable of representing Smith's moral sentiments, pity, compassion, or 'the emotion which we feel for the misery of others', let alone the ambiguity of underscoring these laudable motivations with the essentially human characteristic of corruptibility.

Mathematical modelling of the firm required it to be treated as a 'production function' which sought to maximise its profits. It was defined in terms, such as Q = f(K, L): the quantity of output (Q) being a function of factor inputs, K and L, capital and labour. This production function then served its theoretical purpose by enabling calculations to be made of revenues, i.e. Q times P, where P is the price per unit, and profit which is QP minus QC where C is the cost per unit. And, importantly for theorists, it enabled the marginal analysis, using simple calculus, to maximise profit by setting Q at the level at which marginal revenue equalled marginal cost.

It is not necessary to go into further detail here. The result has been a perversion of political economy, recognised and described by many eminent economists, including Guy Routh who wrote:

> *'Economics…ignores facts as irrelevant, bases its constructs on axioms arrived at* a priori*, or 'plucked from the air', from which deductions are made and an imaginary edifice created. It inhabits a world of purely economic phenomena, of universal validity yet, or because of this, without history; therefore subject to mathematical treatment, its variables and constants unaffected by the passage of time. Man and society are stripped of their attributes, as if they could exist without psychological, political, legal, historical or moral dimension. Thus verification is both impossible and regarded as unnecessary. In effect, then, orthodox economics becomes a matter of faith and, ipso facto, immune to criticism.'*[26]

The departure from observed reality to focus on mathematical modelling has only gathered further momentum since Routh's description.

The obscurity of current economic theory was revealed by Nobel laureate Robert Lucas when the UK Queen, not unreasonably, asked why no one had predicted the 2008 crash. The response was that economic theory predicts that such events are unpredictable. Kay points out some of the eccentric assumptions that have to be made to ground Lucas's 'dynamic stochastic general equilibrium model' which has been so influential in theoretical economics. The flavour is provided by quoting from Lucas's prize lecture on monetary neutrality:

> *'Assume simply that old and young engage in some kind of trading game, to which the old bring the cash* **m** *obtained in the previous period's trading. Either before, or perhaps during, the play of this game, the old receive a proportional transfer that totals* **x***. Let each young person and each old person select a trading strategy. Notice that the strategy of a young person can depend on* **m***, and the strategy of an old person can depend on* **m** *and* **x***. On the basis of these choices, suppose a Nash equilibrium is reached under which each young person supplies some amount of labor and ends up with some amount of cash. I will restrict attention to symmetric equilibria, so that in equilibrium each young person ends up with* **mx** *dollars. Each young person also ends up supplying* **f(m, x)** *units of labor, and this quantity is also the equilibrium consumption of each old person, where the notation is chosen to emphasize that* **m** *and* **x** *are the only state variables in this model. Different specifications of the trading game will have different implications for this out come function* **f***.*[27]

Lucas acknowledges the intelligence of Hayek, Keynes and contemporaries for their earlier *'attempts to deal theoretically'* with monetary issues, but notes their inability *'to work out the predictions of their own theories…without any of the equipment of modern mathematical economics'*. However, those earlier economists were perhaps fortunate not to have been so seduced by the availability of modern mathematical economics and therefore had to depend, at least to some extent on common sense and observed reality.

Prior to the 1980s, several different strands of economic thinking had been taught in university departments and business schools, including development economics, welfare economics and other sub strands even including some economic history. The management and business that was taught, was based on the application of various disciplines such as social psychology to real situations, empirically observed and developed with the benefit of practical experience to create some depth of understanding of human behaviour in organisations. By comparison the neoclassical belief that everything was necessarily based on money and greed was crude, simplistic and reductionist. Nevertheless those more enlightened perspectives were overcome by the neoclassical belief.

The neoclassical approach served as the preferred vehicle for teaching the fundamentals of supply and demand, the price mechanism, marginal analysis and the like, with business being focused on the objective of maximising profit. Profit being such a diffuse concept, its maximization was not an immediately calculable concept. It did not therefore necessarily compromise the knowledge and understanding which had been gathered in what Drucker referred to as the management revolution. Economists sometimes referred to long term profit maximization. Though that is an incoherent concept, it was at least acknowledgement of the problematic nature of pure profit maximising.

For business, profit serves as a measure of performance and a minimum requirement for success. The long term necessity is for sufficient profit, its maximisation not a relevant concept for business operations. Profit might be retained within the business for its future development and security, it might be invested directly in further business expansion, or returned to the providers of capital as interest and dividends. It could serve a wide array of purposes.

The idea of profit as the return to capital had exercised Adam Smith. He had mused about the labour theory of value, the idea that the value of any product was the real value of the labour involved in its production. Ricardo had developed the idea further and Marx had used it to argue that profit was the value of labour that had been stolen from labour by the owners of capital. Thus the great divide between socialism and capitalism, defined in part by the idea of profit, was emphasised by neoclassicals, notably the Austrian school led by von Mises and Hayek. They held that any step from the pure neoclassical position towards socialism, no matter how small, would lead inevitably to a full-on totalitarian communist state.

2.2.3 Friedman's variation

By the late 1970s, the neoclassical strand of economic thinking had begun to overwhelm all other strands, with Friedman's ideas becoming predominant, leading to the so-called profit motive being effectively replaced by the shareholder wealth motive. That change from focus on profit with its essential ambiguity, to the simple single meaning of maximizing shareholder wealth, was fundamental, and detrimental, for business, for economies, for society and for the whole world, present and future.

It had some coherence with the von Mises suggestion that if capitalism was reduced to a single word it would be property, meaning the private ownership of the means of production. Thus a certain logic suggested that if anything was to be maximised it would be the wealth of the owners of that property. However, there was no economic theory which offered real justification for the change.

It took ten years for economists to begin to propose a theoretical justification for this simple and hugely seductive theoretical idea. By replacing profit with shareholder wealth, Friedman had, at a stroke, wiped out a whole lot of ambiguity and clarified the roles of economic actors in the hugely problematic concept of 'the firm'. Economists had never modelled the firm satisfactorily or possibly understood how it worked. Under this new concept they had no need to treat the firm as a key concept any more. In fact agency theory, the theory that was developed to justify Friedman's change, side stepped the existence of 'the firm' altogether.

Misapplying the legal agent : principal relationship to that between company directors and shareholders necessitated the legal entity of the company to be ignored. Despite company directors having written contracts with their company which required them to act in the company's best interests at all times, agency theorists pretended directors' allegiance was directly to shareholders.

Identifying the company as *'a centralised contractual agent'*[28] or a *'legal fiction'*[29] were simply ways of getting round the inconvenient fact of the company's existence. But then there arose the so-called agency problem that directors and managers might not conceive of themselves as agents of the shareholders, but might instead pursue maximisation of their own self-interest. It was to overcome that problem that company directors were offered generous share option bonus schemes which converted them into shareholders.

There was no legal support for the agency theory idea. A survey of statute and common law[30] found no legal statute anywhere in the world confirming company directors as the agents of shareholders, and only one weak item of case law dating back to 1919.

Nevertheless, Friedman's institutional truth that business exists to maximize shareholder wealth, is still the widely accepted orthodoxy in 2015, having a profound impact on the way business and government is managed, serving '*the partial and interested views of the few*', rather than being concerned to make any contribution to the common good.

2.3 The FNEBS' Impacts

The FNEBS persuades its believers onto a collision course with almost every enlightened, sustainable, socially minded or altruistic action, whether individual or corporate.

If shareholder wealth is to be maximised, then other issues will inevitably be neglected and that includes, most importantly, environmental destruction, climate change, mass extinctions and the reckless consumption of finite resources. Its mathematical models are unable to place a real value on the earth in, say, 50 years' time. The use of discounted cash flows, immaculate though the logic is, at any credible interest rate calculates the present value of the earth our grandchildren will grow old on, as more or less zero. Environmental destruction of a zero value earth is therefore, according to the FNEBS, hardly relevant to economic calculations.

An important outcome was identified by Sumantra Ghoshal's description of management under the influence of what he referred to as 'bad theory'. It also freed management from all moral responsibility. Company directors, acting to maximise shareholder wealth, will act against the interests of all other stakeholders such as customers, employees, etc. They will so act even if it involves selling their company down the river, as the directors of Cadbury did in response to the Kraft takeover bid. They opted for a quick windfall for shareholders which, of course, included themselves, rather than looking after the long term interests of their company. The fact they were persuaded in part by the receipt of £multi-million bonus payments for recommending the deal, was, for them, only demonstrating their part in resolving the agency problem.

Under the FNEBS, management treats employees as commodities to be exploited for shareholder benefit. Hence part-time, fixed term and zero hours contracts. Also, new forms of work contract including outsourced services and self-employment in order for companies to avoid sick pay, holiday pay, and pension contributions. Companies are also led to avoid the cost of real apprenticeships, and the training and specialist educational development of employees, resulting in an economy-wide shortage of skilled, qualified, operators, technicians and professional specialists. The other result of these corporate impacts is the explosion of inequality of wealth and income.

The FNEBS also impacts similiarly on government, persuading action with the disposal of state assets wherever feasible, to support the free market ideas of choice, competition and enterprise. This is the justification for the privatisation of resources such as water and energy, as well as the disposal of such ambiguous operations as the railway and postal systems, as well as council housing. It also argues for the outsourcing of health and education wherever feasible. The creation of pseudo competitive markets to accommodate privatised operations has repeatedly resulted in both increased bureaucracy and more expensive provision.

The FNEBS argued deregulation of markets, combined with the new technology enabling easy entry to capital market trading, permitted the *'culture of casual dishonesty'* which supports the extraction of value from the real economy for the benefit of the wealthy. All trust in the financial sector as a whole has thus been destroyed.

These various effects observed within the UK economy, are also operative between economies in the globalised markets where the wealthy nations exploit the poor nations for example by allowing aid to be subverted.

The FNEBS is promulgated by bodies such as the Adam Smith Institute, the Institute of Economic Affairs as well as most of the mass media. The Adam Smith Institute website refers to its *'pioneering work on privatization, deregulation, and tax reform, and for its advocacy of internal markets in healthcare and education.'*

The original fears regarding the formation of public companies, that the wealthy few would exploit the rest, appear to have been realised. Where there are limitations on such activity, for example, in Germany where employees have 50% representation on corporate supervisory boards which have responsibility for matters of corporate ownership, the excesses are more limited.

2.4 A Footnote on Friedman

A few months before the 2007–8 crash Nobel memorial laureate, Paul Krugman, raised the question whether Milton Friedman was the profound theorist, or a simplistic ideologue, populariser and propagandist of monetarism and the free market doctrine, whose ideas proved unworkable in practice and whose intellectual honesty was at least questionable?[31]

Krugman's answer was that Friedman was all these. The problem was that Friedman, the simplistic populariser, gained huge credibility from Friedman, the profound theorist, and his intellectual dishonesty was evident in his populist exploitation of that credibility. Moreover, since the theory is itself disreputable, the profundity is not worth much.

Friedman's impact on the Anglo-American world has been greater than any economist since Keynes. Moreover his free market perspective still dominates Anglo-American political thinking despite, as Krugman pointed out, his ideas having proved unworkable in practice.

Friedman completed Capitalism and Freedom in 1962, when the world appeared to be divided between the two philosophies of socialism, most of which had in practice become totalitarian, and the free enterprise society which was arguably democratic. At that time it was uncertain that 'our free society' would prevail. Friedman and colleagues at Chicago and his Austrian predecessors, shared the commitment to free markets and the unreasonable belief that any step towards social democracy, no matter how small, would lead ultimately and inevitably, to a full-on totalitarian communist state. He may have imagined that progressive taxation was just such a step.

Friedman's early public association was with monetarism. His belief in monetary policy sprang directly from the commitment to free markets. Government's role in stimulating an economy in recession should be focused on feeding in the requisite liquidity. The markets would automatically allocate its use to the most efficient and effective applications. He rejected the alternative, tax and spend fiscal policies, because they would involve government interventions in specific public spending projects with all their assumed inefficiencies and political biases, inevitably involving government as market regulators, bureaucratic authors of endless enterprise stifling red tape, leading ultimately to the totalitarian socialist state.

Friedman supported his argument for private ownership with the assertion that it cost the state twice as much to do anything as it cost private enterprise. There is no empirical evidence for this and much to the contrary, but Friedman told the Institute of Economic Affairs that his son had called his attention to this '*sort of empirical generalization…and it is amazing how accurate it is*.'[32]

In the same IEA talk, Friedman made the argument for low flat rate taxation and proposed a single rate income tax of 23.5% as appropriate for UK at that time. Again no empirical evidence was provided but the apparent precision of the rate was no doubt intended to suggest some serious calculation had been completed. Friedman's argument was that low rates of tax would anyway gain from tax payers not seeking to avoid and evade payment. He later expressed disappointment that when tax rates were reduced, a substantial part of the benefit was invested in the pursuit of ever more elaborate avoidance and evasion schemes.

Both Thatcher and Reagan pursued monetarist policies for the first few years of their administrations and found they didn't work. Friedman himself subsequently expressed his disappointment at the result of the monetarist experiment.

Curiously, that failure did not dissuade the current generation of from a monetarist approach to dealing with the 2007–8 crisis. Through quantitative easing government has pumped hundreds of billions of taxpayers' money into the UK economy to stimulate growth. It did so by funding banks, but the banks were reluctant to pass the money on because they needed to rebuild their own balance sheets, having themselves made such a mess of them. So quantitative easing had negligible impact on real business and real jobs. That was exactly as Irving Fisher had indicated as far back as 1911: if money doesn't circulate, pouring more in will have no effect on the economy. It was what JK Galbraith had referred to as trying to push the economy with a piece of string.

Nevertheless, at the end of 2008 the approach was argued by Friedman's fellow Chicago School economist, Robert Lucas, with a more or less standard free market argument:

> *'There is no other way that so much cash could have been put into the system as fast. It entails no new government enterprises, no government equity positions in private enterprises, no price fixing or other controls on the operation of individual businesses, and no government role in the allocation of capital across different activities. These seem to me important virtues.'*[33]

Lucas ignored the fact that it also had no beneficial impact on the real economy.

Analysis of privatization confirms that no convincing general case has been made. Friedman's doubling of private costs for public performance is clearly way off the mark. Public services companies such as Serco, 4GS, Sodexo, Interserve and the rest, though adept at winning contracts for privatised services, are not always so effective at running them and not infrequently produce quite shocking stories of incompetence and profiteering.

Over the past few decades economics has progressed further into mathematical fantasy. For contemporary economics, practical reality is not a serious consideration. Friedman himself argued that realism was unimportant; what mattered was the ability to predict.

Friedman clearly regarded 'corporate officials' exercising social responsibility as one of the steps towards social democracy which would lead inevitably to totalitarian communism. Though that possibility no longer exists, the argument has had, and is still having, a huge and damaging impact. It has justified the extraction of value from the real economy for the benefit of investors and the destruction of real economy jobs. Fox and Lorsch noted a *'multi-trillion dollar transfer of cash from US corporations to their shareholders over the past 10 years.'* The City of London has achieved similar disinvestment. Also over the past decade the number of public companies in the UK has almost halved and declined by 38% in the United States. Similarly, the number of Initial Public Offerings (IPOs) has declined by over two thirds, and in the case of small and medium sized enterprises (SMEs) on which the hopes for an innovative high tec future rests, by more than 80%.

Still today most company directors believe, or claim to believe, the Friedman line, that it is their legal duty to do what they can to maximise the wealth of shareholders. That duty is foundational to the many codes of practice relating to corporate governance, from the first, the 1992 Cadbury code, which argued that

> *'shareholders, as owners of the company, elect the directors to run the business on their behalf and hold them accountable for its progress. The issue for corporate governance is how to strengthen the accountability of boards of directors to shareholders.'*[34]

Institutions, such as the Confederation of British Industry and the Business Round Table in the United States, endorse and promote this belief. Influential magazines such as The Economist, and think tanks such as the Institute of Economic Affairs, actively propagate the idea. It is the often unstated, but almost invariably active, assumption behind finance and business reporting in the press and broadcast media. The general belief is that shareholder primacy is what capitalism is all about.

Moreover, a July 2013 report on business education confirms it is still taught by business school faculty, as confirmed by INSEAD professor Craig Smith:

> *'Students come in with a more rounded view of what managers are supposed to do, but when they go out, they think it's all about maximising shareholder value.'*[35]

But it is all based on falsehood. When Friedman made his assertion it was completely without legal or theoretical foundation. Economists did subsequently develop a theory to justify shareholder primacy, an unconvincing and dishonest speculation which became accepted dogma referred to as agency theory, a deliberate misapplication of the legal principal : agent relationship.

Academic economists developed the theory to pretend the public company had no legal existence. In a frequently cited paper, Jensen and Meckling defined the firm as a *'legal fiction'*. Since it was a fiction, the totally false claim was made that the directors and executives were agents of the shareholders and therefore bound to act at all times in the shareholders' best interests.

But the company is not a legal fiction; it is a legal fact. That is its whole point. Company directors are appointed as the agents of the company. Their contracts of employment and service agreements are with the company, not shareholders, and are specific about the requirement to act in the best interests of the company at all times. Since 1844, company law has been clear about directors' duties to the company and its long term prosperity and also to have regard to the interests of all stakeholders. Nowhere in the world is there a legal statute which confirms company directors as the agents of shareholders. And despite it being the mainstream belief, a review of case law found only one item providing any support, back in 1919, and that was so weak it has only ever been cited once.

So Friedman's statement about the responsibilities of corporate officials is untrue. It fits his free market fixation, but at the time it was made Friedman must have known it was an existential lie. Corporate officials do not have a responsibility to make as much money as possible for stockholders; and they do have moral responsibilities, as Friedman himself subsequently admitted. Those moral responsibilities include concerns for issues such as justice, fairness and sustainability, all of which are threatened by the naked pursuit of the Friedmanite objective of maximising shareholder wealth.

Friedman was right about one thing in the real world. The economy carries on surviving the incompetent assaults of economists and politicians. This is not because of the magic of markets, but because of the continuing efforts of the mass of people needing to earn a sufficient living. Competitive markets no doubt contribute to that robustness, but markets suffer a natural tendency to concentrate and, in the absence of effective regulation, to become ever more monopolistic and subject to fixing and abuse: a very real problem that Friedman never faced up to.

Friedman's legacy then is of profound theory largely without practical value. Attempts to use that theory for practical purposes have invariably failed. So, his legacy should be to be taught, rather like in the past Latin was taught, as training of the mind. His legacy should be maintained and respected in the groves of academe, honoured by such as Robert Lucas.

But it would seem reckless to retain it as a guide to policy making.

3 Business Evolution

Learning Objectives:

To understand how a company as a system evolves through different stages from start up to publicly quoted company.
To understand how the relevance of apparently simple ethical rules changes as the company evolves.
To understand the implications of the change from producer company to wholly-owned subsidiary.
To understand how company evolution impacts on corporate culture and employee relationships with the company i.e. their psychological contract.
To understand the natural evolution of industries and the impact on levels of competition and consequent relevance of regulation.

3.1 Introduction

This chapter looks at businesses from the inside and recognises their inherent ambiguity, not just because of the ambiguous contexts in which they operate, but because of the way they are formed and evolve.

Independent business start-ups are owned and managed by the founding entrepreneur who not only has access to the till, but owns it. The liquid assets of such a business are typically all kept in the entrepreneur's back pocket. As the business evolves its culture develops and new rules are established with its members or employees, ownership and management control being progressively separated, and the business refocused on new targets and activities.

These successive stages of development automatically generate different threats to business integrity, requiring different responses for its maintenance. Ultimately the nature of business itself may make fundamental changes. An essentially co-operative competitor may, as a result of its own success rather than any malevolent intent on the part of its leaders, become an exploitative monopolist.

The following sections identify stages of evolution and considers the possibility of ethical rules shaping the decision process at each stage, as well as considering the broader implications of the evolution of whole industries.

3.2 Evolutionary Stages

There is a natural cycle in the development of most systems, whether biological, technological or social. It seems to apply to systems as diverse as single cells, lighted candles, human beings, products and businesses, even nation states. They all appear to follow the familiar pattern of birth, growth, maturity, decline and death and at each stage they appear to be driven by certain common goals as summarised in Table 3.1.

In infancy, most successful systems are dominated by the survival needs. This is entirely natural and appropriate because of inherently high infant mortality rates. High infant mortality among human beings has been reduced primarily by state provision in such areas as public hygiene, health and other social provision. Moreover infant humans are usually nurtured by loving parents in a generally benign adult population.

The infant business has few of these benefits. The doting parent or founder may lack the competence to ensure the fledgling survives. The wider population is by no means benign – an infant business exists in a competitive marketplace, and has to ensure its product or service gives sufficient customer value for it to survive and progress, and also to avoid being squashed by larger competitors.

System Phase	Company Evolution	System Goals
Birth	Start up/entrepreneur	Survival to achieve maturity
Growth	Adolescent/Family control	Building strength to achieve maturity
Maturity	Public (quoted) company/Wholly owned subsidiary	Autonomy and control of environment
Decline	Wholly owned subsidiary	Dictated by new parent
Death	Disinvestment/liquidation	Returning wealth to shareholders

Table 3.1 – Systematic Business Evolution

State provision in support of infant business is extremely unreliable. Governments invariably vow to be 'business friendly', but have little idea of what business is, let alone what its needs are. In particular they make little distinction between start-ups, small and medium sized enterprises (SMEs), large publicly quoted businesses, and the financially focused monopolistic leviathans which now dominate most mature industries. They are all businesses. But their very different needs and capacities are barely recognised.

Business mortality in the first three years of existence is around 76%. Though governments may make welcoming noises about small business, enterprise and the like, few coherent attempts are made to provide a healthy environment. There are no state midwives, hospitals, doctors and health visitors for the infant business. Under such circumstances, an obsession with survival is vital for the infant business. If its survival is threatened, the infant business must take any necessary life-saving action and put other considerations, ethical niceties included, on the back burner. If it survives this first phase the adolescent will be able to turn its attention to growth and the development of functional technological strength. It progresses through adolescence being sharp, innovative and focused on satisfying customers' needs better than its competitors. It carries no spare weight, no passengers. It is lean and fit, quick on its feet and builds its strength through constant striving to improve.

This phase sees the business change from being a one man band with a simple structure to employing an increasing number of professional specialists concerned either with the firm's technological development or the professionalisation of its various management functions.

In a growing market the adolescent business has to run fast in order simply to maintain its market position. If it fails to do this then in all probability it will not survive the first shake out when market growth starts to falter. In a static market there is not the same necessity to grow. Many businesses stay small, providing relatively stable employment for small numbers of people. Other businesses are more ambitious and grow rapidly in order to achieve the critical mass at which the new specialists can be profitably supported. Growth in static markets can only be achieved by increasing market share or by moving into new markets, both of which may be problematic in highly competitive situations.

To achieve maturity is the goal of all systems. Maturity is the phase when a successful system achieves maximum entropy, the most efficient process of energy conversion, the closest to self-actualization or fulfilment. In the case of a business, maturity is the phase when wealth creation is maximised, when the most surplus cash is generated and when the business achieves its position of greatest power and influence. Leadership in a mature market used to be an enviable position when a business could expect to maintain the generation of surplus for many years. This is no longer true and the successful business has to continue striving to maintain their dominance. They may do this by innovation, by threat of competitive reprisal or through collaboration or collusion to exploit monopolistic power. These are the commonest ways which mature businesses use to control and stabilise their environments.

In most systems it appears that ultimate decline and extinction are certain. In most cases they are entirely predictable. A candle, for example, follows all these system stages[36]. When first lighted, it may spit and sputter and possibly go out. If it stays lit, the flame quickly burns up to its full size. This is its mature phase when it burns the maximum wax and gives off the greatest light. In due course, it starts to putter and flicker and thereafter fairly quickly declines and goes out. Depending on the size of wick and the diameter and length of the candle, its longevity is fairly predictable. Likewise, the longevity of a biological cell is also reasonably predictable. But social systems are less so. They are renewable in a way that living systems are not and one of the aims of most social systems, and most managements, is to prolong the life of the system for as long as possible. Some succeed better than others.

For those that do not achieve continuous renewal, decline will ultimately set in. During decline the focus of attention moves once more back to a focus on survival, which preoccupation becomes totally dominant up to the point of extinction.

During these different phases in the natural evolution of the business, there are quite different pressures on the owners and managers of the business. Sometimes these will be totally dominant as in the infancy and extinction phases when a single minded concern for survival may appear to justify almost any action, no matter how unethical. At other times, a more balanced approach may be sustainable. Even in maturity, however, there are natural pressures which may push the business to the edge. For example, the tendency for mature businesses to form protective or exploitative cartels may seem natural but is both illegal and except in unusual circumstances unethical. Reaching a cartel arrangement is an abuse of economic power, usually in order to exploit the relatively weak whether they are competitors, customers, employees or other stakeholders such as the local community or the natural environment.

The spirit of such arrangements is justified by the economic theory referred to previously as the Friedmanite institutional truth. Adoption of such strategies can only be destructive of a company's reputation and perceived level of integrity. The natural evolution of business as a system suggests that business will naturally operate at the boundaries of what might be regarded as ethically acceptable behaviour. But crossing those boundaries, justified or not by Friedman, can only be destructive of long term business.

3.3 Evolution and Ethical Rules

As business evolves at the boundary of ethical acceptability it develops certain rules of behaviour related to ownership and management control, referred to here as *ethical rules.* These can be inferred from the custom and practise of the individuals concerned in their business setting. They are ethical in the sense that they are value loaded, pertinent to the reputational standing and perceived trustworthiness of the business, rather than having a particular ethical value themselves. This explanation might seem obscure but should become clear as the examples are illustrated.

As a company grows and the form of its ownership evolves, so the rules, custom and practice in which ownership is embedded also change. The customs and practice of the entrepreneur/owner may be radically different from those of the professional manager, but the dilemma is not simply of the differences between ownership and management of the business. Ethical rules which are applicable to a sole trader may not be relevant to a small entrepreneurial business. Rules which apply to the entrepreneur may not be appropriate for a firm being managed by the second or third generation of the owning family. Rules which apply to a publicly owned but family controlled business may not be applicable to the same business if it becomes the wholly owned subsidiary of a larger quoted company.

The points of change in ownership may themselves be discrete and explicit events, but the change in ethical rules implied by the change in ownership often remain implicit. In practice, changes in ethical rules may be both delayed and gradual. However, if the change in ethical rules is too delayed and too gradual, the result is likely to be a certain dissonance and cultural break-down. The resultant behaviour patterns and standards may not merely cease to bind the social group together as predicted by White [1984], but may have the strategically decisive effect of breaking it apart.

The evolution of ownership typically follows the stages set out in Table 3.2.

Control/Phase	Organisational Form	Ownership
Start-up	Sole trader	100% founder/entrepreneur
Entrepreneur	Private company	Reduced (~90%) founder/entrepreneur
Family	Private company	Further reduced (~80%) founder's family
Family	Public company	Large (>50%) family holding
Public	Quoted company	Smaller (<50%) family holding
Parent Company	Subsidiary company	Wholly owned by parent company

Table 3.2 – Phases of Ownership and Control

The six phases identified are those where the change in ownership and control have the most direct implications for the relevant ethical rules, both directly and through concomitant changes in the organisation's culture and the psychological contracts of people working within the organisation. The phases also tend to coincide with a strategic refocusing of the business which again may have implications for the ethical dimension.

In the following sections the phases of evolution are illustrated by reference to a company named S.T.P. Limited which is a composite of a number of real companies, the issues highlighted all being drawn from the real antecedents of STP.

3.3.1 Startup

Box 3.1 illustrates the early formation of the first ethical rule to which most rational individuals would be likely to subscribe. Though, of course, it is highly incomplete it seems clear that such an ethical rule is an early shaper of the *'behaviour patterns and standards'* which are subsequently built up over many years to form a *'unifying philosophy, ethic and spirit',* in short, an organisational culture.[37]

By the time the first **financial** accounts are being prepared the entrepreneur will have been in business for some time and certain systematic ways of operating will have been developed which appear to take the initial ethical rule a stage further. The crux of these rules is simply, at this early stage of cash starved business, to minimise the payment of tax, a concept which seems likely to command widespread support.

The establishment of this basic ethical rule is fundamental to business and is directly in line with the spirit of capitalism. Few people would suggest there was anything unethical in the specified behaviour so long as it is agreed with the tax authorities. Indeed to behave in any other way would be eccentric, even irresponsible.

Box 3.1 – Start-Up

Eric Kirtchin set up Scientific and Technical Productions Ltd (S.T.P.), to produce impregnated technical grades of material for electronic applications. He asked Maurice Hope, of Hope & Ellis, to act as his accountant. He had known Hope for several years and knew he would give good, sound advice.

The first thing Hope had suggested was that they agree with the tax authorities a financial year ending April 30th so that they would get an extra eleven months before having to pay any taxes. He also suggested that Kirtchin employ his wife, Ann, in some nominal capacity so that they could maximise their joint tax free earnings. These were perfectly orthodox arrangements. Eric was reassured that Hope & Ellis had his best interests at heart.

The accountants had been retained to advise Eric how to keep his records efficiently, to prepare his financial accounts and, above all, to smooth his path with the tax authorities, with whom Hope and Ellis had 'a good and trusting relationship'.

Hope & Ellis negotiated a number of items with the tax authorities about allowable expenses to be charged against the business. These included 20% of the cost of running Eric's house (council tax, water, gas and electricity) plus 50% of his home telephone bill, the full cost of running Eric's car including his personal use, and a proportion of his wife's motoring expenses. In addition Eric kept all invoices that might be considered in any way related to the business and these were charged in his quarterly VAT returns and then passed to Hope & Ellis along with all the other documents for preparing the company's accounts. Some items included in this way were probably not much to do with the business, e.g. various items which went down as subsistence, also some books, personal stationery and other consumables.

Emergent ethical rule:
The business should be so arranged, by agreement with the tax authorities, so as to keep tax payments to the minimum. It is thus sensible to charge every feasible item against the business in order to minimise the payment of taxation.

Subsequent phases of development serve either to reinforce and elaborate this early ethic, or to render it inappropriate and dysfunctional.

3.3.2 Entrepreneurial Phase

The second, entrepreneurial, phase sees the business growing rapidly and starting to take on additional employees who typically carry out routine tasks as instructed by the founding entrepreneur who retains 100% ownership of the business and 100% management control. Every decision of any significance is taken by the entrepreneur who is answerable to no one except his customers and the tax authorities. This is what Handy referred to as *the 'power culture'* where control is exercised largely by one individual.[38]

The entrepreneur's contract with the business is limitless. Typically he or she works all the hours of the day and including every week-end. For them this is self-actualization. The young business has a voracious appetite for cash. Very probably the entrepreneur will have put up all personal wealth as collateral on the firm's borrowings, very often including the family house. The personal investment in the business in terms of finance, psychological commitment, time and effort is total. Many marriages do not survive the entrepreneurial phase!

Box 3.2 – Entrepreneurial Phase

One of Eric Kirtchin's lifelong interests, apart from the business, was vintage motor cars. He possessed a 1911 Daimler and in the past had entered the London–Brighton run on several occasions. The setting up and early growth of S.T.P. had required not only the signing away of the freehold on his house, but also the reluctant sale of the Daimler. For a number of years Eric had put his hobby on the back burner. However, he still retained an ambition to set up a really well equipped workshop where he could renovate old cars in his spare time should he ever have any.

S.T.P. grew rapidly and was profitable. One of the first luxuries that Eric permitted himself, once the survival of the business seemed assured, was the equipping a machine shop to standards well beyond what could ever be required for the business. His intention was, when time permitted, to acquire an old automobile and renovate it using the company facilities. This in due course he did, recruiting a craftsman charge-hand who was able to lead on the renovation work.

The costs incurred on this venture were indistinguishable from the ordinary machine shop costs and no attempt was made to separate them out.

As the company grew Eric's motoring interests were further gratified and shared with two CEOs of his main customers with who he shared visits to two of he Formula One European Grand Prix race meetings, which were combined with some genuine sales visits. It was agreed with the accountants that these should be treated as overseas sales trips, with Eric's wife travelling as his secretary.

Eric's personal expenditure (e.g. old cars and race meetings) could be paid for either out of his salary which was paid by the business, or by charging it directly to the business as an item of business expense. Either way, as 100% owner of the business, he would ultimately pay. It was generally more tax efficient to charge items of personal expenditure as business expenses and, consequently, Eric charged personal items to the business unless the tax authorities objected.

Emergent Ethical Rule:
Use the most 'tax efficient' way of paying for personal items of expenditure, i.e. charge them directly to the business if it is acceptable to the tax authorities.

Without this manic level of commitment by the entrepreneur few businesses would survive. But there are compensations as suggested in Box 3.2. The emergent ethical rule seems to be moving the entrepreneur a stage closer to using the business for his own personal ends. However, since the business is legally 100% his and since his psychological contract with the business is completely open ended, it does not seem that at this stage there are any serious moral issues raised.

3.3.3 Family Business

The aim of most successful entrepreneurs is not to maximise profits but to build a business of substance that will survive and prosper. This is despite the fact that business advice to any founding entrepreneur is likely to include the admonition to have their exit strategy clearly in mind when they start out. The normal advice is to develop a business which can reach a level at which the most financially beneficial strategy is to sell the business off to a leading competitor. Nevertheless, entrepreneurs, as opposed to financial opportunists, may wish to develop their business so that it could be handed down to their children and at the same time offer a little bit of immortality, like Mr Marks and Mr Spencer. This is the true spirit of capitalism, according to Weber, though Milton Friedman might choose to differ.

The change from entrepreneurial to family business is usually a progressive development. At some stage the company ceases to be the sole possession of the founding entrepreneur and becomes a family business. The change may be symbolised by some ritual such as the son or daughter formally taking on an executive role, or the assumption of life presidency by the founding entrepreneur, but the real process may be much less perceptible and occur informally and progressively.

Box 3.3 – Family Business

S.T.P. was very profitable and grew rapidly, soon employing several hundred. Eric agreed to bring his daughter and two sons onto the board, all three being employed in the business. Annette was made Marketing Director, Peter became Production Director and Charles, Administration Director responsible for accounting and personnel matters.

In the past Eric had tended to charge things to the business if he felt he could persuade his accountants that a reasonably legitimate case could be made for it. However, now that other members of the family were involved, he felt it would be better to be more systematic about what personal expenditure by family members should be charged to the business. Consequently he agreed a list of such items with the accountants. This included the following items:

* 'Top hat' pension scheme for himself.
* Bentley car himself and Porsche for his wife.
* Executive cars for Directors (all family).
* All Directors' motoring expenses.
* Overseas 'sales' trips for himself and wife.
* Generous general expenses.

Emergent Ethical Rule:
It is rational and ethical to maximise the 'family take' subject to agreement with the tax authorities and the Company's financial capacity.

Nevertheless the metamorphosis from entrepreneurial unit to family business is of critical importance. Often the entrepreneur's children or other succeeding relatives fail to share his passion and commitment for the business. Often there is not just one inheritor – there may be two or more progeny among whom the business will be ultimately divided.

Different family members are therefore likely to have different psychological contracts with the business, some possibly replicating the founding entrepreneur's, while others may be based solely on what they can extract from the business while putting little back into it other than retaining their inherited share.

The rules of the business therefore change somewhat as indicated in Box 3.4 and a distinction is made which appears to entitle managers to 'take' from the business in ways which are not legitimised for either non-managers or non-members of the owning family.

Box 3.4 – Family Management

In due course family roles became further differentiated. Annette married and started a family and ceased working in the firm but retained her share-holding. Her husband took her position and in due course became a Director. Peter Kirtchin appeared not well suited to management and became something of a passenger with a professional Works Manager nominally reporting to him but in reality doing the job. Charles became Managing Director and devoted all his energies to the business just as his father had.

These developments caused considerable strain among family relationships. So far as 'family take' was concerned the rules did not change. However, the justification for them changed radically, with Annette and Peter both taking substantially from the business while putting little back. In due course they no longer enjoyed the benefit of being able to claim significant expenses. Eric and Charles being both fully dedicated to the firm, continued to enjoy their former emoluments.

Thus a distinction was made between those family members involved in managing the business and those that were not. 'Family take' became the preserve of family managers rather than shareholders. The behaviour patterns and standards which had been built up over the years were embedded as family custom and practice and formed an important part of the organisation's culture.

Emergent Ethical Rule:
Family members who are also managers of the business are entitled to the full 'family take' from the business because of their role as managers. Family members not also managers forfeit this 'right'.

This distinction is further complicated when the company enters its next stage of evolution and gains a public quotation.

3.3.4 Quoted Company

In a publicly quoted company there is no formal role for family members; there are simply shareholders, directors and employees. The position of family managers or directors is therefore no different from non-family members and they fulfil the tasks or roles of either shareholders, executive or non-executive directors and or professional managers or employees. The system makes no legal distinction between family members who are shareholders, directors and employees and non-family members; indeed the law specifically lays down that all shareholders should be treated exactly alike.

In order to obtain a quotation a business must meet certain criteria of substance and have a reasonably long and successful track record. For most businesses this means that, by the time they go public, the customs and practices, behaviour patterns and standards, have become well formed, fixed and embedded in the culture of the organisation. For many companies, these behaviour patterns and practices may conflict with the legal requirement to treat all shareholders alike. Clearly the family managers are not treated like other shareholders, nor like other managers. This is typical and widespread – vestiges of family influence on quoted company boards of directors remains common. Nevertheless, at the stage when the company achieves its public quotation, the former customs and practice of family managers is starting to appear less acceptable, both to the institutions of its new financial environment and, as illustrated in Box 3.5, to employees.

Family managers may still, quite wrongly but nevertheless understandably, behave according to ethical rules which were applicable to earlier stages of the company's evolution. For example, they may still operate within the mind-set which suggests it is not particularly important whether they benefit from the firm in terms of salary or 'family take' i.e. if the latter is more tax efficient than it is acceptable. In particular aspects of 'take' which are not specifically proscribed in the new situation, for example director's expenses, former customs may continue.

Box 3.5 – Quoted Company

Eric Kirtchin achieved his ambition when S.T.P. achieved its public quotation. It set the seal on his achievement: a substantial business that would survive for the benefit of succeeding generations.

Eric was regarded by employees in a variety of ways. He had not been a particularly charismatic leader, but he had been conscientious and hard working as several company stories testified. However, there were many other, less benign symbols of his leadership. Two are described below:

During the late 1980s Eric had spent a holiday in West Germany and had, rather unexpectedly, ordered a 2.5metre wide paper machine. This was a much wider machine than they had ever used before and there did not seem to be much justification for purchasing such a big unit. The machine was eventually delivered in thirteen huge packing cases, which were unpacked while Eric was away on a visit to America. The engineers were surprised to find that the contents of case number 7 was a large bodiless vintage Mercedes Benz ready for restoration. The 2.5m machine proved to be a white elephant that was never adequately utilized. The story was told and retold that Eric had bought the machine because an 84" machine could be packed into cases which were too small to contain the Mercedes. Whilst rational reflection would suggest this story was untrue, it was nevertheless a much repeated symbolic tale the meaning of which shed light on management's concern for the company and its fortunes.

The sequel to this story was that the Mercedes was renovated at great and obvious expense in S.T.P.'s remarkably well equipped machine shop, often referred to as 'Mr Eric's folly'. The car did later run in the London – Brighton and some acknowledgement of S.T.P.'s 'sponsorship' was made.

These stories, and many others of similar ilk, were told by successive employees because of their obvious symbolic meaning. The importance of this symbolism was increased when the company barely survived a four year recession in its main markets. Amid redundancies and cut-backs such symbols of extravagance and exploitation caused considerable alienation among employees.

Emergent Ethical Rules:
The previous rules which seemed initially acceptable, now appear unacceptable, but it is not necessarily clear where the line of acceptability should be drawn.

But the fact that family managers might be slow to adapt their customs and practices to the new situation does not arise because they are uniquely wicked. They may be equally slow to behave as ordinary employees in terms of the amount of personal effort and commitment they continue to give to the business and the loyalty which they continue to display. This slowness to adapt to the new stage in the company's evolution is one source of ethical ambiguity which impacts most businesses at some stage and its impact is cultural and long lasting. It is not simply restricted to family businesses, or even to family members in former family businesses, but impacts all stakeholders in those businesses. What is acceptable in the behaviour of one director is clearly also acceptable in another. Over time, the culture created is likely to affect the behaviour of professional, non-family managers, just as much as it does family managers and the overall impact, for good or ill, will be on the organisation as a whole. The incident described in Box 3.6 is apparently an example of clearly dishonest and unacceptable behaviour.

It is unacceptable in business terms – not only is the company being defrauded, but the behavioural impact on other people in the organisation might be very considerable. It looks like a simple black and white situation. However, the process by which such an incident comes about, though it is extremely common in business, is not simple. Labelling the perpetrator of such a transaction as a crook does not help the real position to be understood, which is the first vital step to it being managed effectively.

Box 3.6 – Internal Dealings

Charles Kirtchin, Managing Director, exercised management control through what he called the Executive Committee, which comprised the Executive Directors of the Company. After one of these monthly meetings Charles asked Gerald Smith, the new Finance Director, to stay behind a moment after the others had left the room. They talked a moment or two about some cost calculations, then Charles casually pushed a piece of paper across to Gerald and said,

"Code this to the works canteen, would you, Gerald."

Gerald looked at the piece of paper. It was an invoice for a domestic refrigerator. Gerald knew full well that no such item had been purchased for the works canteen. He looked across the table at his boss who was already turning his attention to other things. He mumbled something incoherent, picked the paper up and hurriedly left the room. He knew exactly what was afoot. It was a straightforward fiddle. In itself it was trivial, but what else did it symbolize. Gerald knew also that in not questioning it immediately he had passively condoned it.

From that moment on Gerald felt that his relationship with Charles Kirtchin had changed irrevocably. Charles, on the other hand, was wholly unaware of the impact of this relatively routine transaction, which though not strictly above board, was a trivial 'perk' in comparison with the total dedication he had given the company over very many years. And continued to give.

Emergent ethical rule:
The rules are clear: this is theft. But the situation that leads to their disregard is full of ambiguities and needs to be understood if the rules are to be obeyed.

3.3.5 Wholly Owned Subsidiary

The most important issue which arises when the company becomes a wholly owned subsidiary is the almost covert change in the company's legal status. As outlined in the previous chapter, the public limited company is a legal entity with all the legal rights and duties that implies. When it becomes wholly owned by another entity, whether it is another company or an individual, whether it is contested or not, many of those rights and duties are taken on by the acquiring entity and the company's effective legal status changes, becoming more akin to that of an item of private property.

As a consequence, the ethical rules applicable to the wholly owned subsidiary become somewhat clearer, with the obligation to operate to the rules of its new owners. An incident such as the one described in Box 3.6 becomes less ambiguous. The perpetrator can have no vestige of doubt that what he is doing is a straightforward act of theft. Nevertheless there may still be some areas of doubt. For example the acquiring company may be family managed or controlled and bring its own ambiguities to the new subsidiary.

The loss of its effective legal standing as a separate entity leads to the subsidiary company presenting a whole new category of ethical dilemmas which ware considered in later chapters.

3.4 Evolution of Culture and Psychological Contract

The evolution of ownership as a business evolves from start up through family ownership and management, and public quotation to being a wholly owned subsidiary is one perspective. The changing pattern of ownership has direct consequences for the 'philosophy, ethic and spirit' of a company. What is acceptable at one phase may be unacceptable at another. Ownership is not the whole story.

For example, during the early stages of the company's evolution it is completely dependent on the owner/entrepreneur, whereas by the time the company has gained its public quotation it has established its own critical mass as an institution, with structures, rules and regulations which make it no longer reliant on any individual. The entrepreneur's psychological contract with the business, which starts out completely open-ended based on him or her dedicating unlimited time and resources to 'self-actualization' in the business itself, becomes progressively less open as the business develops, being what Handy called 'co-operative' in the typical family business and rather more 'calculative' by the time the business goes public.

This progression is mirrored by the changing organisational culture which is dominated by the entrepreneur from the start in a 'power culture', and progressing through a phase of 'task culture' and ending up as a large company 'role culture'. To a substantial extent it is the changes in culture and psychological contract which changes the ethical acceptability of the behaviour patterns described. These changes are summarised in Tables 3.3 and 3.4.

As has already been noted, the behaviour patterns and standards which are shaped by the culture and psychological contract only change slowly after a change in ownership and control. During this lag, the behaviour patterns, which are likely to be well known and understood by employees within the organisation, will be widely perceived as inappropriate, and are likely to be seen as symbolic of low corporate integrity.

Ownership Phase	Control	Psychological Contract
Startup	Entrepreneurial Control	Self-Actualisation
Entrepreneur	Entrepreneurial Control	Self-Actualisation
Family	Entrepreneurial Control	Co-operative
Family/Public	Entrepreneurial Control	Co-operative
Wholly owned subsidiary	External/PLC control	Calculative

Table 3.3 – Control and the Psychological Contract

Ownership Phase	Control	Organisational Culture
Startup	Entrepreneurial Control	Power culture
Entrepreneur	Entrepreneurial Control	Power culture
Family	Entrepreneurial Control	Task culture
Family/Public	Entrepreneurial Control	Task culture
Wholly owned subsidiary	External/PLC control	Role culture

Table 3.4 – Control and Organisational Culture

The progressions outlined in Tables 3.3 and 3.4 are typical of how many businesses develop. However, the calculative contract and role culture may appear to be less appropriate to organisations operating in volatile and fast changing environments. High rates of technological innovation are encouraging businesses to find alternative forms of organisation which can remain flexible and responsive to change, adding further to the complexity of maintaining appropriate ethical rules in response to the evolving business organisation.

3.5 Industry Evolution and Competition

The concept of system evolution applies generally, not just to individual businesses, but to products, technologies and whole industries as depicted in Figure 2.1.

Typical successful industry development involves two major phase changes. The first occurs when the growth phase comes to an end. The sudden and usually unforecast end of the growth phase is at first denied with growth resumption being forecast. After several assertions that the experience is just a blip, predictions of a return to growth and unpleasant decisions being avoided, the major shake out decisions have to be made. Marginal competitors start leaving the industry, unable to achieve viable volumes in the new lower growth market. A similar period of volatility occurs when the industry moves into decline, the phase change at first being denied by expectations of maturity continuation. The fall out of competitors is typically achieved by a process of mergers and acquisition as well as some bankruptcy and voluntary exits.

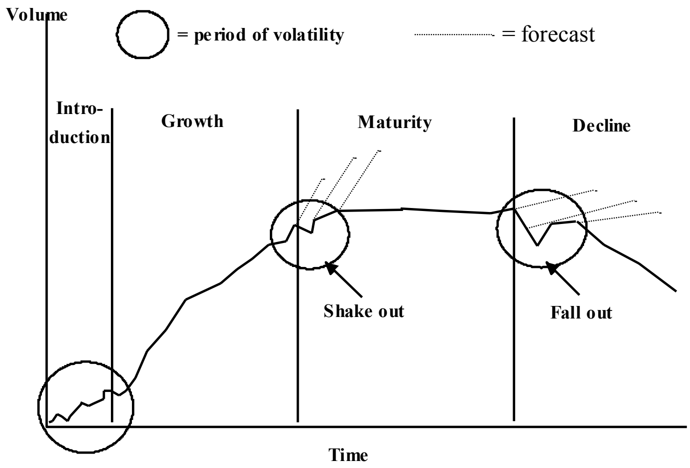

Figure 3.1 – Industry Phase Changes

There are typical patterns of corporate behaviour as the industry progresses. In the early stages the industry tends to comprise many small innovators focused on delivery of high performance product. As the industry matures product technology tends to standardise and the focus moves to cost reducing process innovations as suggested in Table 3.5.

Industry Phase	Technology	Innovation	Competition
Infant	Many alternatives	Product innovation	Competition emerging
Growth	Product standards beginning to emerge	Focus on best quality technology	Highly competitive
Phase change			Shake out
Maturity 1	Product standards established	Lowest cost processes	Competitors leaving
Maturity 2	M&A	Deal making focus	Monopolistic
Phase change			Fall out
Decline	M&A	Value extraction	Exploitative

Table 3.5 – Industry Progression and Competition

Neoclassical economist Michael Porter proposed a system of competitive strategy for business with different routes to achieving competitive advantage which might be achieved by delivering the best value to customers. That might be either through lowest costs or a differentiated highest priced product. These were the two routes out of the economists' perfectly competitive market where every player has the same costs, prices, products, mode of delivery and information about all aspects of the market.

Such a market is, of course, wholly unrealistic. Real competitors and real products or services differ in a myriad of ways, some being better than others and the best ones progressively taking a greater share of the market.

Porter's approach identified the only ways that the theoretical model of perfect competition could be breached, by one competitor achieving lower costs or higher prices than the rest. Once such a competitive advantage was achieved, that leading competitor would inevitably continue to progress, unless prevented by market regulation, till it achieves a monopolistic influence over market prices, technologies, supplies, delivery systems and so on. Thus, the economic model involves a standard industry progression from perfect competition to monopoly, which could only be prevented by external regulation, as was imposed following the 1930s great depression.

However, the current economic orthodoxy is that regulation is an unacceptable form state interference. Consequently markets are unregulated, competition is not protected and mature markets tend to be controlled by the monopolistic few who now dominate almost all mature industries. They are in the powerful position of being able to fix and rig markets for their own benefit. This is especially apparent in newly privatised natural monopolies such as energy provision, health and social services including housing.

Given the ambiguous position of business with regard to ethical behaviour, already described, this monopolistic power might be regarded as especially unfortunate in the context of ecological destruction, climate change and exploding inequality.

Business has contributed hugely to all of these unsustainable quantities and is the only institutional system sufficiently powerful to reverse those trends.

3.6 Conclusion

Companies are set-up and evolve in a way which deliberately pushes at the boundaries of what is widely regarded as ethical acceptability. Even though the neoclassical microeconomic model is almost wholly unrealistic, the business responsibility to maximise shareholder wealth has nevertheless become the dominant belief system over the past four decades. This is despite the fact that short term maximisation has produced business behaviour which is increasingly recognised as not just unacceptable, but actually threatening to the future of economies and even to humanity itself.

This does not arise because of the intrinsically low integrity of those who engage as entrepreneurs or managers. It is, firstly, because the imperatives of business goals, notably to survive, which give start up entrepreneurs more pressing concerns than ethical niceties. Secondly, it seems to be the natural result of the evolution of business ownership and management control, from start-up to the achievement of public quotation and beyond. This evolution is accompanied by the implicit but systematic imposition of rational, ethically pertinent *rules*, on the advice of professional specialists, with which most managers would feel perfectly comfortable. The resulting low integrity business behaviour is finally explained and justified by a spurious economic belief system which has delivered to the wealthy few, what was originally feared when industrialisation first began.

What are the checks and balances which could constrain businesses to behave with integrity? There are two broad schools of thought.

The first approach suggests that ethical business depends crucially on the ethical standards of the individuals who take the critical decisions. According to this view, the business environment continuously offers opportunities for profit from unethical behaviour whether it is theft, fraud, deception or exploitation of some other form. The only way such activity will be constrained, in a basically shareholder wealth maximising world, is through the high integrity and action of key people. Such a view seems to be broadly supported by the religious and academic communities with some support from practitioners.

The second school of thought is based on the assumption that ethical behaviour in business is required for long term survival and prosperity. Therefore enlightened self-interest requires that businesses behave in ways which would be considered to be ethical by most people. This view is probably given more credence by practitioners, but has not been very well formulated in terms which practitioners can use.

The next two chapters look a little more closely at these two approaches. Theoretical business ethics is the approach broadly adopted in most business schools and which relates management behaviour to the analysis of moral philosophy. The enlightened self-interest approach demands, on the other hand that ethical behaviour is related strictly to business considerations.

4 The Business Ethics Movement

Learning Objectives:

To understand business ethics as an academic subject area based on moral philosophy.
To understand the limitations of business ethics as a practical business initiative.
To appreciate the different philosophical approaches to business ethical dilemmas: utilitarianism and universalism.
To understand the contradictions between business ethics and neoclassical economics.

4.1 Introduction

Corporate officials, as Friedman labelled them, managers and professional specialists of all kinds, enjoy considerable autonomy and freedom to exercise their own personal value systems, for good or ill, in this ethically ambiguous environment. Most of them, being ordinarily frail human beings, inherently neither more nor less ethical than the rest of the population, are well intentioned but potentially corruptible, some more so than others. Over the past few decades the pressures to act unethically in pursuit of economic goals has undoubtedly increased, at least in part justified by the dominant economic belief system that they have no social responsibility other than to make as much money as possible for stockholders. That is the context against which business ethics is taught in the world's business schools.

Some academic specialists simply continue to regard business ethics as an academic subject area, as set out by DeGeorge a quarter of a century ago:

> *'As an academic field it stands or falls on the quality of the research done in it, on the body of knowledge developed, and on its success as an academic, liberal arts subject.' Its legitimacy is not dependent on it 'being effective in changing the climate of business.'*[39]

The 'liberal arts subject' was constructed on a foundation of moral philosophy, stretching back to Plato, Aristotle, Epicurus and beyond. This provided an impeccable academic foundation for a weighty business ethics curriculum. However, the ancient Greeks and their successors, Bentham, Mill, Kant et al, knew nothing of modern business and applying their theories in this alien context becomes a highly personal commitment.

Moreover, as philosophers themselves acknowledge, there are no final answers, no ultimate truths. The most that philosophy can provide is an approach to the problem: a structured way of thinking about things, of balancing conflicting arguments, but without taking business realities into serious account. And even if they did, they would still only provide a range of alternative views, with few definitive answers.

Sumantra Ghoshal, writing in 2005, noted that *'by propagating ideologically inspired amoral theories business schools have actively freed their students from any sense of moral responsibility.'*[40]

The amoral theories to which Ghoshal refers are encapsulated in the Friedmanite economic orthodoxy. They still dominate management education curricula. The business ethics, or even corporate social responsibility (CSR) counter-curricula, where they are offered on MBA programmes and the like, are only offered as option modules from which students are liberated as a matter of choice.

Nevertheless, the business ethics movement provides theories and mechanisms with which to structure analysis of the ethical dimension of business. Parker provides a critical assessment of the business of business ethics.[41] It provides a focus on values, especially in areas of discretion where the law may lack precision. By raising awareness and understanding of ethical values and their relevance to business, behaviour of people in business may be modified, and the ethical performance of business as a whole might be raised.

This chapter provides a brief overview of the business ethics subject area, providing some appreciation of the general approach and the issues raised. Dialogues between two opposing views on the subject area of business and ethics go back to the ancient Greeks.[42]

4.2 The Business Ethics Approach

The business ethics approach is supported by various interest groups, as noted when they come together, for example, at a business ethics conference. On such occasions there may be three quite distinct groups of delegates. There will be senior managers from business and commerce, some delivering papers concerned with issues in their own particular industry or confronting the role of industry in society at large. There will also be academics, from a variety of disciplines, some already in the field of management studies, many from other areas such as philosophy, science and mathematics, even literature, drawn together by their interest in business ethics as an academic field of endeavour. The third group, surprisingly substantial in numbers, come from various religious backgrounds, mainly from branches of the Christian churches, but also some from other cultures.

These three groups are not wholly separated; many individuals belong to more than one constituency. Moreover, many share the same broad aims though their detailed agendas may have been somewhat different in emphasis.

The religious community seek both to learn and to proselytise. Their underlying motivation for attending such a conference is presumably to increase their understanding of the ways in which the world of business functions, or malfunctions, so that their efforts to improve man's moral worth, and in particular the ethics of business operations, might be better informed and more effective, so that they might increase their beneficial impact on the world.

The academic community, though perhaps lacking the driving force of religious conviction, share many of these long term objectives, but approach them by a fundamentally different route. For the academic, business ethics is a field of study whose day has come. In America, and increasingly now in Europe also, business ethics is a taught subject on both first and higher degree courses such as management science, business studies, business administration etc. The ultimate aim might be to work for the practical benefit of the world of business, though academic purists among business ethicists strenuously deny this, claiming that business ethics need have no relevance at all to the practice of ethics in business.

The agendas of these groups are implicit, if not covert. Many of the business delegates to such conferences are bemused by the plain clothes clerics and the academics. There is, of course, the inevitable language barrier between three such disparate groups, especially arising from the use of the language and vocabulary of philosophy. But beyond this, there is confusion as to motivations. The business people attend simply because they want to try and do something to improve the ethical standing of business in general, and their own organisations in particular, and so offset the bad press from the rest of the world when it comes to ethics and morality.

Business scandals such as Enron, JP Morgan, Worldcom, Tyco, Freddie Mae and Freddie Mac and so on – the list is endless – do not mean that every business is run by dishonest, exploitative rogues. Most business delegates attend because they believe their long term business success is necessarily based on a reputation for high ethical standards and they have a code of ethical practice which they try to live by and they may be interested to share this experience, learn from other parallel examples and help others learn from it too.

The business practitioners are sometimes puzzled, even dismayed, to find their concerns being hi-jacked by clerics and academics and turned into a subject which they do not understand as relevant to practical business situations. Appealing to people to behave in a certain way because the creator of the universe wishes it so, is not helpful if most of the population do not believe in the existence of such a superior being. Similarly, appeals to ethical behaviour on the often subtle and obscure grounds advanced by moral philosophy, may have only limited effect on managers who are largely unconcerned with that subject area.

The business ethics approach addresses the increasingly obvious need to improve the ethical performance of business. It assumes that improvement will only be achieved by raising the ethical values, awareness and relevant skills of people in business. It is focused on achieving that improvement through the process of education. Thus education is of prime importance to the business ethics approach.

The business ethics curriculum is unusually well endowed from an academic point of view, with theoretical roots which stretch back to the ancient Greeks and beyond. By comparison most other management subjects have a lineage which barely reaches back to the Second World War. Moreover, business ethics is a subject which naturally lends itself to interesting and stimulating, participative, student-centred, learning methods.

Most business ethics courses are heavily focused on the use of case studies. These are often quite short and typically centre on some topical, real-world, ethical dilemma relevant to people in business. Students may then be asked questions such as: 'Is it ethical?', 'What **should** be done?' and 'What would **you** do under the circumstances?'

These are questions which serve to raise the student's perception of ethical issues and to explicitly identify their own values which can be deployed, assisted by common sense and intelligence, to the assessment of ethical performance of business in many different circumstances. Such ethical issues can present genuine dilemmas, suggesting the need for a more structured method of thinking and analysis. This is provided by introducing some the analytical frameworks and conceptual tools of moral philosophy to assist finely balanced ethical judgements to be made in answering 'is it ethical?' and 'what should be done?'

Further exposure to philosophical ideas and experience with this form of dilemma and analysis, raises the student's own ethical standards and awareness and so the cumulative experience finally impacts on their answers to the final question, 'What would you do under the circumstances?' It is a process which, according to feed-back from students themselves, provides a valued learning experience.

4.3 Normative Ethical Theories

The forms of analysis used in business ethics are mainly those borrowed from moral philosophy in necessarily abbreviated form. Managers and management students are not expected to become philosophers of substance on their way to achieving their management degree. There are obviously problems in this abbreviation and the philosophical explanations offered on management courses may be superficial and limited. To the philosopher these shortcomings may be crucial, but to the management practitioner they are not so important, so long as they assist with effective resolution of ethical dilemmas.

The business ethics approach, being mainly concerned to develop people's sense of values, is largely concerned with the application of normative ethics. Its focus is, as far as possible, on practical issues. It is not concerned with descriptive ethics which avoids judging matters of right and wrong. Nor is it concerned with the field of meta-ethics, which is concerned with the analysis of the meanings of crucial ethical terms, such as 'right', 'obligation', 'virtue', and 'responsibility', the logic of moral reasoning and the nature of moral justification. Common sense interpretations matter.

General normative ethical theories seek to formulate and to defend a system of fundamental moral principles and rules that determine which actions are right and which are wrong. Since the ancient Greeks, people have tried to define such a set of ethical principles which would apply to all situations at all times. The *golden rule* (e.g. 'do unto others as you would have done unto you') is one such endeavour; Kant's categorical imperative (e.g. 'what if everyone did it?') is another. Not surprisingly there has not been a single principle or truth, but a variety of approaches and theories. Among this great variety there are certain broad streams which have been widely adopted in business ethics. One such, the consequentialist approach or utilitarianism, is concerned with the consequences of an action, while another broad approach, sometimes known as universalism, is concerned more with acting on principle or out of duty, i.e. the motivation underlying an action, rather than its consequences. These represent different perspectives that can be used to answer the question "Is it ethical?"

4.3.1 Utilitarianism

Utilitarianism asserts that we ought always to do whatever has the best consequences. It was originally based on the idea that actions are right in proportion as they tend to promote happiness and wrong as they produce the reverse of happiness, sometimes labelled as pleasure and pain.

A more modern formulation holds than an action is right if it produces, or if it tends to produce, the greatest amount of good for the greatest number of people. Alternatively, we ought, in all circumstances, to produce the greatest possible balance of value over disvalue for all persons affected (or the least possible balance of disvalue if only bad results can be brought about).

These various formulations are simple enough concepts to understand at face value, but rather more difficult to apply in practice. The immediate problem is how to define 'pain' and 'pleasure', or 'good' or 'value' in meaningful terms. Whatever instrumental value some action may have, its ultimate justification must be that it contributes towards something which has *intrinsic* value, i.e. it is valuable for its own sake, such as providing health, happiness or freedom from pain.

Hedonistic utilitarianism claims that there is ultimately only one intrinsic value, that is pleasure or happiness. Bentham defined happiness as intended pleasure and absence of pain:

> *"Nature has placed mankind under the governance of two sovereign masters, pain and pleasure. The principle of utility recognises this subjection and approves or disapproves of every action whatsoever according to the tendency which it appears to have to augment or diminish the happiness of the party whose interest is in question."*[43]

Mill also defines utilitarianism as

> *'the creed which accepts as the foundation of morals, Utility, or the Greatest Happiness Principle, (which) holds that actions are right in proportion as they tend to produce happiness, wrong as they tend to produce the reverse of happiness. By happiness is intended pleasure and the absence of pain; by unhappiness, pain, and the privation of pleasure."* [44]

Although both Mill and Bentham regard happiness and pleasure as synonymous, Mill was at pains to point out that happiness does not just mean "a continuity of highly pleasurable excitement", but rather happiness must be understood in the broader sense of satisfaction, or contentment or being rewarding. The primary objection to hedonistic utilitarianism is that it is by no means obvious that all we do is only in order to attain pleasure and to avoid pain.

Pluralistic utilitarianism replaces this monistic idea of intrinsic value with a range of possible goods which are thought to be good in themselves, such as friendship, knowledge, courage, health, and beauty. On this view moral rightness is to be assessed in terms of the total range of intrinsic value ultimately produced by an action. The difficulty of determining what has intrinsic value has, however, led to the use of the concept of preferences. On this view, what is intrinsically valuable is what individuals prefer to obtain, and utility is translated into the satisfaction of those needs and desires that individuals choose to satisfy.

A major problem with this approach is that some individuals' desires will be morally unacceptable and it is unclear whether these should be excluded from the calculation. Other preferences may be based on ignorance, false reasoning, affected by sour grapes, or unrealistic expectations. Defenders argue that morally unacceptable preferences would be ruled out by their being inconsistent with other firmly established group preferences, while others argue that the correct principle should be based not on actual preferences of agents, but on their 'perfectly prudent preferences' i.e. what someone would desire if fully informed and unconfused. This then begins to look as if utilitarianism will not necessarily allow anyone to achieve their own desires, only those of some 'ideal observer' who does not actually exist.

Controversy has arisen over whether the principle of utility is applied to particular acts in particular circumstances or to **rules** of conduct that themselves determine which acts are right and wrong. Act utilitarianism asks, "what good and evil consequences follow from this action in this circumstance?". Rule utilitarianism asks "what consequences follow from this rule being generally obeyed?"

Act utilitarianism regards rules such as "tell the truth" as useful guidelines, for while they may offer a rule of thumb about what is most likely to produce the best consequences, they do not always predict what will actually bring about the general good and therefore can always be overridden in particular situations.

Rule utilitarianism suggests that if the general rule of truth telling produces the greatest good, then that rule should be followed, even in circumstance when it would appear that the good is not maximised.

Act Utilitarianism has been criticised for producing results which, intuitively, seem to be wrong. For example, it seems to condone breaking promises when someone can do so undetected, or acting unfairly when in so doing one maximises benefits. Rule utilitarianism avoids these unfortunate consequences of act utilitarianism, but runs into problems of its own. For example, when exceptions to the rule are clearly justified. If we never allow exceptions then all our actions will be controlled by unchangeable, general laws, which would be inflexible and quite unable to respond to the exigencies of particular circumstances. On the other hand, if exceptions are allowed, then rule utilitarianism collapses back into act utilitarianism.

It is important to note that in Utilitarianism no rule or action is ever absolutely wrong in itself. A rule's acceptability in the system of rules depends strictly on its consequences. Even rules against killing may be overturned in circumstances when permitting killing would maximise value. There is in principle no objection to any action until the consequences of that action have been assessed. This may be seen as an advantage, in that no appeal is made to a 'transcendental' source of moral right (such as a deity) or to an authoritative source (such as holy scriptures) and it seems to hold out the hope of a flexible policy based on empirical investigation of what will maximise welfare. But equally the possibility that anything might be justified in particular circumstances may seem abhorrent to those who think there are moral rights and wrongs which are unchanging and over-riding.

Also, there is a difficulty in assessing concepts such as pleasure, pain, good and value. This is important in business since many, if not most, business decisions contain elements of both pain and pleasure. In order to assess whether an act is ethical it would be necessary to define both pain and pleasure and measure the amounts resulting from the act in question. Only if the act produced a net increase in happiness would it be adjudged ethical.

These problems of definition and measurement are in practice very substantial and the approach by no means presents the non-philosopher manager with an answer that can be confidently applied to the real situation. Moreover, even if these problems did not arise, there may still be difficulties of simple justice. We might assume that all people are to be valued equally in measuring aggregate pleasure and pain, but what if an action produced a large increase in pleasure for a large number of people, but extreme and prolonged pain for a minority? How such injustice should be handled remains unclear.

The practical problems with utilitarianism do not apply to every act or decision. Some business actions may have no consequential downside. However, such decisions present no ethical dilemma and so the application of ethical theory would not arise in the first place. Where a dilemma does arise, it may be useful to think through the consequences and try to assess some net effect, but that would be reducing utilitarianism to simple common sense and philosophy is not common sense. Thus there is no alternative but to conclude that if utilitarianism is to be used at all it should be used rigorously, with all the detailed implications identified and the logical consequences understood. However, in the case of business, this only seems to provide firm solutions where no problems exist, but none where they are most needed.

4.3.2 Universalism

Universalism or deontology (from the Greek term referring to duties or obligations of individuals) is the other main strand of ethical theory applied to business. This approach is based on the idea that the moral worth of an action is dependent on the intentions of the person taking the action. Thus, duty is the foundation of morality and some acts are morally obligatory regardless of their consequences. Examples of the kinds of principles that are widely accepted include such things as "tell the truth, keep your promises, aim at the happiness of those around you." These 'moral axioms' are ones which we can 'see' to be moral by a kind of 'intuition' or 'moral vision', though such vision may be culturally defined and does not apply the same at different times and in different places.

The claim that certain moral principles are self-evidently true is made in the opening words of the American Constitution:

> *"We hold these truths to be self-evident; that all men are created equal; that they are endowed by their Creator with certain inalienable rights; that among these are life, liberty and the pursuit of happiness."*

Similarly, some modern theorists on human rights suggest the following as self-evident:

> The right not to have one's health impaired or threatened by the careless manufacture or design of a product available for sale.
>
> The right not to be sexually harassed by a fellow employee or boss.
>
> The right not to have personal property invaded, undermined, damaged, or degraded by the activities of a company.

It is argued that where someone has such rights, then this entails that others *ought* to respect the rights of the right-holder. So from a claim about what rights we possess is entailed a view about what actions we ought or ought not to perform. However, there is the problem of determining what our moral rights are. Moral philosophers have attempted to provide rational procedures for determining what is right. Kant, who was writing at the end of the 18th century, was a most important influence on deontological ethics.

Kant's theory suggests that

1. The rightness of an action depends on the person acting for the right reasons, it does not depend on the consequences of the action.
2. Nothing is intrinsically good except a *good will.* Other things may also be good – like happiness, wealth, courage etc, but these are not unconditionally good, because unless they are accompanied by the good will they can be worthless or even evil.
3. The good will shows itself in a sound disposition to do your moral duty- to do what is right because you want to do what is right, and for no other reason than that it is right. When agents act like this they do so out of **duty**, and this is the only moral way to act. It is not just a matter of acting in *accordance* with duty – one has to act out of duty.
4. If duty or obligation is to have absolute moral force it cannot be based on anything contingent, but must be absolute.
5. All human action is purposive and based on 'maxims' – that is rules for what to do under set circumstances. Most maxims are hypothetical, but the moral law is **categorical** – that is it applies in all circumstances, and is the principle upon which rational beings necessarily act.

Kant thus derived the categorical imperative, for which he provided several varying formulations:

> *Act only on that maxim through which you can at the same time will that it should become a universal law,*
>
> *Act as if the maxim of your action were to become through your will a universal law of nature.*

Act in such a way that you always treat humanity whether in your own person, or in the person of any other, never simply as a means, but always at the same time as an end.

Act only so as to be able to regard yourself as both a subject and a law-giver in a kingdom of ends.

These variations suggest the key concepts of Kantian ethics are:

universality – moral principles are general rules which apply universally. A modern version of this is Hare' s idea that 'universalisability' is a necessary characteristic of morals, i.e. we can only treat as moral those principles which we are prepared to 'universalise'.

impartiality – moral principles apply impartially to all moral agents. All persons deserve equal respect and consideration.

rationality – we decide what is right by the prior application of reason. This gives us absolute and objective rules to follow.

autonomy – the goal of ethics is to recognise and maximise each person's freedom.

This is a clear and unambiguous statement but not one which is comfortable to live with. Wrongs such as lying or murder, are not merely negatives which enter into a calculation of net good and which might be outweighed by the concurrent good that might be done or bad that might be avoided. They are absolutely, unequivocally and universally wrong and must not be done under any circumstances. The apparent simplicity and unambiguity may, however, in some cases be an illusion. Murder is clearly always and absolutely wrong and as a consequence British law accords the murderer a mandatory life sentence. However, there are murders and murders. Consequently, there are life sentences and life sentences ranging from a few weeks to a whole lifetime.

Universalism has been closely associated with the "laws" of religion. Thus, for a Christian as for many others, the Ten Commandments are regarded as fundamental statements of right and wrong. Under any circumstances, breaking any of the commandments would be wrong, no matter what.

This simplicity and lack of ambiguity has always been a source of great difficulty. An early statement of the position on lying was made by St Augustine:

"It is evident that speech was given to man, not that men might therewith deceive one another, but that one man might make known his thoughts to another. To use speech then for the purpose of deception, and not for its appointed end, is a sin. Nor are we to suppose that there is any lie that is not a sin, because it is sometimes possible, by telling a lie, to do service to another."

St Augustine – The Enchiridion

Even before Augustine the absolute wrong of lying had been difficult to live with. Ways round it had been widely practised. Augustine himself allowed of different categories of lie – they were all sins but some were more sinful than others. Others had practised equivocation – the use of ambiguity in order to induce a belief in something in another sense from that in which it was understood by the equivocator. Mental reservation was the practice of saying, for example, that one did not do such a thing (though one did) but adding silently that one did not do it on a particular day. These primitive, childish, methods of deceit without telling lies, just indicate the problems with deontology. It was not easy to live with in the middle ages and it is no easier in a modern business.

Kant's assertion is even more absolute than St Augustine's.

> *"Truthfulness in statements which cannot be avoided, is the formal duty of an individual to everyone, however great may be the disadvantage accruing to himself or to another."*

Moreover Kant does not allow of any different categories of lie: they were all equally wrong. The customary argument against such an absolutist position, specifically considered by Kant himself, is when a known murderer enquires whether "our friend is in the house?" Should one lie to save a friend's life, or should you tell the truth? Kant was consistent and said you should tell the truth, though simple common sense suggests otherwise.

The universalist approach can thus clearly lead to behaviour which under utilitarian analysis would seem to be obviously wrong. Similarly acts which lack any ethical motivation but which have a good utilitarian consequence might by this approach be regarded as unethical. There are many examples of such incompatibilities, especially those deriving from religious philosophies. For example, traditional Catholics who follow the teachings of the church as currently promulgated, might still believe that the production and open sale of contraceptives is universally unethical, whereas, the utilitarian view of the consequences for the world's population might be regarded as quite the reverse.

Universalism cannot be interpreted at a common sense level. It does not advocate general norms of behaviour such as 'whenever possible be honest with your stakeholders'. It is precise and absolute. If it is interpreted at a common sense level then it reduces to something which in business decisions either is not relevant, or in those particular difficult decisions where some philosophical guidance would be most useful, it retreats into an ivory tower purity which is impervious to attempts to extract any intelligent utility.

4.4 Application to Business

Looking at ethical dilemmas from the dual perspectives of universalism and utilitarianism sheds light on the question 'is it ethical?' and such consideration may help towards an informed view of 'what should be done?' However, there are problems in applying either approach, and little guidance as to how to respond when the two produce conflicting interpretations. Moreover, the more thoroughly these philosophical approaches are applied, the greater appear to be the difficulties.

Because the aim of the ethicist is to 'raise' the ethical values of individuals in business, they are necessarily concerned with the morality of individuals and, in some situations, morality apparently conflicts directly with business. For example, all ethicists attribute value to altruism, i.e. the notion that an individual should do good because it is right or because it has consequences that benefit others, not because the individual will derive any benefit him or herself. In itself this is unexceptionable, but it is the departure point for the academic purist which quickly leads to conflict with the simple, basic tenets of business itself. Stark expressed this simply as follows:

> *"To be ethical as a business because it may increase your profits is to do so for entirely the wrong reason. The ethical business must be ethical because it wants to be ethical."*[45]

Philosophically it is quite clear and understandable, and a great many people in business do in fact behave altruistically with considerable frequency. There is no reason to suppose that business people are naturally inclined to act any less altruistically than philosophers, but they also see themselves as being expected to comply with the economic orthodoxy which requires their maximisation of shareholder value – clearly a head on collision with the business ethics approach.

The suggestion that an act is only ethical if it is done for purely altruistic reasons is incompatible with business, and is where the academic purists cease to claim relevance to business practice. People in business have to make profits if their organisations are to survive. When altruism and profits clash, it is not particularly helpful to practitioners, for philosophers to simply admonish them to be altruistic. Yet this is where moral philosophy leads.

The ethicists' approach leads inexorably to the untenable conclusion that managers cannot be genuinely ethical unless what they do in no way serves their own interests. As Stark succinctly put it: *'ethics has to hurt'*. The various items quoted below all emanate from academic business ethicists. Stark quotes them to highlight the problem, as he sees it, of the increasing uselessness of the orthodox business ethics approach. The main points are paraphrased below:

- The first obligation of every manager is to provide meaningful work for the employees in their organisation.
- If being ethical means cutting into a company's profits then managers should unhesitatingly cut profits, and have no regrets about it.
- Even if it means the company closing down as a result managers must still do only what is ethical.
- The only way an organisation can be ethical is by being wholly altruistic i.e. with no self-interest. The presence of any element of self-interest automatically and inevitable eliminates the possibility of the action or decision being ethical.
- No organisation can be truly ethical unless it has eliminated all forms of external motivation for its employees. (NB by 'external motivation' is meant such orthodox management practices as the exercise of authority or power, the use of incentives or professional modes of leadership). These practices are simply sophisticated forms of coercion and are therefore morally wrong. If organisations cannot be run without resort to these practices then it would be preferable that the organisations did not exist.
- Similarly when 'ethical' behaviour is encouraged by 'external stimuli' e.g. by senior managers providing a model of proper behaviour or provide others with incentives to behave ethically, then the behaviour isn't ethical.
- Capitalism itself is ethically unjustifiable. Socialism may be ethically preferable.

These various statements lead a long way from the world inhabited by business people and are not helpful to those practitioners concerned, for whatever reason, to try and help their organisations to run on an ethical basis.

This is a major difficulty with the application of philosophy to business. Philosophy is about giant intellects grappling with unworldly issues; where things which might appear irrelevant to lesser mortals are accorded huge significance and where what may be commonly regarded as important might be dismissed as utterly trivial. Philosophy seeks to address the truly great questions. It contributes to man's progress in many different fields and underpins pure research of almost every kind. The problem is not with philosophy as such, but whether it is appropriate to this particular project.

As already noted this philosophical business ethics approach is not just in head on collision with the economic orthodoxy, but with business itself. Some economists have sought to bridge the gap, but they face the extreme difficulty that they are unable to accommodate extraneous values within their systems. Economic models cease to work unless they are only fuelled quantitatively and that means by money. Nothing else works in economics. Pareto recognised the utilitarian difficulty and expressed what was referred to as an optimal solution. Pareto optimaility is where an action makes someone better off and no-one worse off. But that fails to avoid the problem of money which is complicated by the obvious fact that a pound is worth more to the poor than it is to the wealthy.

There has been some empirical research seeking to identify how far business practice has been influenced by the business ethics approach. It is true that companies have expressed their adherence to ethical standards and implemented codes of ethical practice with procedures to ensure they are upheld and acted on. But research is problematic, with responses unusually difficult to interpret. Distinctions are difficult between the organisation which has a code and puts a lot of effort into making it effective, the organisation which has a code more or less as an item of window dressing and the organisation which has a code as a deliberate part of the marketing image. Similarly, there are problems with interview surveys with senior executives who are inevitably susceptible to bias, prone to wishful thinking – 'they would say that, wouldn't they!'

The thrust of the business ethics movement has been to achieve results through education and in that field there are some measures of achievement. A number of specialist academic journals now serve the field of business ethics and there are now many textbooks devoted to the subject. An increasing number of professorships and substantial research centres have been established and significant research programmes commenced. There are thousands of degree and diploma courses which include business ethics as a core subject, and many more which offer it as an option at first and higher degree levels as well as post graduate diplomas and most notably including almost all MBA courses. In short, the whole paraphernalia of building academic peer group reputations is active and the area is seen as a potentially fertile field for academics from a variety of different disciplines.

Nevertheless, business ethics remains small scale by comparison with the economic orthodoxy, which still dominates management education. A July 2013 report on business education confirms the orthodoxy still dominates the business school curriculum. As INSEAD professor, Craig Smith put it:

> *'Students come in with a more rounded view of what managers are supposed to do, but when they go out, they think it's all about maximising shareholder value.'*[46]

4.5 Conclusions

The business ethics project seeks to *raise* the ethical values and behaviour of people in business. It is not simply to enlighten and suggest feasible solutions, but seeks also to indoctrinate. Whether ethicists are justified in trying to change the moral values of managers is an interesting question – a moral dilemma in its own right. For ministers of religion this is explicitly their main task, but for management theorists the position is less satisfactory.

Justified or not, these efforts have not so far met with great success, despite building a solid academic position. The contribution of moral philosophy to ethics in modern business, may in due course come to be regarded as a transitional position while the real project was getting established.

The business ethics approach assists the assessment of whether an act is ethical or not, but this is not management's ethical problem. Management's main difficulty in this area is confronting the Friedmanite economic orthodoxy. That is driving business to maximise shareholder wealth and therefore to impoverish all other interests including natural resources and the environment. That orthodoxy necessary has a short term focus, while business management needs to act in the best long term interests of their own organisation, and therefore in the best long term interests of their economy, nation state, planet and humanity itself.

Corporate management across the globe are currently doing the damage. But they are the ones, the only ones, who could first of all stop doing the damage, and then repair it. Steps in that direction are crucial to the establishment of organisational integrity and are the concern of the rest of this book.

5 Interdependence and Business Integrity

Learning Objectives:

To understand the ethical ambiguity of business both from the outside and the inside of the organisation.
To appreciate the results of surveys of business trust and integrity which suggest a continuing erosion of public trust in business and indicate actionable ways of addressing the problem.
To understand the connection between trust and business integrity
To understand how the economic orthodoxy impacts on both trust and integrity.
To understand the increasingly interdependent nature of economies and economic units of all kinds and therefore the overriding importance of trust.
To understand the process of moral development and how it might relate to corporate evolution and the different business types and environments.

5.1 Introduction

The previous chapter examined some of the issues raised by business ethics, the academic subject, and some of its limitations as a practical project related to ethics in business. Ethics in business is what really matters, since every human being is affected by business and, individually or collectively, has some impact on business.

This chapter proposes an alternative approach based more on enlightened self-interest than on philosophical considerations.

The following section examines why ethical performance is important to organisations and in particular to businesses. Subsequent sections outline the organisational integrity model which is intended to help managers define and implement standards of behaviour which are appropriate for their organisations. The model is based on four main foundations:

1. Appreciation of organisation as interdependent partnership.
2. Requirement for integrity between partners.
3. Definition of different levels of integrity.
4. Identification of critical aspects of an organisation's circumstances

A deliberately amoral perspective is taken in defining this model. A conscious effort has been made to avoid using any extraneous value system. The main features of the model are therefore derived, as far as possible from consideration of the business itself.

5.2 Ethical Performance

Business is conceived in the popular imagination as the huge, global, monopolistically inclined, shareholder wealth maximising monsters. That is the format enabled by the economic orthodoxy which argues that market forces will regulate as necessary for the common good, there being little need for external regulation. It is not clear whether this is ill-informed naiveté or cynical opportunism, but the outcome certainly includes the corporate monsters popularly imagined.

Such business entities produce extremes of wealth and poverty, and always have. The young Friedrich Engels, son of a German textiles magnate, who was sent to England in mid nineteenth century for work experience, observed the appalling life experiences in the new industrial towns and the horrendous living and working conditions in the mills, foundries and factories.[47] Excesses at the opposite extreme were exampled by the late nineteenth century American 'robber barons'

Despite business appearing to be more enlightened in the late twentieth century, the first extensive UK survey of business ethics found that company directors still believed firmly in '*the greed-driven motives of the past*'…'*showed little desire to serve the community*', and '*would jettison their principles if they affected their company's profitability*.'[48]

The survey apparently caused surprise that business people had still taken on board so little of the business ethics message and remained solidly 'greed-driven'. External perceptions of business were not much different. A 2014 survey[49] tracked trust in business government, media and non-governmental organisations (NGOs) and overall registered a further 'evaporation of trust'. In developed countries, family owned enterprises were the most trusted with a score of 72%, while big business was distrusted, scoring only 45%. In developing countries the reverse was true. Without going into the detail of the various surveys, it is sufficient for the present purpose to note that levels of trust are declining as levels of inequality increase.

It is, of course, true that if businesses pay too much attention to social responsibilities, they risk losing their competitive way and could end up being unable to fulfil clear responsibilities even to their immediate stakeholders. There is clearly a question of balance to be struck.

But that balance can be achieved. Business can combine both making profits and benefiting mankind. There is a lot common interest in being ethical in business and being profitable. Many businesses focus specifically on ethical business for both business and altruistic reasons. They would cheerfully ignore the moral philosopher who asserted that such a coincidence is impossible because the element of benefit to oneself makes the action necessarily unethical. The coincidence of altruism and self-interest would be better regarded as an ideal rather than impossible.

The one-time chairman of Start-rite, children's shoe manufacturer, was asked which came first in his business: profit or concern for children's foot care? His reply was *'Neither. They work simultaneously. We're a business. We're unashamedly out to make a profit* ***and*** *we're very concerned about the health of children's feet. We run the business on both concerns.'*[50]

The perception that Start-rite actually cared about the health of children's feet was no doubt an important consideration both in their market success and as a value which affects the behaviour of those working in the business. This combination of profit seeking with an element of altruism might be regarded as a form of enlightened self-interest. That had been identified as an effective strategy in the 'Winning Streak' studies of successful British businesses. They identified a surprising degree of *'passion with which our successful companies embraced integrity as an essential part of their culture. This clearly was not window dressing. Each company was convinced that without absolute integrity the business simply could not operate.'*[51]

The Edelman Trust Barometer asserts that trust *'is an asset that institutions must understand and properly build in order to be successful in today's complex world…it's an important factor in driving market acceptance of new business innovations'* Companies looking to build trust in themselves and their innovations, should focus their attention on five particular attributes: integrity, engagement, products and services, purpose and operations and the most important of these is integrity.[52]

The Edelman Trust Barometer found that trust building through integrity and engagement could be actioned through *'having ethical business functions, taking responsibility to address issues or crises, having transparent and open business practices, listening to customer needs and feedback, treating employees well, placing customers ahead of profit and communicating frequently on the state of the business.'*

At the same time many ethical initiatives have emerged which suggest a growing challenge to the FNEBS economic orthodoxy: specific initiatives such as the Soil Association's organic movement, Fair Trade, or any of the other ethical business movements which invite the mass of people to engage. Local authorities and charities invested in various aspects of recycling. Governments and international agencies meet, talk and plan their approach to the environmental issues and some initiatives are started. Progress is still limited by the FNEBS despite the imperatives of sustainability.

The collision between finite earth and maximising man will not long be ignored. Knowledge and understanding of finite earth contradicts the economic orthodoxy on almost every count, and some developments in corporate practice are beginning to confront the orthodox wisdom. Unilever CEO Paul Polman, at the 2014 AGM, announced his company's dedication to a "long term value creation model, which is equitable, which is shared, (and) which is sustainable". Challenged regarding shareholder value, Polman responded "if you don't buy into this…don't put your money in our company…Consumers and retailers want this sort of initiative, and the planet needs it…(it's) the right way to do business."

5.3 Trust and Business Integrity

A business organization is is equally interdependent with its internal stakeholders, its employees, still sometimes anachronistically referred to as labour. The interdependence between a business and its employees is beset with a long history of differences.

The economic orthodoxy directly impacts these relationships, making trust and co-operation more difficult. Management are encouraged to expect employees to be 'shirkers' and 'skivers' rather than 'workers' and 'strivers'. Suspicion and conflict are anticipated, rather than trust and co-operation. Employees are led to expect management would not be wholly transparent and trustworthy in their treatment of employees.

But the reality of interdependence means that co-operation based on trust between stakeholders would benefit all. The establishment of trust between stakeholders in modern organizations had been shown to develop a sense of community and, for example, had encouraged people to work together with less control and obvious hierarchy.[53] In large scale business organizations, hierarchy could to some extent be replaced by trust and its reputation.

In today's organisations, the 'too big to manage' accusation (or defence?) has been made many times in explanation of gross corporate misdemeanours. The organisations involved have become so huge that it is impossible for all their activities to be known about at the centre and therefore cannot be effectively controlled. One prime example was BP's Deepwater Horizon oil spill for which the company agreed to pay $18.6 billion in fines – the largest settlement in US history. 'Too big to manage' is an explanation of one effect of the economic orthodoxy which has demolished most of the competition protections, thus allowing corporations to grow prodigiously through mergers and acquisitions. Heffernan provides an analysis of how and why these many corporate misdemeanours occur.[54]

Jönsson studied the effects of trust on knowledge work. As the value of knowledge work increased and the work itself became more knowledge intensive, so the competence of command and control hierarchies to take decisions over that knowledge work became less feasible and less legitimate unless the decisions were taken in consultation with the relevant knowledge workers.[55]

The development of trust involved being accountable for deviations from the expected performance. So long as those trusted behaved in line with expectations, trust would be reinforced as a result of experience and built progressively over time. It did not need to involve belief in the good character or morality of the other party, merely their conformance to agreed action. The replacement of a command and control approach with a more democratic and communicative approach had to be based on establishing trust between the individuals and groups involved.

What worked for knowledge workers was equally important for all other stakeholders including those broadly categorized as labour. If management appeared to be untrustworthy with one group, that perception of untrustworthiness would quickly leak to other stakeholder groups. Maintaining different levels of trustworthiness with different stakeholder groups was shown not to be feasible. The reputation for trust would sink to the lowest common denominator: in the end, 'the truth will out'.

Every management transaction with other stakeholders either enhanced or damaged stakeholders' perceptions of management's trustworthiness and this became recognized as a crucial aspect of a company's culture. Peters & Waterman found that one of the eight characteristics of their 'excellent' companies was 'hands on, value driven',[56] meaning management in open and regular interaction with other stakeholders governed by the need to develop perceptions of their trustworthiness. This was found to be particularly relevant to the newer forms of more loosely structured organization where the values driven companies outperformed the more traditional ones that had tighter control and more rigid structure.

Managements are not always trustworthy. Drucker highlighted the fact that there was much talk about making people feel their jobs were important, but not enough about making their jobs important; too much of the pretence of 'recognition' rather than real recognition of people's contributions to the organization; much clever technique to make people feel their working lives were meaningful and not enough effort to make their work have meaning. 'Management by walking about' (MBWA) became a recognized prescription. Senior managers were to interact with the workforce by visiting the shop floor or offices where the general staff worked. Not only would it cut through the vertical lines of communication in a hierarchical organization structure but it would also motivate by suggesting that senior management was taking an active interest in the workers. Thus MBWA was a technique to persuade the workers that senior management cared about them despite anything apparent to the contrary.

All such management approaches were shot through with the fundamental ambiguity: is the aim exploitative or genuinely co-operative? Barnard, talking about management's personnel role focused on what he referred to as the 'central consideration' which was the 'development of the individual'. He argued that it was

> *'not merely as a matter of tactics, nor merely or chiefly a matter of industrial efficiency. It will ultimately fail if it is merely a high sounding fiction for stimulating production and good morale. Hypocrisy is fatal in the management of personnel.'*[57]

Barnard accepted that for most managers and management theorists the main purpose of personnel policies was to 'facilitate the working together of groups of people toward definite ends'. But while acknowledging the legitimacy of that aim, it emphasized for him the primacy of the development of the individual, the two aims – group working and individual development – being the entire justification for management in regard to personnel. And the reasons why so little had been achieved in both aims was

> *'the lack of confidence in the sincerity and integrity of management. It is the lack of that confidence…which insidiously thwarts the best efforts that are made in the industrialized world… that discourages the most promising developments. And so the advancement of the interests of all is retarded.'*[58]

The only answer to the apparent ambiguity of management – the *'key role in wealth creation'* – as it operated at the sharp end of the business-labour relationship, was to **be** honest, transparent, consistent and sincere and so earn the trust of all stakeholders. Such managerial integrity was crucial to the advancement of all stakeholder interests.

The integrity of management was promoted by the early American management educators and their sponsors, further shaped by heroic practitioners such as Chester Barnard and Wilfred Brown and promulgated by the likes of Peter Drucker. That management revolution had produced a more informed and enlightened management professional. In economics the 'Keynesian revolution', with the help of the Second World War and its social democratic aftermath, had achieved a more equitable society, and did not challenge the management revolution progression.

The neoclassical, wholly rational and self-interested economic man had remained the fundamental building block of micro-economic theory, but till the 1980s had been one of several strands of economic thinking pursued in business schools and university departments. Economic man denied the concept of integrity as the basis for managerial action, such a qualitative concept not being convertible into monetary quantities it lay beyond the scope of neoclassical modelling. When Friedman's became the singular economic school of thought a new system of governance emerged which made organisation members subservient to one interested party: the shareholder, provider of that particular form of capital.

Devotion to shareholder primacy has tended to shape management itself into the caricature of leadership, described by Sumantra Ghoshal as,

> *'the ruthlessly hard-driving, strictly top-down, command-and-control focused, shareholder-value obsessed, win-at-any-cost business leader.'*[59]

Rebuilding management integrity will require first, the rejection of that Friedmanite view of economics which has become the institutional truth.

5.4 Enlightened Self-interest

If enlightened self-interest is to be a practically workable criterion it needs to be defined with some precision if this is possible. The Start-rite example quoted above is a happy marriage which is the key to strategic success in that particular case, but not many businesses are so based. A more generally applicable model is required, one that might ideally be applicable to Polman's Unilever or even to BP.

Ethical content in social organisations such as businesses, is only of significance in transactions, i.e. in actions or decisions involving other parties. The notion that a business might sin in thought is not very useful; what matters is what the business actually does and how it actually affects the other parties to the transaction. Business people might consider whether or not to carry out an unethical transaction, but what matters is what the business actually does as a result. Considering unethical behaviour is only to be deprecated inasmuch as it increases the probability of unethical action.

A generally applicable model of enlightened self-interest must therefore focus on the various transactions the business has. These have been modelled in various ways, notably by using games theory. A widely quoted examination of this approach was carried out by Robert Axelrod.[60]

Axelrod begins his games theory analysis using the prisoners' dilemma model. In this situation, two prisoners are correctly accused of a crime and the jailers so arrange the payoffs to encourage each prisoner to confess. If neither prisoner confesses, both are given fairly short jail sentences of, say, one year. If one prisoner confesses while the other remains silent, the first goes free while the other receives a long sentence of, say, ten years. If both prisoners confess, both get a heavy sentence, but with time off for good behaviour – say, five years. Neither prisoner knows what the other is going to do.

Clearly, each player does better by confessing than by remaining silent. If one confesses and his partner doesn't, he is freed immediately. If both confess, they each get five years instead of ten. So the question is, why would either remain silent? How is it, when the two are unable to communicate and collude, that co-operation could ever get started?

The answer lies in repeated play. Prior to Axelrod, it had been noted that the tendency to co-operate in prisoners' dilemma games increased dramatically whenever a player was paired repeatedly with the same partner. In this situation a tit-for-tat strategy emerged: co-operate on the first move, then follow suit on all subsequent moves; co-operate when your partner co-operates, defect if they defect, at least until the end of the game is in sight.

The tit-for-tat strategy is one of co-operation in the first period and from then on mimics the rival's action from the previous period. In effect it is a game theory expression of the old testament injunction 'an eye for an eye, a tooth for a tooth', or do unto others as they have done onto you.

"Tit-for-tat embodies four principles that should be evident in any effective strategy: clarity, niceness, provocability, and forgivingness. Tit-for-tat is as clear and simple as you can get. It is nice in that it never initiates cheating. It is provocable, that is, it never lets cheating go unpunished. And it is forgiving, because it does not hold a grudge for too long and is willing to restore co-operation.[61]

Axelrod showed that players adopting the tit-for-tat strategy would seek each other out and go on to accumulate higher scores than other players who adopted more short term strategies of defection. This conclusion was repeated again and again both in computer tournament results and from computer simulations as well as being paralleled in biological systems.

Axelrod's model is widely applicable. Businesses really do co-operate in many different ways with all the different agencies with which they transact. For example, they extend each other reciprocal credit so long as their business relationship is expected to continue. However, if liquidation of one of the parties looms, then co-operation will be terminated, no matter how long the history of previous cooperation. The assumed continuity of the relationship is crucial to its viability.

However, there are several theoretical objections which can be raised against this game theoretical approach. Rather than getting side tracked into a turgid academic discussion a simple alternative is proposed. This model, expounded by Gauthier[62] no doubt also has problems, but it also has the great benefit of simplicity and also of simple outcomes, while at the same time retaining most of the essential characteristics.

The model involves individuals interacting with each other, each having their own 'schedule of preferences or values that relate to the various possible outcomes that can be brought about by their actions'. Importantly for the present purpose, they do not need to subscribe to any particular view of morality, whether religious or philosophical – in fact it is assumed that different persons will have different values and different preferences. It is also implicitly assumed at the outset that persons are at no higher than Kohlberg's pre-conventional level of moral development (see section starting on page 98). They have an egocentric, utterly self-interested point of view, as per neoclassical economic man assumptions. The model also assumes that we live in circumstances of variable scarcity and adopts the idea of society being a co-operative venture for mutual advantage.

Gauthier's simple example involves two neighbouring farmers, one with a crop ready for harvesting immediately and one shortly. If they work alone to harvest their crops it will take 20 hours each; if they work together on each other's crops it will take 25% less time. Co-operation would clearly be of mutual advantage. However, when the first farmer's crops are harvested, he would then have no incentive to help his neighbour. This assumes he would be acting rationally as a short term profit maximiser with no particular view of morality. However, if the transaction was part of an ongoing relationship, the situation would obviously be different. If the farmers were to be in the same position the following year, then long term profit maximising would require co-operation. The difference in timescale, implied by whether or not the transaction was a one-off or part of a stream of such transactions, makes the crucial difference.

If the first farmer was going to retire before next year's harvest he would have no incentive to co-operate beyond his own harvest. However, if the second farmer knew of the impending retirement he would have no reason to co-operate in the first place. Under these circumstances a contract would be required to which both farmers would adhere. A legal contract might be impractical and expensive, but an informal agreement to which both farmers were committed with each knowing the other was also committed, i.e. on a basis of trust, would work very well.

However, unless each person in the transaction of mutual advantage believed the other person in the transaction had internalised the principle of trust, they would not enter into the transaction with that person. Thus, people who are not believed to have internalised the principle of trust would be excluded from transactions of mutual advantage. As Gauthier suggests,

> "*we understand the role of ethical principles as principles which constrain what would otherwise be the rational pattern of decision making in ways that enable persons to reach mutually advantageous outcomes, overcoming the temptation to "free-ride" when such behaviour would on the face of it prove profitable to the individual concerned*."[63]

The idea of exclusion from transactions of mutual advantage if the principle of trust were absent is both powerful and increasingly applicable in today's international or globalised and increasingly technological business world.

Gauthier's model has clear similarities with the games theory model, many examples of which were examined by Dixit and Nalebuff who emphasise the importance of the ongoing relationship:

> "*There is no solution that achieves reciprocal co-operation in a one-time game. Only in an ongoing relationship is there an ability to punish, and thus a stick to motivate, co-operation. A collapse of co-operation carries an automatic cost in the form of a loss of future profits. If this cost is large enough, cheating will be deterred and co-operation sustained.*"[64]

There are some exceptions to this general rule, for example, if the ongoing relationship has some natural end, such as when one of Gauthier's farmers retires. Co-operation then breaks down in the final transaction. Since both parties can predict break-down in the final transaction, they will not be prepared to co-operate in the penultimate transaction either. Logically, it would be expected therefore that ongoing relationships which have some natural termination would not be conducted on the basis of co-operation in the first place. As Dixit and Nalebuff point out, the real world is characterised by episodes of successful co-operation. This could be explained by the existence of some "nice" people who will co-operate despite the apparent material advantages of cheating. "Nice" people are those who have internalised the principle of trust, but as Dixit and Nalebuff point out (not to mention Groucho Marx) credibility of 'niceness' is crucial. Without credibility, trust will not be perceived and co-operative transactions will not be entered into.

> "*Establishing credibility in the strategic sense means that you are expected to carry out your unconditional moves, keep your promises and make good on your threats. Credibility must be earned.*"[65]

These models suggest that, in a strategic time frame (i.e. in an ongoing relationship), the internalisation of the principle of trust leads to engagement in co-operative transactions (from which otherwise the actor would be excluded) of mutual advantage and thereby, it is suggested, to an increase in long term profitability above the level which would be achieved by short run profit maximising behaviour.

The old City motto 'my word is my bond' was based on nothing more than this. Rees-Mogg bemoaned the demise of 'old City standards'.

> *"There is no incentive to good conduct stronger than stability. If you have been doing profitable business with the same man for 25 years and hope to do it for another 25; if your house has done business with his house for 150 years and hopes to do it for another 150, there is no smart short term gain which can possibly be worth the long term loss to the relationship."*[66]

Interestingly, recognition of the need to internalise the principle of trust also implicitly suggests moral development has reached Kohlberg's conventional level where right is done because of the need to be a 'good person' in the eyes of both yourself and those of others and to recognise the other person's point of view (see Table 4.1).

Concern for ongoing relationships between autonomous units is particularly relevant to contemporary business which is increasingly based on technological collaborations and other strategic alliances among networks of specialist organisations. Moreover, this focus on ongoing relationships is also highly pertinent to the fast moving deconstructed team-based organisational forms which, with the help of computers and information technology, are now replacing the hierarchies and mechanistic monoliths of the past. The next two sections examine these contemporary external and internal developments which seem to further emphasise the importance of the principle of trust.

5.5 Collaborations, Alliances, Networks and Teams

The twin thrusts of rapid technological development and the globalisation of markets are together threatening the viability of the autonomous business unit. Firms are having to form collaborations and alliances with other units in order to remain competitive. The basic motivation for collaborating with other businesses is to 'gain additional access to new competencies, to markets, to technology or to specific resources in order to sustain its competitive advantage'[67] which sets the business apart and makes it distinctive in some way.

The rapid rate of technological development and its equally rapid rate of adoption across the globe make it essential that all businesses, large and small, take a global view. Even a localised business, with no global pretensions itself, must take full account of global developments in markets and technologies potentially relevant to its products and customers. This global awareness is essential to the maintenance of technological position.

No longer can firms ignore technological change, wherever it occurs, because its diffusion is comprehensive and affects all industry and society. Neither is it any longer feasible for an individual firm to remain at the forefront of all the technological developments impacting a particular sector. The technologies are diverse, but their impact is general. Thus there is an urgent need to collaborate with other organisations in order to maintain and extend the firm's own distinctive competence.

The ever increasing scale of investment required by advancing technology means that there must be a rapid exploitation of that technology in order for it to be profitably exploited. The required speed of exploitation means that the fruits of technology must be sold to ever larger markets, ultimately to the whole world. The assiduous pursuit of a global market results inevitably in convergence of consumer tastes[68] and changes in the global environment arise directly from global technology development.[69] Previously the cultural differences between, say, Japan and Britain, meant that it would be difficult to envisage the same consumer product succeeding equally in both markets. But tastes for many technically advanced consumer durables clearly now coincide and the same product can be marketed effectively in both London and Tokyo.

The globalisation process appears irrevocable, globalisation of technology both facilitating and requiring globalisation of markets at an ever increasing rate. Thus firms are tending to become ever more expert in ever more tightly defined technologies. In order to maintain this rapidly developing expertise, they need to focus all their efforts on the core technologies. They therefore find it both necessary and profitable to buy in those technologies which they have not defined as core to their own business. The notion of focusing on core competences and outsourcing all others, has developed as one of the strategic imperatives for survival in an era of rapid innovation.

The approach is simple: Concentrate resources on those components that are critical to the product and that the company is distinctively good at making, but outsource non-core components to external suppliers. Such outsourcing enables effective concentration on the core and achieving leading edge competence. Reliance on external organisations for non-core, though nevertheless essential, elements in the business process results in the establishment of various forms of strategic alliance.

Such collaborations are not restricted to friendly supplier-customer relationships or the essentially unthreatening industry-academe transactions. Fierce competitors may be forced to collaborate for their future survival and prosperity, as did Cannon with Xerox. Komatsu and Caterpillar, motivated by the need to acquire key technological competence. This is perhaps the most powerful motivation of all.

Lei reviewed several multi-national based strategic alliance systems.[70] Eight American firms in the semiconductor industry having twenty five such alliances with mainly Pacific Rim firms to achieve a variety of aims. Lei's examination of AT&T revealed alliances with seventeen autonomous, mainly foreign firms, some aimed at learning new core technologies, some at penetrating new markets, some at a combination of both. A similar examination of IBM's alliance strategy revealed no less than forty such strategic alliances.

It is worth re-emphasising that these are all genuinely strategic alliances, not simple one off transactions. They are planned to last for a considerable time and in many cases may be regarded as indefinitely ongoing. As such they all meet Gauthier's essential criterion. Each party to these strategic alliances must necessarily therefore be able to demonstrate their having internalised the principle of trust, otherwise they would have been excluded from such mutually advantageous collaborations, left only to participate in those where the gains were strictly short term.

Just as globalisation impacts all businesses, great and small, so does the need to establish long lasting alliances. It is advantageous for the major multi-national firms to collaborate, but it is crucial for the minnows to do likewise and forge relationships which help them leverage up their meagre resources. Only in this way can they hope to maintain any shred of even localised leadership in their core technologies.

Globalisation and rapid technological change are the dual pressures forcing firms to establish long lasting relationships in order to achieve two objectives. The first is to concentrate all their resources, efforts and enthusiasm on their core competences. Only by such concentration will they achieve leadership and superior economic results. This is done by deliberately buying-in the non-core competences – in practice one of the most difficult of strategic decisions to implement. The second is to replicate the speed and flexibility of small organisations so that they can be innovative and ensure that their leadership positions are maintained despite a rapidly changing environment. This is done by managing through networks and teams rather than through hierarchies and functions.

A curious effect of the Friedmanite economic orthodoxy is that, while cartels and corporate conspiracies to fix prices have remained illegal, the protection of competitive markets has been largely dismantled. Consequently, companies can engage in mergers and acquisitions which result in huge corporate entities, rather than cartel alliances. Those huge corporates have the power to set prices, rather than illegally agree them with co-conspirators. Most mature markets today are dominated by a big three or four or six players who in effect fix the prices that apply in their industry.

Being big is not all good news for the companies concerned. The downside of such scale is the problem of management – too big to manage is the populist explanation when things go wrong. A growing number of large multinationals, which stripped back to their core businesses and focusing on their key technologies, are managed increasingly like a collection of small businesses – but with the difference that they also share various degrees of management skills, research, design, development and purchasing, as well as aspects of distribution and service. Bigness can certainly bring benefits.

The key to achieving these benefits is to exercise the optimum degree of co-ordination and integration: too little and the benefits do not accrue, too much and all the dysfunctions of large scale bureaucracy will be experienced.

The study of management was originally very much concerned with large scale organisations, employing large numbers of semi-skilled and unskilled labour. This was the focus of classical management, principles of which were defined by Henri Fayol whose practical experience had been gained heading up the French mining industry at the end of the nineteenth century. Taylor added 'scientific' methods to management, based on his study of work, and in no small way facilitated the establishment of mass production methods first achieved by Ford and on which much of the world's industrial wealth was based. These huge organisations, employing masses of labour performing standardised tasks to produce standardised products were the dominant industrial form of organisation through the last century.

The change, as mass labour was progressively replaced by machines and as the old 'smoke stack' industries were replaced by new knowledge based industries, was examined early on by Burns & Stalker who described two organisational categories: mechanistic and organismic.[71] Their contribution is worth a brief examination here since their categories remain important to the debate about contemporary organisational forms.

Burns and Stalker studied the attempts to implant the fledgling electronics industry in parts of Scotland which had only previously experienced the old heavy industries of coal, steel and ship-building. The job of management in these older industries was broken down into specialist functions, each with its precisely defined task. There was a clear hierarchy of control, with the reins firmly held at the top. Communications flowed down the line and occasionally back up, but rarely across the organisation. The result of this bureaucratic system was that individuals in the organisation were not committed to its fundamental business aims, only to obeying the rules and fulfilling their (strictly limited) employment contract and enjoying whatever perks such a regime might offer. This 'mechanistic' system was ill-suited to handling change and innovation.

The clear definition of 'the job' and the simple set of bureaucratic relationships, broke down when conditions changed. New situations did not exactly match the traditional frontiers of responsibility. The individual no longer knew just what instructions were needed or where to seek them; they had to consult with, rather than merely give orders to subordinates.

The organismic organisation was at the opposite end of the spectrum. It lacked rigid structure, lived by a process of continual adaptation, often involving the redefinition of individual tasks. Communications occurred in any direction as might be required at any particular time, and the commitment of employees was open ended and generally dedicated to the achievement of organisational aims. As one might expect, organismic systems were well suited to handling the new and unfamiliar: they were highly effective innovators.

In a static world the mechanistic system might still work, but clearly, the organismic system, or some modern form of it, will be much more appropriate to a rapidly changing business world.

The elimination of mass unskilled and semi-skilled labour has largely removed, for good or ill, the problem of bigness in terms of numbers employed. This does not mean that companies do not employ large numbers, but individual units no longer have to manage mass low skilled labour which is almost inevitably alienated by the meaningless nature of their work.

A widely quoted exemplar of the modern organisation form is ABB of Zurich. ABB is a big company in any terms. It employs around 140,000 people, has an annual R&D spend of around $1.5 billion driven by its 8500 technologists in its five divisions and seven research centres. ABB operates a multiplicity of semi-autonomous subsidiary units. Potentially this organisational form could achieve an ideal balance between the benefits of scale and the advantages of being small. The force of ABB's anti-bureaucratic style can be read on the company's website which quotes CEO Ulrich Spiesshofer as declaring "a culture of integrity is a prerequisite for a world class business – ABB is committed to fostering a culture where integrity is woven into the fabric of everything we do," and ABB's Chief Integrity Officer Hanna van der Put says "It's not about rules. But about developing and working with integrity. Integrity is about behaviour."

Drucker suggested that the key economic resource is no longer labour, capital or land, but knowledge; the central wealth creating activity is no longer the allocation of capital and labour to production processes but the allocation of knowledge to productivity and innovation; the key groups in this 'post-capitalist' society are the knowledge workers who know how to allocate their knowledge to this productive use.

Various models of this new organismic organisational form have been established. One example is WL Gore and Associates, maker of Gore-Tex fabric plus thousands of advanced technology products for electronics, fabrics, industrial and medical markets. Gore is a private company co-owned by the Gore family and the employees, with sales revenue around $2.5 billion and employing more than 8,500 people in nearly 50 facilities world-wide.

> *"There are no titles or conventional lines of command at Gore, where the only way of becoming a leader is to attract followers – if a project can't attract people to work on it, then it doesn't get done."* [72]

In 2009, Gore was ranked 30 in Fast Company magazine's "Fast 50" list of the world's most innovative companies. 2010 was the 13th year in a row that Gore was listed by Fortune magazine as One of the 100 Best Companies to Work For in the United States. For several years its overseas units have had similar recognition in Germany, France and Italy, while its British plants in Livingston and Dundee headed the Sunday Times 'Best Companies to Work For' list four years in a row.

A team of associates is widely held to be the most effective organisational form for today's knowledge processing, learning organisation. This is a stage further than organismic organisation. The replacement of hierarchy with teams and of mechanistic structures with networks is increasing, following the examples of Gore and ABB. Very large organisation can be highly effective in minimising hierarchy, using a team based structure with strong networks throughout the firm to exploit the advantages of scale.

Team based organisation facilitates the individual knowledge workers contributions. The permanent organisation form is an arrangement of networks of teams of associates which may take many different forms. Networks may be internal, connecting individuals and departments which have no other formal organisational links. They may have a physical form, as with electronic networks, operating as important aids to communications. Or they may be external, connecting the organisation with its existing and potential customers, competitors, and technology suppliers, or other external system e.g. financial markets. The science park concept derives its strength from networking. Silicon Valley is not just a geographical area, but a network.

Networks are systems of communications links which overlay the formal organisation and increasingly are replacing it. They may be informal and be activated only irregularly, but they are persistent and, most important of all, they are clearly purposive.

External communications, i.e. networks involving customers and technology suppliers, both existing and potential, as well as other networks concerned with competitors though not necessarily involving them directly, are crucial to the achievement of an effective business. Without such networks, the firm's strategy will be based on an inadequate understanding of customer needs, a lack of knowledge about technological developments and an ill-formed view about competitive strengths and weaknesses.

Networks are set up directly with the sources of primary information such as customers, suppliers, technology suppliers, or less directly related experts who may be useful in providing strategically relevant information in one field or another. As the speed of technological development increases and markets become more global, so the inadequacies of the individual organisation are exposed and the networks become more important, to the extent that they may take over parts of the organisation where their expertise gives them an advantage.

Networks and teams and collaborations and alliances are all part of the same process: the deconstruction of the purpose built modern organisation of the mass production era to the fragmented post-modern organisational form of today and tomorrow.

Organisations and managers are now utterly dependent on the voluntary but ongoing relationships between autonomous parties from which both draw mutual benefit. Exclusion from such ongoing relationships would prove crucial, as it would for Gauthier's farmers, whether the exclusion was from an external collaboration intended to assist the acquisition of technological competences, or whether it was internal in the form of being unable to recruit and retain the right technologically specialist knowledge workers.

More than ever before businesses must be able to engage in such relationships and so must establish the principle of trust.

5.6 Moral Development

The model of interdependence between enlightened but self-interested partners needs to be firmly based on an understanding of the modern fragmented business organisation. The model also needs to incorporate the means for potential partners to understand how trustworthiness will be perceived for different organisations in different situations.

Business organisations behave at different levels of 'moral development' according to their culture, history and circumstances, as outlined in the following chapter. It is therefore worth examining Lawrence Kohlberg's original application to individuals in rather more detail to appreciate the relevance to organisations.

Kohlberg identified the pre-conventional level of moral development as the level of most children under age 9, some adolescents, and many adolescent and adult criminal offenders. The conventional level was the level of most adolescents and adults in modern society. The post-conventional level was reached by a minority of adults and usually only after the age of 20–25. The term *conventional* does not mean that individuals at this level are unable to distinguish between morality and social convention but rather that morality consists of socially shared systems of moral rules, roles, and norms. Individuals at the pre-conventional level have not yet come to really understand and uphold socially shared moral norms and expectations. Those at the post-conventional level understand and generally accept society's rules, but acceptance of society's rules is based on formulating and accepting the general moral principles that underlie these rules. These principles in some cases come into conflict with society's rules, in which case the post-conventional individual judges by principle rather than by convention.

> *One way of understanding the three levels is to think of them as three different types of relationships between the self and society's moral rules and expectations. From this point of view, Level I (pre-conventional) is a perspective from which rules and social expectations are something external to the self; in the Level 2 perspective the self is identified with or has internalised the rules and expectations of others, especially those of authorities; and the Level 3 (post-conventional) perspective differentiates the self from the rules and expectations of others and defines moral values in terms of self-chosen principles.*[73]

These levels and stages were identified in long term research studies of individuals and groups of individuals examining their responses to basic ethical questions as they change over the years. A number of these longitudinal studies are reported in Colby & Kohlberg and some examples are quoted below in order to further illustrate the meaning of the different stages and levels.

One of the questions asked in Kohlberg's longitudinal study was *"Why shouldn't you steal from a store?"* One of the respondents at age 10 gave the following pre-conventional level response:

"It's not good to steal from the store. It's against the law. Someone could see you and call the police."

This is a response from a clearly egocentric socio-moral perspective.

Seven years later the same respondent answered the same question as follows:

> *"It's a matter of law. It's one of our rules that we're trying to help protect everyone, protect property, not just to protect a store. It's something that's needed in our society. If we didn't have these laws, people would steal, they wouldn't have to work for a living and our whole society would get out of kilter."*

This is a conventional level answer where the respondent is clearly concerned with the good of society with which he clearly identifies strongly.

A further seven years later, the same respondent, now 24, gives a clearly post-conventional or principles based response:

> *"Why shouldn't someone steal from a store?"*
>
> *"It's violating another person's rights, in this case to property."*
>
> *"Does the law enter in?"*
>
> *"Well, the law in most cases is based on what is morally right so it's not a separate subject, it's a consideration."*
>
> *"What does morality, or morally right, mean to you?"*
>
> *"Recognising the rights of other individuals, first to life and then to do as he pleases as long as it doesn't interfere with somebody else's rights."*

How does this approach relate to business? From Kohlberg's opening assumptions it is clear that we must understand the general socio-moral business perspective as it is perceived by people in business. The opening chapters aimed to assist this process: in some aspects, business is deliberately set up and managed at the margin of ethical acceptability. Moreover, the Friedmanite economic orthodoxy reinforces the idea that business management should operate at the pre-conventional level, seeking to maximise shareholder wealth constrained only by the requirement to keep within the law. Economic orthodoxy aside, business should seek to maximise its technical efficiency, necessarily measured in terms of profitability, and in order to compete has to operate at the margin of ethical acceptability. However, the margin is indistinct – the clear definition of what is acceptable, and what is not, is yet to be made, despite the efforts of the business ethicists. The economic orthodoxy makes it understandable that the margin should be overstepped and even justifies it since it is management's duty to work in the best short term interests of the single stakeholder.

Setting economic orthodoxy on one side, most businesses, most of the time might be expected to operate at Kohlberg's conventional level at which something is considered to be wrong because it is generally considered wrong. They would behave in a such a way that they would be perceived as generally trustworthy and suitable partners for their stakeholders. Such organisations could be defined as exhibiting the conventional level of integrity.

To attempt to raise such organisations to the post-conventional level, which is the project of most business ethicists, seems doomed to fail. The alternative approach is to accept that an act is sufficiently ethical if it is generally accepted as being ethical. If an act has to be worked through in detail, using the tools and frameworks of moral philosophy, to assess whether or not it is ethical, it probably doesn't matter from the business point of view.

Perhaps it is not important if people in business are not interested in being any more precisely ethical than that. Using normative moral philosophy to assess whether or not an act is ethical is in any case a fruitless exercise only resulting in alternative views. This alternative approach recognises the realities of a conventional level and accepts that different business organisations operate at different levels at different times and in different situations in order to be most effective in achieving their organisational aims. The role of management then is to set up those structures and processes within the organisation which would result in them behaving at the level of integrity at which they would be most effective. It is not a question of what actions would be ethical in a particular circumstance, but what businesses should do to achieve the required level of integrity.

An essential first step would be for business to set aside the orthodox economic argument that they exist to maximise short term shareholder wealth. Some businesses have acted unilaterally on this, but for most it will be necessary to make that change collectively.

5.7 Conclusion

The application of orthodox moral philosophy to business is at least problematic. Thus the model of enlightened self-interest proposed here may be more pertinent. The first step is to recognise the interdependence of business organisations with their various stakeholders, both external and internal and therefore the importance of being seen as worthy of trust.

The model of co-operative business behaviour requires businesses to establish their credibility as having internalised the principle of trust. It is this apparent trustworthiness which makes individuals and organisations attractive partners in mutually advantageous co-operative arrangements. Such collaborations and alliances are increasingly crucial to the strategic success of modern business.

Similar criteria also apply within the modern business organisation. The monolithic hierarchies which enabled mass employers to be mass producers of standardised products have limited relevance to the contemporary business. If organisations are to be effective knowledge processors they must adopt flexible, fragmented, network and team-based organisational forms which can relate people and initiatives and encourage their unlimited contributions. Such organisational forms cannot rely on orders down the line, but require the principle of trust to be recognised among equals.

The boundary between the networks and teams within an organisation and its external collaborations and alliances is becoming increasingly blurred. The contemporary business is based on layers of relationships, internal and external, which will only continue on the basis of trust. It is therefore vital to know how such trust can be achieved.

One way of assessing this is to establish at which of Kolberg's stages of moral development does business need to be in order to demonstrate that it has internalised the principle of trust. The credibility of this integrity is vital if firms are to be invited into the mutually advantageous relationships, its reality is crucial to their continuity. Acceptance of the dominant economic orthodoxy is destructive of such credibility.

To follow this Kolbergian approach it will be necessary to fully understand the moral judgements that business people are likely to make, i.e. to understand their socio-moral perspective. This is best done by examining the long term aims of business and taking a view on how these might complement or conflict with ethical criteria. This is the subject matter of the following chapter.

6 Business Perspectives

Learning Objectives:

To understand the business perspective and how it contrasts with the ethicists' perspective and the importance of the time horizon being considered and therefore of strategic considerations.
To understand the role and formulation of business strategy and business objectives from short term survival to long term mission.
To understand how the importance of business integrity increases as the relevant time horizon lengthens.

6.1 Introduction

Integrity can only be understood in context. If a patron of the RSPCA was attacked by a pack of hungry hyenas it would be understandable if he or she, at least temporarily, accorded animal rights a fairly low priority. The perspective of the subject is crucial. To understand organisational integrity, it is important to understand the organisation's perspective.

The aim of this chapter is to examine the perspective of people in business so that their moral judgements can be better understood. The approach is intended to be, as far as possible, values free – i.e. not based on any extraneous value system, but having regard only to the best interests of the businesses and organisations themselves. It is recognised that, in today's harsh and competitive environment, businesses must focus on business aims to ensure they are successful in business terms. Social responsibility is a side issue – it is not a primary role of business to put funds on one side to, for example, help the urban poor.

Business ethicists may suggest that always putting profit first is not somehow 'good'. More than this, they may suggest that businesses should deliberately undertake non-business related expenses, whether it is employing more people than is strictly necessary, or perhaps contributing to the welfare of the local community in some way. Ethicists would have social responsibility added to the list of management tasks. They do not envisage social responsibility as a pre-conventional level phenomenon – i.e. something which should be done because it's the law and if it is ignored, you will be found out and punished. Rather social responsibility refers to something over and beyond what is legally necessary, which managers have a responsibility to ensure that their businesses voluntarily undertake to achieve a level of business integrity.

Clearly, there is a clash between two different cultures. Looked at from the perspective of the business, investments in social responsibility are essentially wasteful. They go against everything that the professional business manager has learned and experienced from the time the business was first set up. Suggesting that such investments should nevertheless be made, because of an unanswerable Kantian argument is not very convincing from the business perspective.

These opposing arguments, from the business and ethicist viewpoints, appear irreconcilable. Understanding the different perspectives is the only possible way to achieving any resolution.

Gauthier and the games theorists showed that short term profit maximising leads to long term failure and that a more appropriate version of the business perspective would be one which takes account of the need to engage in ongoing relationships, rather than simply one-off transactions, i.e. they suggest a strategic perspective.

This is not to deny that businesses based on one-off transactions exist, nor that short term profit maximisers can make a quick killing. Nor that those perspectives are actually encouraged by the economic orthodoxy. The wild-west snake-oil peddler coming into the frontier township on the wagon train selling his patent medicine, knowing that tomorrow he will be on his way again, certainly has his modern counterpart. Why should he be honest and admit the medicine will cure nothing? The only reasons you might trust him is because he is a man you know to be of deep religious or other philosophical conviction, or because you know he'll be by again next week and need to sell some more. Otherwise you would be prudent to assume he is in business for a swift buck.

Most businesses are intended to last and to have some substance and be able to recruit and retain high calibre professional specialists and managers and enter into long term relationships with other organisations. We need to understand this strategic perspective of such businesses if we are to be able to understand the level of integrity at which they will be most effective.

6.2 Business Strategy

Strategy is concerned with long term prosperity, long term asset growth, not short term profit. Focusing on short term profitability as required by neoclassical economics, to the exclusion of strategic considerations, leads organisations to make short term opportunistic decisions. These may be financially rational in themselves and appropriate for a hedge fund style operation which has no strategic direction other than to make quick profit. But for a business in the real economy (i.e. extraction, manufacturing, distribution and non-financial services) it lacks coherence and consistency and would lead to the business becoming widely diversified, highly complex and in the end unmanageable.

Businesses need a coherent strategy in order to ensure that resources are allocated in the most effective way. This is particularly important when it comes to major resource allocation decisions such as large capital expenditures, disposals or divestments and all forms of diversification, including acquisitions. When such major decisions arise, consideration of the strategic issues involved is more or less unavoidable. Such decisions themselves serve to clarify strategic thinking and overtly planned strategy usually focuses on these major resource allocations. However resources are also allocated by a thousand and one minuscule decisions, mainly taken by default, every day by every organisation member. Cumulatively these decisions may be far more important than the occasional one off large scale investment. The important question is whether all these thousands of mini 'strategic' decisions get taken in a way which reinforces the organisation's strategy, or they get taken more or less randomly with regard to strategy.

So it is important to be specific about what strategy means. The strategist's role is often conceived in terms of the corporate navigator and the strategic plan as the charts by which direction is set and progress measured. This is perhaps the most commonly used analogy. We wouldn't leave London along the Edgware Road in a random attempt to get Canterbury.

Thus, the familiar idea underlying the cyclical strategy process:

> "Where are we now?
> Where do we want to get to?
> How can we get there?
> Start moving,
> How are we doing?"

The directional idea is far from being the whole story, but it is nevertheless surely crucial. Once the direction is set, it becomes possible to take decisions in a consistent manner with regard to strategy. Only when direction is set is it possible for all members of the business to know which way they are headed, and only then can they shape their own efforts accordingly. With no direction, members may well allocate their efforts and enthusiasm in random and conflicting directions and investments be made similarly.

Setting direction sounds simple, but is difficult to achieve in practice. The main difficulty is that it requires management continually to reject other courses of action – products, markets, technologies etc – which in themselves look perfectly sensible, profitable strategies. It requires determination and commitment on the part of management, to overcome the natural processes which result in a thin spread of resources across a wide front. It requires that management reject an apparently natural attitude to risk, the risk of putting all your eggs in one basket. They require courage to overrule the almost inevitable resource allocations suggested by orthodox accounting and administrative processes which otherwise control the business.

Setting direction and concentrating all efforts on it is the key purpose of strategy. Drucker and others have continuously highlighted the power of concentration as the key to real economic results.

Managers must concentrate their efforts on the smallest number of products, product lines, services, customers, markets etc. Such statements have continuously highlighted the power of concentration and the need for strategic focus.

Concentration applies both to the small number of large scale capital investments, and also to the million and one mini-decisions about apparently unimportant jobs and work priorities, that are taken every day by people at every level in an organisation. The strategic importance of the big decisions is difficult to ignore, but the cumulative weight of the mini decisions is less frequently recognised as being truly strategic and, as a consequence, in most firms they are taken pragmatically with little regard to strategy and receive little attention unless catastrophe threatens.

Concentration seems to be one of those concepts about which there is a high degree of consensus, but with only few exceptions, businesses continually fail to put it into practice. The 80:20 rule is a monument to the failure to concentrate. Resources tend to get misallocated and spread thinly across all activities, products, customers etc. No other principle of effectiveness is violated as constantly as the basic principle of concentration.

The reasons for lack of concentration are various. The most difficult aspect of concentration is the very positive management decision not to do things. If there is known market, which a business could satisfy using existing competences and which looks highly profitable, then why not go for it? Very few managers would be able to mount a very persuasive argument and even fewer would be prepared to stand by it and insist the opportunity is passed up, just in order to stay focused.

This is one of the most difficult of all managerial decisions. The reason for the diffuiculty is the requirement for a clear strategic direction. Without clear direction there can be no concentration simply because there will be no agreement as to what to concentrate on. Most organisations do not have simply stated, unifying strategic objectives such as 'the most powerful computer in the world'. Few businesses really understand what their particular specialism is. Most formally stated strategies are not simple, but reflect the complex world in which the business operates. As a consequence strategy statements often appear to convey conflicting messages and strategic managements seem reluctant to acknowledge the simplicity of effective strategic concepts.

Concentration remains one of the key determinants of business success, but with no direction there can be no concentration.

A third main purpose of strategy is to provide consistency. All that has been said of concentration applies to consistency. Consistency is simply concentration over time. Like concentration it applies to the big one off investment decisions and it applies to the myriad mini-strategic decisions which determine how an individual's time, effort and enthusiasm will be allocated.

Without consistency the organisation will continually change direction, flitting like a butterfly from one project to another, developing no critical mass of expertise or even proficiency let alone any form of leadership position.

Direction, concentration and consistency, extremely simple ideas in themselves, are the essence of strategy. An appropriate direction on which resources are consistently concentrated is the key to long term prosperity. It can lead to the establishment of a leadership position, based on a continually developing body of knowledge, skill and expertise which generates real economic results.

The successful behaviour patterns which are regularly reinforced, the successfully established position and effective culture of the organisation gradually become more deeply imprinted on organisation members and more rigid and automatic. Individual members become expert and make heavy personal and psychological investments in their expertise and the organisation as a whole accumulates substantial investment in, and commitment to, the existing and successful technology, customers, competitive positions and ways of doing things. The successful strategy has a built in obsolescence and will tend gradually to blinker the organisation and render it less capable of noticing, let alone creating, change.

Drucker pointed out in his classic 1964 *Managing for Results 'any leadership position is transitory and likely to be short-lived'*. If it was true in 1964 it is far more so in the 21st century, and the need to be flexible and responsive to these changes is more vital than ever before.

Strategy needs to set direction, concentrate effort and provide consistency, but at the same time, it needs also to ensure organisational flexibility. The concepts of direction, concentration and consistency are simple, perhaps too simple, but flexibility is rather more complex. A flexible strategy may be almost a contradiction in terms, yet this is the other main purpose of strategy.

Direction, concentration, consistency and flexibility do not arise from any natural process but require determined management action for their achievement. That management action needs to engage every business activity and all the people in a business, to ensure those four concepts apply to every part and action of the business, to products, to markets, customers and technologies, and the way it serves these various dimensions and develops its own business character as an innovator and communicator. Maintenance of strategic focus (i.e. direction, concentration, consistency and flexibility) is critically affected by the level of corporate integrity perceived by stakeholders, including especially members within the organisation.

Integrity is one of the essential factors which determines the commitment of all members of the organisation to an effective business strategy.[74] The impact of low integrity has been illustrated many times, where top management are meticulous saying all the right things to create a corporate culture based on highly laudable sounding aims, but where the reality differs so far from the official version that the effect is entirely counterproductive, resulting only in cynicism and alienation among employees. In such circumstances, attempts to articulate a coherent strategy and to engage individuals in pursuance of that strategy, are rendered completely ineffective because of the perceived lack of integrity.

6.3 Business Objectives

If strategic focus is to be achieved then it must be expressed in some readily communicable form, so that people inside and outside the organisation know and understand what it is about. Such expression usually takes the form of a set of objectives against which performance can be measured.

The debate about objectives has continued right through the history of management literature, and before that the literature of classical economics. Objectives play a key role in the strategic management of any business. However, no really coherent theory of objectives has ever achieved any consensus.

Neoclassical economics was based on the mathematically convenient concept of profit maximisation, amended by Friedman to maximising shareholder wealth. Pursuit of these objectives within an unregulated market setting leads to a focus on achieving monopolistic levels of market control through opportunistic M&A deal-making. That business future may be simple but is ultimately destructive and not one pursued in this text. Here the assumption is that the value of competitive markets contributing to the general good will at some stage be again understood and pursued. In that real economy, long term business objectives are more diffuse, and always have been. Since the days of Henri Fayol, multiple objectives have been the common ground. Half a century ago, Drucker cited the necessity for objectives in the following eight areas:

Market standing
Innovation
Productivity
Physical and financial resources
Profitability
Manager performance and development
Worker performance and attitude
Public responsibility

This practical approach to multiple objectives presents a complex picture where often objectives will be in opposition to each other. Maximising one would inevitably mean failure with another. A balance has to be achieved, but there is no indication as to how this should best be done. Drucker's concept was an unstructured check-list. Management's job was to achieve the balance between conflicting objectives, but they were given no guidance as to how this should be done.

The systems approach presented the firm as a complicated open system having a constantly changing relationship with its various environments.[75] These are the firm's product markets, its suppliers, technological, financial and emploee environments, government and society. Management's job was to control the boundary conditions of the firm, i.e. its relationship with these various environments.

The idea of boundary management and of constantly changing relationships cast some new light on the subject. The idea of managing the firm's relationship with, for example, its financial environment, implies managing the firm's share price. This would not simply be a matter of maximising the shareholders' wealth, but managing the share so that its performance was sufficient to permit adequate performance in other boundary areas. Increasing the shareholders' wealth by more than is necessary, would be just as wasteful as over designing a product (i.e. giving the customer something he neither wants nor is prepared to pay for). The idea of balancing the firm's performance in its various, and often competing environments, still implies management's role is basically a balancing act.

Unstructured multiple objectives, which require trading off against each other, only serve to confuse and paralyse. What is required is a system of objectives which can be used to focus effort and guide the firm towards a unified strategic approach.

Translating boundary ideas into a set of objectives might produce targets in each of Drucker's eight objective areas. The systems approach implies that the firm ought to set financial objectives, for instance, which would ensure the share price performed well enough to safeguard the firm's continued independence, together with its ability to raise such finance as would be required to perform on other objectives, such as market standing and innovation. These corporate objectives would be required to be achieved, in order that other objectives could be aimed for.

This seems to imply a hierarchical ordering of objectives, analogous to Maslow's model of intrinsic human needs.[76] Maslow suggested a hierarchy of needs going from the lowest level of physiological needs (food, sex, sleep etc.) through safety needs, love needs, esteem needs, up to the highest level, what he called the need for self actualisation. As each need level in the hierarchy was satisfied so the next level up became potent. Thus if physiological needs were satisfied, the need for safety became dominant, and if at any time a lower level need ceased to be satisfied then that lower level need would again become prepotent. Maslow's model has often been criticised as lacking empirical support and subsequent motivation theorists suggested that needs were not necessarily ordered hierarchically and that more than one level might be active at the same time. Nevertheless, the Maslow hierarchy remains intuitively plausible.

Business objectives seem to follow a similar pattern, as shown in Figure 6.1 and in this case the hierarchical ordering is the common experience of anyone who has worked in a business that, for example, runs short of cash.

The objectives system of a business is a means of the business concentrating its efforts and resources on achieving success over different timescales, in different situations and with respect to different criteria. Management has to do more than simply balance these multiple objectives; it has to express the objectives in a hierarchical form which remains valid consistently in different situations and timescales, so that they do not have to be continually revised thus confusing organisation members.

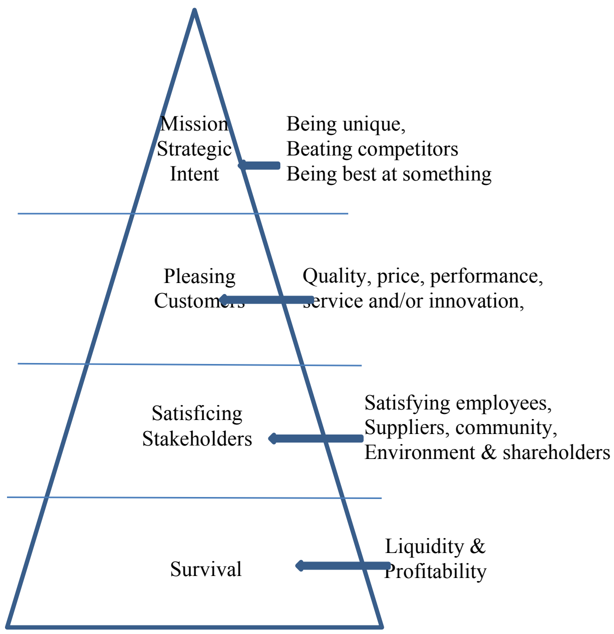

Figure 6.1 – Hierarchy of Business Objectives

The strategic intent, or mission, is what the business exists to achieve, the lower level objectives are means to this end. If any of the lower level objectives cease to be satisfied they become prepotent, and the lower the level the stronger is its dominance when not satisfied. Thus, when the organisation's survival is threatened all higher level objectives are ignored.

The strategic aim is not expressed as a generalised mission statement specifying the organisation's espoused values and other cultural variables. It is a concise statement which clearly identifies the organisation's strategic direction expressed in a form which is readily communicable and capable of assisting people in the organisation to concentrate their efforts on the identified intent.

Mission statements are more often used to present an idealised picture of a business to the outside world. For example, Coca Cola's 2015 website states its mission as

> *To refresh the world*
> *To inspire moments of optimism and happiness*
> *To create value and make a difference*[77]

This is supported by its Vision comprising 6Ps (People, Portfolio, Partners, Planet, Profit, Productivity). The oxymoronic profit vision is to

> *'Maximize long-term return to shareowners while being mindful of our overall responsibilities.*

The vision is then further elaborated by

> *'Our Winning Culture' defines the attitudes and behaviors that will be required of us to make our 2020 Vision a reality'.*

That is then detailed with statements about *'our values'* which, as is standard in such statements include *'passion'* and *'integrity'*.

Such window dressing lost credibility decades ago and are widely ridiculed, in the UK at least, for their examples of 'management speak'. But they are still expressed with an evangelical fervour. A much quoted example from the 1980s was Zale Corporation's summary statement of company mission, published before it filed for Chapter 11 bankruptcy, which included the following:

> *We feel a deep, personal responsibility to our employees.*
> *We are committed to honesty and integrity in all relationships.*
> *We are demanding but fair.*
> *We recognize community involvement as an important obligation.*
> *We believe in the free enterprise system and in the American Democratic form of government.*
> *This mission statement spells out the creed by which we live.*[78]

Rather more useful statements which actually helped define the strategic focus of the business have an equally long history:

> *NEC: 'Exploit competence in computing and communications.'*
> *Komatsu: 'Encircle Caterpillar.'*
> *Canon: 'Beat Xerox.'*
> *NASA: 'Put a man on the moon by the end of the decade.'*[79]

These have obvious attractions in terms of their definitive direction and also in terms of communicability and are also transformational or motivational. They also have one other great virtue: they are sufficiently precise that an analytically sound set of milestones can be defined leading to the achievement of each. These milestone sets include very specific dated, target achievements, in some cases extending over a ten year period.

The strategic aim is what should drive the business. When other objectives intervene, the business is being blown off course. This applies even to the next objective down, pleasing the customer. The model suggests that the customer must be pleased before the business can focus on its real strategic aim. However, many successful businesses remain stuck at this level on the hierarchy. Peters has suggested that you should have a passion for your customer, but this is not entirely rational. The supplier – customer relationship should not be passionate, but calculated. Providing the customer with an overabundance of some product attribute is itself simply wasteful and may be directly counter-productive. Sticking at this level inhibits the unique achievement of a strategically focused firm.

Other firms never seek to progress beyond the second level objectives. Those that have adopted the Friedmanite shareholder primacy injunction regard these not as *satisficing* objectives, but *maximising*. Maximising shareholders' wealth is the current orthodox wisdom, despite maximising performance at this level is wasteful from the business' perspective. Providing the shareholder with greater returns than is necessary to achieve the required share performance is a form of liquidation which suggests a paucity of strategic aim.

Liquidity and profitability are measures of performance which define minimum levels necessary to permit the business to focus its attention on the higher level objectives.

The idea of social responsibility is at an intermediate (i.e. satisficing) level in the hierarchy. It is clearly not the main purpose of the business to maximise the amount of social good it does. Nevertheless, a complete disregard for social responsibility is not a valid strategy. Externalising environmental pollution is certainly one transgression which satisfying social responsibility would not permit. The business should aim to satisfy the minimum needs of society, wherever there is a direct contact, and having done sufficient to satisfy those needs, address itself to the higher level objective.

Apart from the strategic objective, none are maximisation objectives. They only require some minimum level of achievement in order that the business may then seek to satisfy the next higher level in the hierarchy. Thus the business is focused on achieving its top level, strategic intent. Anything more than satisfaction of needs at lower levels merely serves to inhibit the firm in its attempts to satisfy the business strategy objectives. From time to time the lower level needs become prepotent and then the firm has to shift its attention, for example, away from the long term strategy on to short term survival. This is common enough experience when managements may find it prudent to ration capital, postpone long term developments, reduce R&D expenditure and so on. In an accounting culture, such actions can take on an almost heroic aspect, almost as though the aim of the business is simply to operate at minimum cost. In reality these are the means to the end. Sometimes they become dominant, but they should be recognised as an interruption in the pursuit of the strategic goal.

The hierarchical view of objectives provides a systematic way in which a firm may balance the conflicting priorities of various opposing interests. In particular it helps management to balance the long term interests of the business itself against the short term interests of the firm's financial environment.

It may also be apparent that this examination of the hierarchical organisation of objectives coincidentally also considers each of the other agencies with which the organisation interacts. These are the agencies with which the business will seek ongoing relationships and which are the actors in Gauthier's model. With each of these stakeholder groups the business needs to establish credibility of having internalised the principle of trust so that they will be invited into mutually advantageous collaborations. The next chapter looks in more detail at this aspect of the hierarchy.

6.4 Strategic Health and Performance

This brief examination of the business perspective has made a general assessment of the main strategic issues which business managers have to confront. Each organisation does so differently. Each business has a unique strategic intent or mission and they each express different lower level objectives. So the business perspective contains both general business factors and also other factors which are unique to the particular company. To understand the moral judgements made by people in business, it is essential to understand both aspects of the business perspective.

The general perspective is adequately defined by the hierarchy of objectives. The unique aspects of the perspective demand a means of measuring the strategic performance of the particular business. Orthodox financial measures are not sufficient. Accounting methods only measure past performance – reported profitability is not even a measure of short term health and performance. Accounting, with impeccable logic, accords the greatest value to the quickest gain – a pound now is worth more than a pound in a year's time. But strategy is concerned with a five or ten year horizon and even longer. So it is crucial to have an adequate measure of strategic health and success.

Strategic considerations frequently result in very different evaluations from those produced using orthodox accounting criteria. For example, when Blue Circle Industries put its sand and gravel business up for sale, the business had a balance sheet total net asset value of around £9m. A professional revaluation of the land and minerals in the business produced a surplus over book value of almost £10m, implying an asset value of £19m. An alternative valuation was made by estimating the maintainable level of earnings multiplied by the then current sector PE ratio plus a 50% premium to reflect the bid situation. This produced a valuation of almost £20m. A third valuation was based on an estimate of future cash flows from the business discounted at 8% (a then not unreasonable figure) to a present value of £16.8m. These three different methods of valuing the business showed an average valuation of £18.6m. The business was actually sold for over £30m.

The justification for the premium was strategic. The Blue Circle Aggregates business included huge deposits of minerals in the West Midlands region. Many of these were not currently being exploited – some appeared unlikely to be used for as long as 40 years. The value now of £1 in 40 years' time, discounted at 8%, is negligible, but the strategic value of having a secure business for the next 20 years may be immense. Strategic value, whether it is invested in minerals under the ground, long term research and development or a structural or positioning change in the business, is not measurable in orthodox financial language.

The measurement of strategic health, might only be achieved by analysing the viability of the firm's strategy, and measurement of its strategic performance in terms of its progress in achieving its strategic objectives. There are no universal measures of strategic health and performance: they are always unique to the individual business and its particular situation. Thus the assessment of strategic health and performance must be made by understanding two particular issues which are unique to the individual business:

Firstly, the strategic intent of the business as expressed in its hierarchy of objectives, and including the practical milestones derived from the statement of strategic aim or mission, and, secondly, the level of objectives on the hierarchy which are operative at any particular time. For example, it is vital to understand whether the business is able to attack its strategic objective or be forced to satisfy intermediate level objectives such as focusing on survival.

6.5 Conclusions

A basic assumption of Kohlberg's approach was the recognition that integrity could only be understood in its socio-moral setting. If we are to understand how people in business perceive the integrity of organisations, we must take the business perspective fully into account. The business perspective focuses not on short term profit maximising but on the achievement of strategic goals.

Management's task is to ensure that business pursues its strategic goals, whatever they are, and gets side-tracked as little as possible from this overriding aim, i.e. that lower level objectives in the hierarchy do not become prepotent and force attention away from strategic aims.

When a business is first set up the dominant objective is likely to be survival. The high rate of infant mortality among new businesses suggest this focus is rational. Thus right from start-up businesses focus on being deliberately efficient, i.e. not wasteful of resources. This inevitably leads to business behaviour at the boundaries of ethical acceptability. In the opening chapter this was exampled through the series of snap-shots depicting the development and evolution of the generic company STP.

It is management's job to ensure that the avoidance of waste is comprehensive. Businesses should not pay more taxes than they have to; they should not carry more stocks and work in progress than is strictly necessary; they should not employ more people than are required to perform the business task; and so on. This emphasis on efficiency is so strong that professional specialists are hired, from the very earliest days of the business' existence, to ensure that no such waste occurs. In many successful companies the emphasis on cost control and waste avoidance is built into the culture of the firm, so that all employees are imbued with the idea and behave accordingly.

The economic orthodoxy which has resulted in the remuneration of top management at a level of more than 300 times the average shop floor worker is entirely destructive of the management focus on waste avoidance. Discussions of whether such bonuses are, or are not, justified by corporate performance, is utterly irrelevant. Especially is that the case when that management performance is measured, as it most commonly is, solely by the returns to shareholders. It doesn't only destroy any focus on waste avoidance, but is directly counter-productive to it, encouraging alienated employees to maximise waste.

Drucker suggested the ratio between top executive's pay and that of the average hourly paid worker

> *'could be no more than twenty to one without injury to company morale…Few executives can imagine the hatred, contempt and even fury that has been created – not primarily among blue-collar workers… – but among their middle management and professional people.'*[80]

The excessive remuneration of management makes almost impossible the already challenging task of concentrating all available resources, efforts and enthusiasms on the strategic intent.

The question remains as to how far these business objectives conflict with the requirement to behave with integrity. Firms which accept and pursue the economic orthodoxy in seeking to maximise shareholder take, are clearly operating at Kholberg's pre-conventional level of integrity. They would be expected to take advantage of any legal opportunity to add to shareholder wealth, no matter that it might require the impoverishment of other stakeholders.

For other businesses not so dedicated, the business perspective suggests there may well be conflicts from time to time between business objectives and integrity. In most situations, such businesses might be expected to operate at Kohlburg's conventional level of integrity. This is the level at which firms would be recognised as suitable or desirable partners in the mutually advantageous collaborations and alliances on which businesses increasingly depend; the level at which they would appear attractive as members of co-operating networks and teams. At other times, businesses may find their position on the hierarchy of objectives changes and in those circumstances they may be forced to adopt a different level of integrity.

The impact of strategic objectives on organisational integrity is the subject of the following chapter.

7 Objectives and Responsibilities

Learning Objectives:

To understand the hierarchy of business objectives and the implied responsibilities at each level.
To understand the implications for business integrity of each level.
To understand the implicatyions for business integrity of each stakeholder group.
To understand the implications for business integrity of achieving the strategic objectves and collaboration.

7.1 Introduction

A fundamental assumption in this approach to achieving business trust and integrity is that ethical performance and judgements can only be understood in the context of what Kohlberg referred to as the socio-moral perspective of the actor. In this case we are concerned with the socio-moral perspective of business and perhaps the most helpful summary was suggested in Figure 6.1 – the hierarchy of business objectives (see page 111). Not only does this suggest the business aims, which it should be remembered do not normally include any explicitly ethical initiatives, but it also indicates the various agencies with which the business has transactions. The transactions could be of a one-off, amoral, profit maximising nature, or alternatively, part of an ongoing Gauthierian strategic relationship which depends on each party believing the other has internalised the principle of trust. Figure 7.1 below highlights these interactions and the agencies with which they are conducted.

The different levels in the hierarchy on which a business is focused exert different pressures on the integrity of the business. A business whose survival is threatened may be expected to behave in a quite different fashion from a business which is securely focused on achieving its strategic intent, whatever that is. In this a business is no different from any other biological or social system. Constraints which are fully operative under normal stable conditions, including all ethical constraints, are relaxed when continued survival is threatened.

At the intermediate levels of the hierarchy, normal ethical standards – whatever they are – might be expected to prevail.

However, at the top, strategic level, different rules apply. The focus at this level is essentially the beating of competitors, by producing a better value product or service. According to universalist philosophy beating competitors to extinction would in principle be unethical, while for utilitarians it would also be unethical if successful. This is why, for most normative moral philosophers, business is a fundamentally unethical pursuit to which they have little to contribute. They fail to achieve what Kohlberg identified as necessary: an understanding of the actor's perspective.

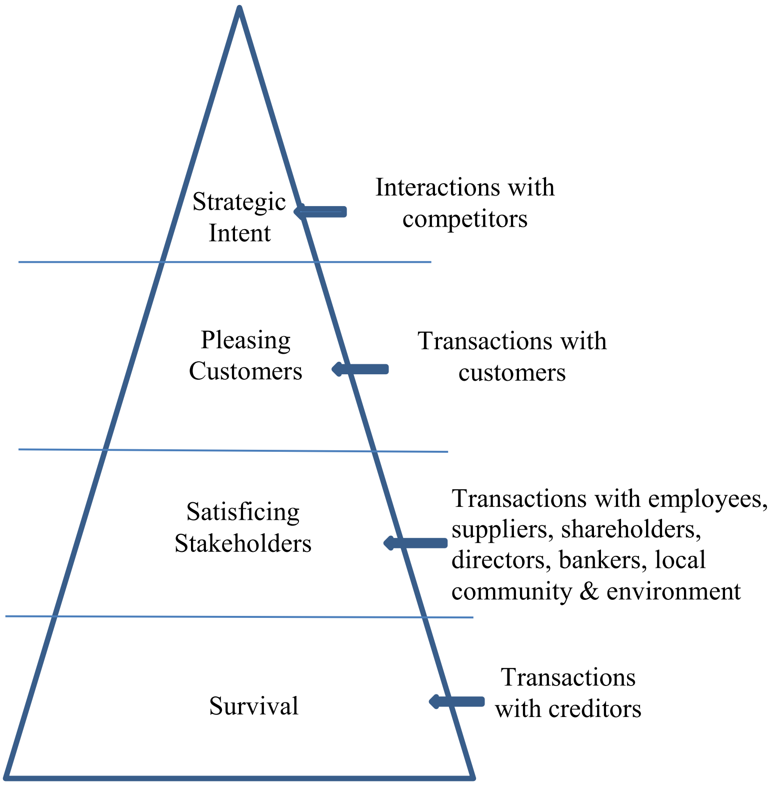

Figure 7.1 – Objectives and Transactions

The following sections briefly examine the various transaction categories and provide one or two examples of each.

7.2 Survival

When survival is threatened, the niceties of ethics inevitably take second place to the fight for life. This is hardly new or surprising, a common phenomenon with many biological, social and political systems.

Gauthier emphasised this situation in his model of the two co-operating farmers. If one farmer retires the co-operative agreement collapses. It is not significant that retirement was the cause of the discontinuity, it could have been any cause. The important point about the impending retirement was that it was predictable and therefore affected the collaboration. If only the retiring farmer was aware of his forthcoming retirement, then he would be able to exploit the situation by taking advantage of his neighbour and then not co-operating when his turn came. If both farmers were aware of it, then the arrangement, if based only on mutual advantage, would collapse.

In the case of threats to the survival of a business the level of knowledge is also important. The threatened business, may try to carry on as before in order to preserve the fiction of its continuity so that confidence is not damaged. However, at some stage, the business is likely to take whatever action is necessary to preserve or prolong its existence. When the business with which it is co-operating, for example, a creditor, also learns that the business is about to collapse, it is also likely to change its mode of behaviour. Overnight the creditor is likely to change from a trustworthy collaborator to a suspicious opponent out to secure the best possible terms of terminating the partnership. Nor in most cases would it be significant how long the previous co-operative arrangement had been in place. Loyalty, and sentiment are likely to play little part in a bankruptcy.

The change in behaviour occurs when survival is threatened, not just when the due process of winding up is under way. It is this change in behaviour which is likely to see ethical considerations put on one side. When Gauthier's farmer is going bust and his only chance of survival was to double-cross his friend, then perhaps he will do it. Certainly, if they had both accepted and believed in the economic orthodoxy more than they believed in the value of trust and integrity, he would be likely to do it. Perhaps under those circumstances and beliefs he will do it even though they have known each other and collaborated for a life time. In the case of a business it would be prudent to assume that this would be the case.

If a business continues to trade though it is insolvent, its directors are guilty of fraud. It may be perfectly possible to weather the liquidity crisis and recover to more normal trading, but the directors who take a business through such a crisis take a considerable risk. If there is a 60% chance of going bankrupt and a 40% chance of surviving, what should the directors do? If the company fails, everyone suffers; if it survives everyone wins. In many cases the difference between success and failure in these situations is simply a matter of confidence. Like a Chancellor before devaluation, company directors are bound in these situations to preserve the fiction that everything is OK. For them to breathe even a word about cash problems would be a self-fulfilling prophecy, making the company's failure a certainty. Moreover, as one director described how his business went bankrupt – 'slowly to start with and then bloody fast', directors do not have a lot of time at the critical stages to think though their reasoned responses to the situation. Kant would have hated it.

The directors in such a situation have to behave in a way which they know full well could subsequently be interpreted as continuing to trade when insolvent i.e. fraud. Is the manager who carries on and takes that risk – after all he is the prime sufferer if it doesn't come off – to be condemned as unethical or applauded for being courageous?

There is, however, a brighter side to threatened extinction. Management is liberated to take the sort of action which in any other circumstances would be unthinkable.

The freedoms that are opened up when a company's survival is threatened include a great relaxation of ethical standards. Kohlberg looked at several parallel personal situations. For example a post-conventional analysis of whether or not someone should steal a drug to save his wife:

> ***'It is the husband's duty to save the wife. The fact that her life is in danger transcends every other standard you might use to judge his action. Life is more important than property.'***
> *'Suppose it were a friend, not his wife.'*
> ***'I don't think that would be much different from a moral point of view. It's still a human being in danger.'***
> *'Suppose it were a stranger.'*
> ***'To be consistent, yes, from a moral standpoint.'***

Thus, even at the more sophisticated post-conventional level – the moral perspective where the individual understands why something is right or wrong rather than simply what is right or wrong – the threat to life transcends normal rules. So it is with businesses and the people who run them.

Kohlberg's, analysis is, of course, concerned with the moral development of individuals over time, and particularly as they progress from childhood to adulthood. But its application to a social organisation does provide some insights by analogy and metaphor, which may be useful. One of the more obvious differences between Kohlberg's application and the present use of his model is highlighted in this consideration of business survival. Kohlberg's post-conventional subject quoted above has explained the reasons why ethical considerations are overturned when life is threatened. Business does not provide post-conventional explanations. The business perspective does not go beyond the conventional level of moral development, so that post-conventional explanation is not available. Nevertheless, considerations of survival certainly dominate the ethics of normal business. Perhaps the best Kohlbergian analogy would be to suggest that business, as a social institution rather than a maturing individual, is capable of renewal and regression and when its survival is threatened, the moral perspective regresses back to the pre-conventional level. The gloves are off. Any action to preserve the business is open to consideration. The only constraint is the law, the likelihood of being caught and the probable punishment.

Survival is one reason why business cannot be run according to the rules of moral philosophy.

7.3 Satisfying Stakeholders

If the lowest level objective, survival, is prepotent, then the business may be expected to behave as though its moral perspective is pre-conventional. But at higher levels in the hierarchy, such as satisfying stakeholders, the business might be expected to behave at the conventional level. This has already been briefly examined, but it is worth filling out the definition a little here.

Kohlberg explicitly considers the issue of trust, which is important component in Gauthier's co-operative model. At the conventional level, trustworthiness is something one expects of others in society. One of Kohlberg's subjects, at age 17, expressed this as follows:

> *Why should a promise be kept, anyway?*
> ***Friendship is based on trust. If you can't trust a person, there's little grounds to deal with him. You should try to be as reliable as possible because people remember you by this. You're more respected if you can be depended upon.***[81]

At this conventional level, the subject views trust both as a truster, and as someone who could break a trust. He sees that individuals need to be trustworthy, not only to secure respect and to maintain social relationships with others, but also because, as members of society, they expect trust of others in general.

Seven years later, the same subject provided a post-conventional explanation. At this level he did not automatically assume he was in a society in which people need the friendship and respect of other individuals. Instead he considered why any society, or social relationship, presupposes trust, and why he, if he was to contract into society, must be trustworthy:

> ***'I think human relationships in general are based on trust, on believing in other individuals. If you have no way of believing in someone else, you can't deal with anyone else and it becomes every man for himself. Everything you do in a day's time is related to somebody else and if you can't deal on a fair basis, you have chaos.'***

These expressions identify the moral perspective to be expected of people in business actively engaged in forging the collaborations and alliances and operating the teams and networks which are an essential aspect of the contemporary business organisation. They also identify the chaotic result which seems the unavoidable outcome from businesses adopted the short term profit or shareholder wealth maximising perspective.

Axelrod's tit-for-tat games strategy suggests trust is built up through 'clarity, niceness, provocability and forgivingness'. If these four are evident then trust can both be established and be robust (i.e. survive some failures). It is important that the characteristics are evident. Moreover, establishing credibility in the strategic sense means that you are expected to keep promises and make good on all threats i.e. be predictable.

In *The Maltese Falcon* Gutman gives Sam Spade an envelope containing $10,000, and Spade points out they had been talking about more money than that. Gutman agreed,

> "*…but we were* **talking** *then. This is* **actual** *money, genuine coin of the realm. With a dollar of this, you can buy ten dollars of talk.*"[82]

Credibility is crucial. Unless trustworthiness is believed it will have no strategic effect i.e. it will not enable firms to engage in mutually advantageous collaborations. If it is disbelieved it will have a directly negative impact. Firms have therefore to be very careful not to take actions which damage credibility of their trustworthiness.

The following sections provide a few examples of stakeholder satisfying interactions and show how relevant ethical issues might be understood and resolved.

7.3.1 Employees

Firms are involved in a tremendous variety of transactions with their employees, some once only, others continuous. They arise in the following areas: selection and recruitment, induction, health and safety, training and development, remuneration, working conditions, job content, supervision, management and motivation, discipline and grievances, holidays and working arrangements (i.e. hours and place of working, flexitime etc.), achievement and recognition, promotion, equal opportunities and an endless list of factors which might conveniently be lumped together in the catchall term culture – items which may crucially affect the working climate and attitude of people at work.

Most of the above are worthy of books in their own right and there is little point examining each in detail here. They each contribute to the employee's psychological contract with the employer, and they all interact. A dishonest transaction between the employer and employee in one area is inevitably going to influence the relationship as a whole and affect how transactions are undertaken in other areas. Having once been treated deceitfully, the innocent party to the transaction, whether it is the employee or the employer, will be wary about any recurrence. The principle of trust which may have been painstakingly established, will have been quickly destroyed or damaged and will take a great deal of concerted effort to rebuild.

Rather than discuss each aspect of such transactions in detail, two alternative approaches to employee relationships are evidenced. On the one hand, the leadership style, identified by Ghoshal (*'ruthlessly hard-driving, strictly top-down, command and control focused, shareholder-value obsessed, win-at-any-cost business leader'* – see page 86) as the result of teaching Friedmanite orthodoxy which freed MBA students from all moral responsibility.

Directors and chief executives are, according to the orthodoxy, expected to behave as though they 'own the stadium', rather than merely manage it. All too often this has an unhinging effect on executives as described in the story of STP's evolution. It does not require executives to be crooked megalomaniacs to convince themselves they own the stadium – the economic orthodoxy requires them to behave as though they do, and devises share option bonus schemes to convert them to 'ownership'.

Even though that approach, conforming to the economic orthodoxy may be dominant, there are many examples of successful businesses which do not conform and evidence an alternative way forward. The examples of ABB and WL Gore & Associates have already been noted.

Robert Haas' participative approach at Levi Straus[83] was based on a distinctive, very much calculated employee – employer relationship. The sharing of profits was quantified and agreed in detail with calculations very much up front and transparent, thus having what Axelrod referred to as 'clarity' – they were clear and simple.

It was also apparent that Levi Strauss would not initiate cheating, i.e. the transactions also involved 'niceness'. They probably also involve 'provocability' – any cheating, by either participant, would not go unpunished. Moreover, the relationships almost certainly also involved 'forgivingness', i.e. an outbreak of cheating would not bring the relationship to an end, but after 'punishment', efforts would be made to resume transactions on the former basis.

This calculated nature to the relationship is important. It is the foundation of the enlightened self-interest which enabled Gauthier's farmers to collaborate to their mutual advantage.

Over time, transactions which continue on this basis become relationships which are based on these certain values. Their foundation, however, is not some extraneous value system or philosophy, or even religion. No matter what the origination of the business, it is the dependence of both parties on their mutually advantageous transactions and thus their mutual interest in continuity.

Transactions with employees are therefore carried out on the basis of a contract which is both formal and informal. If either written or unwritten parts of the contract are broken, the parties which contravene must, according to Axelrod's model, be punished, and be seen to be punished. Many contraventions are obvious and direct. In some areas, however, contravention is less explicit.

Aspects of 'equal opportunities' still lies in this twilight area. Reports on the position of women in industry, still in 2015, show they are paid less than men for the same work, get promoted less often and far fewer get to top jobs. In aggregate it appears there must be a fairly powerful prejudice against women, but it may be difficult to identify particular instances, even from within the organisations (or even individuals) which exercise the prejudice.

Equal opportunities issues may arise only obliquely, not as a direct part of the employee – employer transaction, but as part of the interactions between fellow employees. These may be difficult to manage, but nevertheless form an important part of the fabric of the employee – employer relationship, and the employer has to create a culture where equal opportunities abuses (relating to race, sex, disability or age), are not tolerable and not tolerated. Examples of punishment for such abuses are not widely reported. Presumably this is because the firms involved do not wish to bring themselves this odious publicity. Nevertheless, if the relationships are to be conducted on the basis of trust, instances and punishments need to be carried out and seen to be so.

In all these various interactions with employees, business need to maintain a consistency of integrity. Mistrust arising as a result of some shortfall in one area, will affect the level of trust accorded transactions in other areas. Firms need therefore to behave as though they have internalised the principle of trust as a value affecting all their transactions and relationships with employees. This means being vigilant in all the areas where employee transactions are active and ensuring that any actions by people acting on behalf of the business, or by other employees, which might affect the credibility of the business' trustworthiness are punished and seen to be punished.

7.3.2 Suppliers

The traditional way of looking at suppliers is that of the economist, focusing on an assessment of their bargaining power. The buyer:supplier transaction is seen as one which itself produces an economic surplus which will be divided between the two parties according to their bargaining strength. This is essentially the neoclassical economics analysis.

The transaction becomes more complex when viewed as a continuing relationship over a strategic time scale. Businesses need to forge links with suppliers who can support long-term as well as short-term objectives. Marks and Spencer, for example, has some suppliers who date back over a hundred years. No M&S supplier makes a quick killing out of the high street chain, but they are expected to earn enough to ensure continued capital investment to maintain quality and productivity.

However, long term relationships are based on much more than long term viability. Whether one is considering the supplier of raw materials, of technology or of knowledge and information, the buyer needs to be assured of the suppliers standing in several different aspects. Reliability and predictability are crucial parts of this relationship. The supplier must be trusted to deliver the detailed specification, quality, the price and the delivery schedule, agreed. The buyer must be trusted to accept delivery as agreed and to pay on the basis agreed.

This is a calculated relationship. The terms of the supply agreements will all be written down. Adherence to those terms need to be monitored and any deviation from the terms need to be punished – the terms of punishment may will be written into the agreement. The satisfactory performance of such transactions will result in the cementing of a strategic relationship which may develop in surprising ways. For example, the supplier of technology, may agree to supply, run and test prototype/development equipment and plant in their customer's facilities, with a mutual benefit in terms of innovation and new product development.

There is also an increasing pressure on ensuring that your suppliers perform in ways which are seen, by your customers, as being ethical. The general public is increasingly aware of, and sensitive to, supply chain arrangements. Premier Brands launched a fair trade initiative sourcing TyPhoo tea only from plantations which satisfy them in terms of social and environmental criteria, and placing the 'Caring for tea and our tea pickers' logo on all Typhoo packaging. In similar vein Grand Met phased out the use CFC's in freezing vegetables because of public concern over CFC's role in global warming.

But supply chain issues continue to be problematic with notorious failings such as the Bangladeshi collapse of the Rana Plaza building with a final death toll of 1,129 and around 2,515 people injured but rescued alive. It had accommodated a garment factory supplying UK retailers Primark and Bennetton. Encouraging protesters to surround Primark's Oxford Street store with a War on Want spokesperson quotes as saying

> *'deaths from the building collapse were not an accident – they were entirely preventable deaths. If Primark had taken its responsibility to those workers seriously, no one need have died this week.'*

Supply chain transactions in the increasingly globalised world are receiving ever more public scrutiny.

7.3.3 Shareholders

The generally accepted role of shareholders, under the guidance of Friedmanite economics (summarised in Appendix I), is that of private property owners, with the role of business, as with any item of private property, merely to serve the interests of its owners. This ignores the legal status of the company and the limited nature of shareholder ownership. It also ignores the hugely changed nature of shareholding since the 1986 'Big Bang' computerisation of stock markets and deregulation of the financial sector with its explosion into shadow banking and the development of hedge funds, private equity etc.

Under the established Friedmanite system, shareholders own the business and therefore have largely unrestricted freedom to do with it what they like. Directors are appointed to implement the wishes of shareholders and to act on behalf of, and in the best interests, of shareholders, i.e. to maximise their wealth.

Today, over 80% of shares are traded by professional fund managers/traders, mostly trades are automated, driven by some algorithm capable of responding rapidly to information or rumour. Over two thirds of such trades are of the ultra-fast category which respond to information in nanoseconds. Prior to 1986, shareholdings were held on average for around seven years and most of the shareholdings were owned and controlled by individuals who it might be assumed had some interest in and knowledge of the company they owned shares in. They might even have felt some emotional loyalty to the company they had chosen.

Investment funds work differently. The investor, or the pension fund on their behalf, buys shares in the investment fund, while the trader deals in the marketed stocks and shares, mainly through automated systems. The average length of time shares are now held for is down to a few months. Moreover, the originating investor has limited knowledge of where their funds are invested or what trades are completed on their behalf.

It is therefore difficult to conduct relations with shareholders in any meaningful sense. The actually purchaser of the firm's shares is not the ultimate investor. Their expectations and demands are extremely disparate and may change quite rapidly. It is unknown whether they are friends or enemies of the firm. Their interests are likely to be short term, possibly extremely short term. They may be hoping for the firm to prosper, or they may lie in a short term speculative gain from attacking the firm, and killing it and, like a hungry vulture, picking over the entrails. Or it may be in pursuit or development of an acquisition story which might introduce an element of profitable volatility to the company's share price. Establishing a rational relationship with such shareholders is problematic.

Establishing a systematic relationship with shareholders might be to treat them as customers, or potential customers, for the firm's shares. But rather than trying to please the shareholders, or maximise their take. the aim might be to satisfy them, and the measure of their satisfaction would be the share price. It is not the aim to maximise the share price, but to maintain it at a level which preserves the firm's continued autonomy, and makes it feasible when necessary to raise either debt or equity finance. From the company's point of view, anything more than this would be wasteful.

The means by which the share price is managed and through which the firm conducts its relationship with its shareholders is first and foremost through its financial results and, secondly, through its regular reporting, financial and otherwise. Reporting either directly or through the press provides the firm with an opportunity to inform stakeholders about strategic issues so that they know what the firm is about and may be able to interpret its financial results against that strategic backdrop. Thus a firm may engender in its shareholders support for a course of action which may produce short term problems but long term success. There have been many examples where an opportunistic merger or acquisition has been successfully fended off because the explanation of the strategic issues has gained media support.

Thus, business:shareholder transactions are also calculating. The business does not waste more than is necessary on satisfying the shareholder, but it does at the same time try to increase the understanding of shareholders about what the business is trying to achieve. Trust can be a crucial part of this relationship. If the business management has developed trust, then their shares will be valued that bit higher all else being equal. Moreover, the firm might attract shareholders who understand the role the business will play in their particular portfolio, whether it is capital growth or dividend yield, low risk or high. From time to time credibility of trust is forfeited – a board will break promises, fall down on profit forecasts etc etc, and if their credibility is finally eroded they will in the end be forced to go.

Businesses in the shadow banking finance sector are exceptions from the current discussion since their aim is not the creation of wealth but its redistribution, their socio moral perspective is firmly set at the pre-conventional level of development rather than the conventional, and they are largely engaged in short term shareholder wealth maximising rather than anything more substantial and long lasting.

As firms grow and evolve under free market economic orthodoxy, if successful, they reach the stage of maturity where they transmute into financial entities, too big to manage as real economy businesses, but capable of being controlled as deal making financial entities. They may look like real economy diversified conglomerates, but the reality is they are controlled by financial motivations. The list of such conglomerates is extremely long, but few have been long lasting. Hanson Plc was a good example, which achieved many large scale acquisitions, but in due course, reformed itself into four separate business, the main one being in building materials which was eventually in 2007 itself taken over by Heidelberg Cement and seven years later was subsequently sold to a private equity operator. None of these deals had much to do with the businesses Hanson was operating in, more to do with the speculative gains that might be might by wheeling and dealing in corporate assets.

Maximising the wealth of shareholders is an essentially short term objective which can only be achieved by the business delivering itself up to rape and pillage.

7.3.4 Directors

Directors operate in locus of the legal business entity and they therefore have a statutory responsibility to behave in its best interests at all times. The best interests of the business may be difficult to interpret. It is certainly less clear than, for example, acting in the best interests of the shareholders. The business comprises various stakeholders, including employees, customers, and suppliers as well as shareholders. Assessing whether a director has acted in the best interests of the business or not may therefore be quite difficult. Both the business and, more particularly, its best interests, are open to interpretation. Second-guessing a director's decision to assess whether they acted appropriately, without the benefit of hindsight, is notoriously difficult. Consequently, there are few examples of directors being found guilty of acting against the best interests of the business. The only exception to this is the case where there is a conflict of interest, i.e. where the personal interests of the director and the best interests of the business, appear to be in direct conflict.

Directors have more or less complete dictatorial power within their company to do as they please. They have ample opportunities for dishonesty and they are unlikely to be found out. Even if their actions are known by their peers, they are unlikely to be stopped. Consequently, company directorship is an exceedingly attractive field of endeavour to the straightforwardly crooked. Few crooks make it into the big time of company directorships, but those that do may make it big, likeAmerican swindler Bernie Madoff, who defrauded investors of an estimated $18 billion.

The vast majority of company directors are not crooks, but just ordinary human beings with ordinary human frailty. Given the opportunity of paying themselves a 4% rise, or a 40% rise, most directors would go for 40%. They might even go for 40%, while trying to hold everyone else's rise to less than 4%. They might even go for 40% while trying to eliminate the jobs of substantial numbers of their employees. That is what the economic orthodoxy leads to, an acquired taste for huge sums of money. Keynes referred to it as 'a somewhat disgusting morbidity'.

An example was headlined in The Times of 26th March 2007:

> *'Rewards for Barclays' Diamond hit more than £80m – The bank's president and boss of BarCap collects £15.2m in salary and perks.'*

At the same time the Daily Mail reported that Bob Diamond could also

> *'recoup an annual bonus worth up to £3.375m this year…long term performance based incentive shares worth £6.75 million next year.'*

On 7th March 2011, Diamond's bonus was reported as £6.5m for work which the Chairman of the Financial Services Authority described as "socially useless". And in 2012, Diamond received a £22m pay off when he was forced out as CEO of Barclay's Bank following their LIBOR market fixing criminality fine of £290m while he was in charge. In a 2011 BBC lecture about how banks might restore public trust, Diamond confessed that Milton Friedman was his *'favourite economist'*.

The explanation for excessive directors' remuneration is twofold. The economic orthodoxy invokes the so called agency problem, that executives would not act as agents of shareholders unless they were converted into share owners themselves. Therefore they are remunerated with large scale share option bonuses. The second explanation is that bonuses are the reward for productivity increases, as though the increases came about as a result of the skill and effort of the recipients.

The simple explanation is that directors have the opportunity to take more than is justified by any conceivable criterion, and, being normally frail human beings, most of them do. Such 'taking' clearly alters the perception of would be collaborators about the trustworthiness of the businesses and individuals concerned. It contributes to the general level of cynicism about business and business people among the population at large, but importantly among those with who the businesses directly interact.

The existence and level of this directorial abuse also presents a considerable opportunity. To be seen to be fair and equitable in all such dealings will attract some recognition and enhance the credibility of the business's integrity.

7.3.5 Community

Interactions between the company and its local community have for some time been largely restricted to those roles it undertakes with members of the community as employees, customers, suppliers etc. Apart from these the business may have to take special care with its business operations so that they do not have uncompensated adverse impacts on the local community e.g. noise pollution, traffic nuisance etc.

In earlier times the business played a much more important role in the community. The old Quaker companies, for example, built 'model villages' to accommodate their employees. Companies which dominated their locality not only built housing and shops, but also provided schools and churches. Companies laid on social events such as children's parties and Easter parades as well as providing sports and leisure and other social facilities. The companies supported their own football and cricket teams and their own brass bands. Some even provided hospitals.

Companies no longer have these roles, and despite the growing reluctance of governments to tax and pay for all these undertakings, companies are unlikely to resume. Companies are no longer mass employers and, with few exceptions, no longer dominate their local communities as they used to do.

Nevertheless, there is considerable interest in some quarters in encouraging business to engage more with its local community. For example, 'Business in the Community' is a UK umbrella organisation with over 500 corporate members, aimed at helping create partnerships between business, government and local communities to improve the economic, physical and social environment. This initiative is based on extremely worthwhile ideals and may well result in a significant increase in business' community involvement. There are many different ways in which businesses may become involved.

Viewed in the context of the hierarchy of objectives adopted here, these community activities, are not relevant. In themselves, they may be laudable, but they only serve to confuse business strategy and get in the way of the business focusing on its strategic objective. Given the general level of cynicism nurtured by the Bob Diamonds of this world, genuinely altruistic community activities might well be seen as a public relations exercise aimed at disguising less commendable interactions with the community. At the intermediate satisfying level of the hierarchy, trying to do more than satisfy merely serves to distract and prevent concentration.

The modern role of the business in community should probably be restricted to ensuring that any adverse effects of the business are minimised and compensated. If a company's interactions with its local community are seen to have adverse or pollutive (very broadly defined) effects, this may well impact on the way other stakeholders perceive the business as a potential collaborator. This effect may then be multiplied by any attempts to avoid compensation or to deny the pollutive effects. Such denial or backsliding, if recognised as such, will certainly be perceived by potential collaborators as indicative of trustworthiness.

Companies no longer have community responsibilities as were undertaken by their Victorian forebears. Minimising, and compensating for, any adverse impacts are the main concerns for management regarding their business – community interactions. Beyond this, the main responsibility of business management is to ensure success in business terms, so that they maintain a contribution to local prosperity.

7.3.6 Environment

A business does not interact with the environment in quite the same way as it does with other stakeholders. The environment is not an obvious stakeholder. The environment itself is passive, there to be exploited so far as regulations and the law will permit. The law and the increasingly active environmental pressure groups are there to protect the environment. It might well be argued that so long as their requirements are satisfied, then surely businesses will have done enough.

The environment might be regarded as a proxy for the best interests of future generations and it is these stakeholders with whom the business is really interacting when it impacts on the environment. A business that is in it for the long term needs to be aware of its impacts on future generations. It needs to conduct itself in a way which is not only regarded as generally ethical by today's standards of awareness and understanding, but by the standards that will be applied by future generations.

The asbestos companies, for example, in the past conducted their businesses in ways which would be totally unacceptable today. They poisoned generations of employees, their families and local communities, as well as distributing potentially lethal material for multifarious applications throughout the world. People today are suffering because of the 'sins' of the asbestos companies half a century ago. It is still not known when the last repercussions of this particular form of environmental pollution will have been finally worked through. The behaviour of the asbestos companies has been assessed with all the benefits of hindsight and most of them have been destroyed as a result.

Turner and Newall instituted the research on which health and safety standards were subsequently based. They invested heavily in both research and in safer methods of working (e.g. wet weaving processes, better extraction, working conditions and practices etc.). The threat to survival was such that they carried on producing asbestos based products when, as is now acknowledged, it was unsafe to do so. They promoted asbestos as a life-saving material and, with hindsight, stand accused of being cynical exploitative profit maximisers. They argued vociferously over compensating their victims. T&N was exceptional in that industry in the care it took to find out the facts and the actions it took when it began to understand the facts. Nevertheless it is judged not by contemporary standards, but from the perspective of today's knowledge and understanding.

In interacting with the environment, long term businesses must therefore take into account the knowledge that future generations will have of their environmental impacts. They must therefore accept responsibility for being expert on their environmental interactions and behaving in a way which future generations will find acceptable, otherwise they will not survive those future generations.

In thinking through the response of future generations, it is important to recognise that the environment is another area where there is a growing awareness and it is becoming clear that business should take a more pro-active stance, ensuring its environmental impacts are sustainable in the long term future.

Satisfying these future stakeholders through environmental interactions is therefore one of careful balance. With hindsight, even quite well intentioned actions might look cynically exploitative (as in the case of asbestos) and therefore off putting to any potential long term collaborator. How much less acceptable is the cynically exploitative, whether it is western tobacco firms selling high tar cigarettes to unsophisticated third world markets, or western firms exploiting less rigorous environmental regulation in developing economies.

There is also a positive side to interactions with the environment. Firstly there are genuine new opportunities created by the need to sustain the environment. The areas of potential are extremely wide as the few examples listed below indicate:

- Recycling materials, whether it is the recyclable BMW, or the more mundane business of rebuilding and replenishing cartridges for laser printers, represents a huge potential market.
- Cleaning up processes, e.g. the Corex process for reducing iron ore directly to hot metal, developed by the state owned Voest-Alpine group of Austria, produces substantially fewer emissions than traditional methods and is viable on smaller scale production.
- Creating and selling to the environmentally aware, e.g. Body Shop publishes a values report[84] which balances an objective if incomplete account of Body Shop's activities and their effects with corporate propaganda in an attempt to push corporate accountability for the environment a stage further.

These interactions with the environment might become more than simple satisfying objectives and represent the strategic focus of the business. This has to a considerable extent happened at Body Shop. The fact that Body Shop makes and sells cosmetics is not incidental, but the environmental aspect is of crucial importance and is certainly the factor which differentiates Body Shop from its main competitors.

For most businesses, however, environmental interactions will remain at the satisfying level in the hierarchy and the aim will be to conduct such interactions in a way which will suggest to future stakeholders that the business is trustworthy and suitable for long term collaborations.

7.4 Pleasing Customers

At the intermediate levels in the objectives hierarchy, a business would be expected to behave at Kohlberg's conventional level. This applies to both satisfying stakeholders and pleasing customers. From the perspective of a moral philosopher, the business of pleasing customers is a little more problematic than satisfying the other stakeholders. If you deliberately set out to please a customer, there is implicit in your strategy an unstated intention to compete. Competition is a difficult concept for business ethicists, implying as it does an attempt to inflict some kind of defeat on a third party or parties, a further problem in applying moral philosophy to business situations.

The start of any customer:supplier relationship will generally be through some form of marketing initiative. These are categorised as the 'marketing mix' controllable by marketing managers: promotion, product, price and distribution. Here these are considered following the chronology of a typical customer interaction. The first step is typically some form of promotion, whether it is an advertisement or PR release, a sales promotion or even contact with a personal salesperson. The second part of a customer interaction will be through the product itself, which is defined here as a set of attributes, one of which is the price of the product. The third part of the transaction, which may or may not be crucially important depending on the product, is its distribution. Then finally, there is an after sales contact, which may be very important to the repeat of the transaction and its eventual development into an ongoing relationship.

7.4.1 Promotion

This first contact is likely to set the tone of the whole relationship whether it is in the form of advertising, personal selling, public relations or sales promotion. The aims of promotion may be to inform, to persuade, or to alter the underlying affections and perceptions of the audience. Whatever the promotional activity and whatever its aims, it will always be vital to create and maintain an image of trustworthiness and credibility. If the audience disbelieves the message, its communication will be counterproductive.

Advertising, public relations and personal selling all fairly obviously have the power to create whatever image the promoter desires. There are notoriously deceptive examples of each: the advertisement claiming for its product magical powers to reduce the weight of the purchaser; the public relations 'story' being a thinly veiled advertisement; the second hand car salesman claiming one careful owner and extremely low mileage; the overly confidential murmerings of praises for a household insurer. Some may be deceived, but probably few. The implicit message of such promotional initiatives is that the promoter is not to be trusted. While ever the reality and the image are in conflict, the resulting perception is likely to be exactly the opposite of what was intended.

Whether it is advertising, selling, PR or sales promotion that first introduces the customer to the promoter and seller of the product, these are the means of creating first impressions. The initial expectations of trustworthiness and credibility are created, and are subsequently reinforced or destroyed by the customer's experience with the product or service itself and the subsequent relationship.

7.4.2 Product

The most important transaction with the customer is through the product itself. The degree to which it satisfies customer expectations will be the most powerful and lasting communication of all. So, what is a product? It is clearly more than just the physical object. An expensive bottle of wine is not usually purchased simply to satisfy a thirst; an automobile is not bought solely as a means of transportation. Products are loaded, both physically and psychologically with many extras that may be important determinants of sales success. Marketing literature is replete with descriptions of the many and various components that comprise the modern conception of a product.

One widely held view sees the product as having several layers: the core benefit or service, the formal or expected product and the outer, augmented product layer which includes such things as warranty, service support and so on [e.g. Kotler, 1984]. This onion-like model implies that the product can be unpeeled to reveal hidden depths. The analogy only partially stands up to scrutiny.

The various attributes of a product are not necessarily related in any predictable fashion, onion-like or otherwise. All that can be said is that their are many and various attributes that could be categorised for convenience as physical, implied and psychological as shown in Figure 6.2.

Physical Attributes	Implied Attributes	Psychological Attributes
Price	Distribution	Corporate Image
Quality	Delivery	Brand Image
Performance	Reliability	Product Image
Design	Warranty	Need Image
Packaging	After Sales Support	
	Advertising	
	Service	

Figure 7.2 – Product Attributes

What matters about this complex product is the customer's perceptions of its various attributes. Producing the best mouse trap is of no avail if it is not perceived as such by potential customers. The customer's perception of the product is an amalgam of their perception of the various product attributes, any of which may be critical in adding up to a concept of value which is a combination of price, quality and performance. The concept of quality is not simply unidimensional, but complex. Moreover, its definition clearly depends on the type of product or service being delivered. For example, in the case of food products, distribution is clearly critical, whereas in the case of RAM chips, failure rates and reliability are more important to the customer.

Garvin suggested eight characteristics of quality[85], any of which might be crucial in particular circumstances:

1. Primary Performance
2. Secondary Features
3. Reliability
4. Conformance
5. Durability
6. Serviceability
7. Aesthetics
8. Perceived Quality

Primary performance refers to the product or service's primary operating characteristics, and Garvin noted that these were usually capable of objective measurement, whether the key aspect was in the physical product or the delivery of service.

Secondary features are also usually amenable to objective measurement. They are the extras which may differentiate an otherwise standard product, such as enabling customer selection of detailed product specification, free drinks offered on an airplane, or a wide variety of options in personal investment plans.

Reliability refers to the probability of a product breaking down in use. Clearly this is the key characteristic of many industrial and consumer durable products. Improved standards of reliability achieved in one sector, notably in electronics, appears to have a knock on effect in other sectors.

Conformance refers to the achievement of product specifications, for example dimensions within agreed tolerances. This may be most usually critical in industrial products, particularly where products are to be assembled with other products of similarly defined specifications.

Durability is the expected product life and may be determined either by technical or economic factors. Durability is a characteristic which differed widely between brands – Garvin exampled washing machines which have expected lives of from 5.8 to 18 years, and tumble dryers from 6 to 17 years, for makes of differing quality.

Serviceability refers to the ease, speed, competence and courtesy with which service is provided, (i.e. products delivered, queries answered, repairs achieved etc). Clearly this characteristic is in some respects less amenable to objective measurement. Actual machine down-times resulting from break down may be open to accurate measurement, but the competence and courtesy of the service engineer are clearly subjective measures, likely to be influenced by individual circumstances. Subjectivity highlights the importance of customer complaint handling and in particular obtaining the maximum amount of information about customer perceptions as a result of these transactions.

Aesthetics, the look, feel, sound, taste or smell of a product is clearly a subjective measure, which again means deliberate and calculated steps being taken to achieve any measure of consumer perceptions.

Perceived quality refers to consumers perceptions of quality which may or may not be the same as reality. A firm may have established a reputation for quality which naturally attaches to any product the company offers. The corporate or brand image affects the way potential customers will perceive the product even before its introduction. Clearly this is a powerful factor which may make the difference between success and failure with the introduction of a new product.

These eight dimensions of quality to a great extent accord with the product attributes of Figure 6.2. The main omission is the price attribute. However Garvin's dimensions of quality strike much deeper into the organisation than do the marketer's product attributes, affecting the way each individual in the organisation does their job. The marketer's product attributes may, in organisational terms, be quite superficial even though they may be important aspects of the product or service itself. For example, packaging may contribute substantially to the customer's perception of the product, but the impact of packaging on individuals in the organisation may be minimal.

A ten attribute product, based on Garvin's dimensions of quality and including also the essential attribute of price, plus a tenth attribute labelled as 'Ingredient X' is proposed here as the vehicle for pleasing the customers. Ingredient X is not simply a selling proposition (unique or otherwise), or a marketing gimmick of some kind, but an extra attribute which arises directly from the core competences of the producer and which is intended to provide customer satisfaction above expectations. In the case of service sector businesses, Ingredient X may well relate to special elements of superior service which differentiate the business from its competitors.

Ingredient X is not simply a marginal additional factor in differentiation – it is a remarkable added attribute which takes the customer by surprise. It is a fundamental attribute, stemming directly from the firm's core competences and is therefore not easy for competitors to replicate. Clearly it will not be possible for every business to develop a product or service with a real ingredient X, but for those that do, it may be the most important attribute of all.

These ten attributes are the components of value which the firm delivers to please its customer. No firm can successfully pursue all ten attributes; being leader simultaneously in all ten is hardly possible. Being the price leader may well preclude leadership on any other attribute, and several of the others may well conflict. Management's aim must be to provide a balance of attributes which accords with the requirements of customers. This is the business of pleasing customers and is clearly a far more demanding task than simply satisfying them.

The integrity of the ten attribute product is crucial to business success.

7.4.3 Distribution

Delivery and distribution channels can play an important part in confirming the image that has been created by promotion and by the product itself. An inappropriate distribution channel might severely dent the impact of the image so far created and standard marketing texts are comprehensive in addressing this issue.

Distribution strategy involves careful selection of distributors, and agreement with them of the promotion and product support strategies, thus building relationships of strategic importance to both producer and distributor. Such agreements to collaborate may be of great mutual benefit. Selection of distributors is therefore of great importance, the credibility of their trustworthiness being a prime factor.

Distribution is often important and can be paramount.

7.4.4 After Sales

The sort of after sales relationship that a business has with its customers varies according to the product. A fast moving consumer good will require detailed control of the often repeated transactions, order processing, delivery and payment. Reliability and predictability in these various parts of the transaction can be vital, especially with more firms requiring just-in-time service. One off major purchases need attention to quite different characteristics. For example, the advertising of luxury cars has to focus on past purchasers, not simply to maintain customer loyalty but also to eliminate the phenomenon marketers refer to as *cognitive dissonance*, the uncomfortable feeling that spending around £200,000 on a means of getting from A to B was not smart.

Marketing research can be another ongoing after sales contact. This demonstrates a continuing interest in the customer and their needs and desires and in improving the way those needs and desires are satisfied and even pleased. Lost customers can be a highly productive source of invaluable customer intelligence.

7.4.5 General

Pleasing customers is not just an ill-defined holier than thou intention. It involves all of the sub-parts of the customer transactions outlined above. If each aspect is effectively managed they will all serve to reinforce the customer's initial perceptions. If any particular aspect is not focused effectively on pleasing the customer, it will tend to undercut the intended image and customer perceptions and severely reduce the level of trust that the business is able to establish.

7.5 Beating Competitors

The strategic objective was identified in Figure 5.1 as 'being unique, beating competitors, being best at something.' This is the objective on which every business should ideally be focused. Making profits, creating shareholder wealth, even pleasing competitors, are only means to the end of beating competitors. The ways to beat competitors is to establish and exploit a distinctive competence.

Every viable business has some 'distinctive competence', something at which it is peculiarly effective. It may not be absolutely unique and the firm may not be the best in the world, but at least, in some aspect, it must be better than the competitors which also serve its markets. If it were not so, the firm would go out of business.

For the distinctive competence to be of any strategic value it must be embodied in the product the customer buys. For example, a firm may be peculiarly effective in R&D, but if the fruits of its research are not incorporated in the firm's product this competence will avail it nothing. Similarly the distinctive competence might relate to some aspect of cost, but if that strength is not embodied in the product either in the form of reduced price or increased quality or performance, it will have no strategic impact.

If the distinctive competence accords with the customer need and is embodied in the product, it creates a leadership position, which is the foundation of a successful business. Leadership is not necessarily based on a dominant share of the market, or being first in every product line, or the most technologically advanced, but it does need to relate to something the customer values. It might be in service, or distribution, or some quite narrow aspect of the product. It might even relate to the firm's ability to convert ideas into saleable products.

Potentially then, a leadership position attaching to anything which the customer values, provides the business with economic results. With no leadership position, even if the firm has the major share of the market, the business will at best be 'marginal'.

7.5.1 Competitive Strategies

Neoclassical economist, Michael Porter, based his model of competitive strategy on the simple notion that the only way to maximise profit, given that the only variables he had at his disposal were price, quantity and cost, was to maximise price or minimise cost. Thus he defined the two strategies which he labelled cost leadership and differentiation. The strict meaning of 'differentiation' is 'premium price' strategy, because differentiating the product in a way which does not earn a premium price will not serve to maximise profit, which is what economist Porter intended his strategies should achieve.

These are strategies which are entirely inward looking rather than competitive. Porter acknowledged that the strategic health and performance of a business needed to be measured by something other than profit. It must take into account the performance of competing businesses and through that comparison derive what he referred to as competitive advantage. The way to achieve competitive advantage was by beating competitors, i.e. successfully achieving lower costs or higher prices than competitors, or avoiding them, typically dominating some specialist market segment.

Beating competitors by achieving lower costs, means they can be confronted head on. In this way, with an undifferentiated product commanding a standard market price, a firm is able to achieve the highest rates of profit in its industry. Avoiding competitors is achieved by differentiating the product from that of standard product competitors and achieving a premium price which enables the higher margins to be earned that will lead to long term prosperity.

Both of these strategies can be applied either across a broad front, or by focusing on a limited segment of the market rather than the market as a whole. Cost leadership and differentiation, focused and unfocused, are mutually exclusive and represent the only competitive strategy options available. Any attempt to pursue more than one such strategy only leads to the firm being 'stuck in the middle', i.e. without any coherent strategy, lacking direction and with no prospect of concentration and consistency, unable to focus on the top strategic objective.

Cost leadership is a term that has come to mean many different things. A firm which is accounting dominated and constantly emphasises efficiency is frequently referred to as having adopted a cost leadership strategy. This is not necessarily correct. One of management's jobs, no matter what the business strategy, is to try and operate efficiently, but this does not imply they are necessarily seeking to be cost leaders.

The strategy of cost leadership applies to businesses which attempt to become the lowest cost producer in an industry. If competing products are more or less undifferentiated and therefore sell at a standard market price, the competitor with the lowest costs will earn the highest profits. However, in any industry there can only be one cost leader. All other competitors following a cost leadership strategy cannot by definition succeed. The degree to which their costs exceed those of the cost leader is some measure of their vulnerability. In the event of direct price competition the would-be cost leaders who came second best will almost inevitably be forced to reduce market share or stand making losses, and in the extreme may be driven out of the industry altogether. Following a cost leadership strategy without success frequently leads managements to redouble their efforts to reduce costs. Their focus on cost reduction and efficiency, at the expense of all other factors, may become totally dominant and an end in itself.

In an award winning article, Wickham Skinner wrote about what he called the productivity paradox, recognising the short term orientation of managers focused on cost leadership:

> *'the efforts to improve productivity actually drive competitive success further out of reach. This is because cost leadership is a syndrome, a mind set, which stunts strategic vision and inhibits innovation. Breaking loose from the mind-set is not easy. It requires a change in culture, in habits, instincts and ways of thinking and reasoning'*.[86]

What was true three decades ago, is even more true today under the dominant influence of the Friedmanite economic orthodoxy which has moved the focus from maximising profits to maximising shareholder wealth. Profit can be invested in a wide variety of projects, most of which benefit the company in one way or another. Maximising the shareholder take, removes that value from the company.

The short term cost leadership focus inhibits investment in developing new plant and new technology. In due course that results in firms losing the ability to compete effectively. In the face of price competition such firms inevitably lose both in terms of profit and market share. Consequently, Hayes & Garvin noted,

> *'morale sags, performance suffers, and employees – generally the best ones – begin to leave. Faced with these circumstances, top management often concludes that a division or product line is unsalvageable and purposely continues the process of disinvestment.'*[87]

Once started, this disinvestment spiral is extremely difficult to reverse. Since 1986, the year of the last two references and of the Big Bang stock market computerisation and financial deregulation, that disinvestment spiral has only gathered pace. By 2012 there had been a 'multi-trillion dollar transfer of cash from US corporations to their shareholders over the past 10 years'[88] and similar disinvestment achieved in UK.

The basis of the differentiation does not appear to matter. It may be to do with the product, its quality or with customer service. To be strategically valid the point of differentiation must be one for which there is a need i.e. customers perceive it as being worth a premium price. Differentiation for its own sake has no strategic value. If it is not worth a premium then the product will only command a basic, general market price and the business, unless it is the cost leader, will be unable to earn an economic return.

The most successful differentiation strategies are those where the point of differentiation perceived and valued by customers, coincides with the organisation's distinctive competence. This may be some skill or knowledge, often embodied in some unique or patented plant or process. It could also be in some organisational characteristic which, for example, enables the organisation to deliver product of uniquely high quality. Distinctive competence is the key to effective competition in specific market areas or niches.

7.5.2 Ethics and Winning

The aim of competitive strategy is quite simply to achieve a leadership position or competitive advantage, so that the firm can proceed to beat its competitors. It may do this directly if it has achieved a cost leadership position, or indirectly through differentiation. If a leadership position is successfully achieved, it will attract the competition. Thus, even with a differentiation strategy, it will not prove possible to avoid competitors for long. In the end, every successful business, whether or not it competes head on from the outset, will find itself in direct competition. No matter how reluctant, it will inevitably have to deal with the problem of competition and it will not want to lose. Neither will its suppliers, its employees, or its shareholders want it to lose. Nor will its managers, and their families want it to lose.

Competitive markets serve the interests of the population as a whole. If markets are allowed to be dominated by a very small number of players, they tend to operate as an effective monopoly, fixing the prices at a level which produces a comfortable return without too much effort. Competitive markets demand considerable effort to remain profitable. It is from that competitive effort that the general good benefits.

However, the question might arise, when considering how to beat a competitor, whether it would be right to drive it out of business. For the moral philosopher this may be a deeply unethical proposition. They might question whether there could be any circumstances in which such a course of action – a sort of corporate murder – could be justified?

For those that adopt the enlightened self-interest approach this possibility causes no dilemma. The only reason for not driving a competitor out of business if the opportunity is available, is one of self-interest. A competitive market is one where the participants are deliberately and systematically trying to beat each other for their own advantage, if necessary to the death. A competitive market frequently prevents or punishes the would-be monopolist and it may be the most sensible strategy to allow a competitor to preserve its independence. Nevertheless such a strategy has its dangers. A weak competitor that only exists on sufferance can help breed a dangerous degree of complacency which may result in the whole market becoming vulnerable.

Whether or not a competitor is driven out of business, the key issue remains one of how to behave in such a way that the credibility of your trustworthiness is enhanced rather than diminished by your actions. It is by no means clear that tolerating a weak competitor is the strategy most likely to achieve this aim. If you cannot be trusted to operate as an effective competitor, could you be trusted in a crucially important strategic alliance?

7.5.3 Competitive Collaboration

Whilst no successful business ever forgets that its competitors are fundamentally its enemies whose interests are diametrically opposed to its own, they nevertheless present unique opportunities for strategically effective and highly profitable collaboration.

Collaborating competitors can and do fix prices at which they can survive and prosper. They can and do carve up markets and agree where and when they will compete and, more importantly, where and when they will not compete. Collaborating competitors can and do exchange 'confidential' information about prices, price increases, discounts and special tenders, about customers and about other competitors. Collaborating competitors can and do agree the specifications of generic products in their industry, and they can and do agree variations which they will adopt in order to provide some differentiation.

In some industries these arrangements are more effective than in others. In some industries they are more common than in others. In most industries such collaborations are potentially valuable strategies. And in all industries they might possibly be illegal. The vagueness on legality arises because these are not simple black and white issues. There are degrees of competitive collaboration, from the formal exchange of product information at a regular meeting of an industry research association, to a secretive conspiracy to fix prices.

The question, as always, is not 'is it ethical?' but 'would it enhance or inhibit chances of being invited into mutually advantageous collaborations?' and 'would it increase or diminish the credibility of our trustworthiness?'

In this world of global markets, technological collaborations and strategic alliances competitors also get together for the most positive of reasons, for example, to take forward an industry's technology when separately the costs could never be justified. What collaborating competitors must never forget is that they are fundamentally adversaries and that though their potential partners may appear to operate generally at the conventional level of moral development behaving in ways which are generally regarded as ethical, in competitor transactions they are likely to adopt a pre-conventional stance, behaving ethically only because they would be likely to be caught and punished for their actions.

7.6 Conclusion

This chapter has served several purposes. Firstly it has described and exampled the way businesses may be expected to behave in their different transactions with various stakeholders and at different levels on the hierarchy of objectives.

It is only in transactions with stakeholders that the firm's ethical values become apparent and operative. Abstract ethics have no relevance to social organisations.

At the level of survival, businesses may be expected to adopt different standards of behaviour than when they are better established and aiming at the intermediate level satisfying objectives (see Figure 5.2). When survival is threatened firms will behave as though they were at the pre-conventional level of moral development, constrained only by the prospect of being apprehended and the certainty that if they were the individuals responsible would be punished.

At the intermediate level of objectives firms may be expected to behave as though they were at the conventional level of moral development i.e. they behave in ways which are generally considered ethical.

When firms are focused on their top strategic level objective of beating competitors they may again be expected to behave at the pre-conventional level, Their behaviour regarding competitors will thus be different from their behaviour with regard to any other of the firm's stakeholders.

In identifying these various transactions as the vehicle for expressing a firm's ethical standing, it is clear that ethics can be defined more simply as integrity in relationships. Integrity in business impacts on the business's ability to engage in mutually advantageous collaborations. It is a calculation based on an understanding of the position both interacting parties. It is not a value or a 'passion'.

As Axelrod suggested integrity in relationships must have clarity, niceness, provocability and forgivingness. Potential strategic partners must be able to understand the basis on which they both will collaborate; they must be able to believe in each other's trustworthiness; they must each keep their promises and punish cheating; and if it is to be long lasting they must not hold grudges – i.e. if a lapse in co-operation has been punished, the normal collaborative partnership is resumed.

Various elements have now been identified which are foundational to the establishment of a culture of integrity, which is the subject matter of the next chapter.

8 Business Integrity

Learning Objectives:

To understand what really constitutes enlightened self-interest
To understand why trustworthiness must be a reality rather than a perception in the eye of the beholder.
To understand that it must be real organisational characteristic rather than a management style that can be adopted or changed.
To understand the calculation of different levels of integrity
To understand that integrity must be valid in different cultures.

8.1 Introduction

Most of the pieces are now in place to define this particular approach to corporate integrity. Its foundation is, as far as possible, values free. No judgements are made about the morality of a particular business as currently practised. No suggestion is made that the ethical standards of business, or business managers, should be improved.

Instead it has been recognised that business is an ethically ambiguous enterprise. When a business is first set up the entrepreneur is professionally advised to minimise tax payments and maximise the pre-tax 'take' from the business. To do otherwise, i.e. to pay more tax than is necessary, would simply be wasteful; as would paying suppliers more than is necessary or earlier than necessary, providing the customer with more value than required, or paying employees more than enough to retain their active cooperation. In all these ways, business deliberately pushes at the boundaries of what would widely be regarded as ethically acceptable behaviour. It is of no concern to the business that the surplus taxes it might choose to pay could be put to the greater good of the greatest number.

In becoming an effective competitor, the simple rule that 'all is fair' seems to apply – the avowed intent is to beat competitors. Similarly, when a business is itself being beaten and its continued existence is threatened, it is likely to act in ways which might normally be regarded as unethical.

In the face of all these very real pressures, it seems futile to expect that managers will behave in certain ways because of some extraneous belief system or because of the philosophical teachings from an earlier age. Neither God, nor Kant has had to run a modern business.

Nevertheless there are certain ethical imperatives that business must observe if it is to prosper. For others to willingly engage with it in mutually beneficial agreements, a business must be regarded as trustworthy. If it is known to behave dishonestly with one stakeholder or stakeholder group, it is likely to be regarded as being generally less trustworthy.

8.2 Enlightened Self-Interest Revisited

The ethical performance of business is seen and understood by different stakeholders from quite different viewpoints, firstly as to whether certain minimum standards of performance are being met.

From the point of view of employees, the business may be assessed, first of all, as to how completely it fulfils its part in the contract of employment. From the point of view of suppliers, it will be assessed as to its completion of agreed transactions, paying the agreed amount for the product, within the agreed timescale and accepting the product in good faith, and so on. From the point of view of the community, a business would be required to behave in a socially responsible way, not in any way doing damage to the local community. From the environmental perspective , business interactions would have to fulfil the minimum requirements of 'do them no harm', i.e. not polluting the environment, nor passing onto the relevant public authorities any costs of environmental cleaning up or rectification.

For all business stakeholders, transaction components need to be wholly transparent, and the minimum requirements met for the business to be perceived as behaving in an ethical manner. If any transgression does occur, the minimum requirement is for the business to be totally honest in admission of fault and in immediate rectification and payment of compensation. These are all minimum requirements set on the basis of 'let us do them no harm'.

This is the minimum standard of performance that might be defined as enlightened self-interest. It defines a level of ethical performance at which the business will be perceived as having reached Kohlberg's conventional level of moral development. It does not need to be perceived as god-like in its virtue, but does need to be perceived as trustworthy, as having internalised the principle of trust, as keeping to agreements and fully meeting agreements and expectations, i.e. achieving the minimum levels of performance in all their interactions with stakeholders. That is the level of performance which will make the business attractive as partners and collaborators, included in the mutually advantageous interdependence essential to long lasting prosperity. Moreover, flexible, network and team based organisational forms which are important to businesses as knowledge processors, make acceptability as a partner just as important inside the organisation as it is externally.

However, businesses being managed according to the diktats of the economic orthodoxy will seek to maximise shareholder wealth. They will be unlikely to agree those minimum requirements unless persuaded to do so by the knowledge that transgressions would not escape without rectification and punitive fines for the business and the responsible individuals. Businesses which are not perceived as trustworthy are therefore excluded from such collaborations, alliances and partnerships will inevitably lose competitive strength.

Ensuring that a business operates with enlightened self-interest, i.e. is perceived as trustworthy, is the primary concern of this and the following chapter. The approach is one of deliberate calculation. In order to participate in worthwhile partnerships, the organisation needs to be perceived in a certain way and it is management's job to see that it is so perceived by the all stakeholders with which it transacts.

This is very different from the idea of a values driven organisation which has ideals and passion etc. In addressing stakeholder perceptions there need be no emotion, no passion, nothing woolly or emotive. Calculating stakeholder perceptions should prove more robust than reliance on the passionately held convictions of key individuals.

This chapter makes some basic arguments which are important to the enlightened self-interest approach to integrity. These are not revealed truths, but are deliberately set out as arguments on which the reader can form his or her own view. They are important to the overall approach, being basic to the question of how a business ensures it is perceived as trustworthy.

8.3 Perception or Reality

Perceptions determine behaviour. Perceptions as to a potential partner's trustworthiness critically affect whether or not they will be invited to join in collaborations and alliances. It is the image that is perceived, not necessarily the reality.

Images are what Kotler referred to as *'sticky'*, i.e. they persist and take a long time to change. This is because once people have a certain image of an object they perceive further data selectively, accepting confirmatory data and rejecting new data which does not confirm their previous image. It will therefore take considerable time and expense to change an image.

If a business manager is perceived as untrustworthy, no matter that they are in fact absolutely 100% honest and reliable, the potential partner will act on the perception. The reality is only important in as much as it affects the image. In practice this turns out to be crucial.

Closing image gaps, i.e. the variance between the reality and the perceived image, is a notoriously slow and expensive process. Closing a gap is the process of changing an inaccurate perception to coincide with the reality.

Deliberately opening such a gap to create a false image would be even slower and more expensive and extremely difficult to sustain. The truth would inevitably become apparent from time to time and, in the end, would tend to overwhelm the false image being created. The larger the image gap the more expensive it would be to open and the less likely it would be to be sustained.

The fact that these processes are 'sticky', i.e. slow to change and expensive to manipulate, suggests that in practice if an image differs significantly from the reality it is unlikely to be long lasting. In the end the 'truth will out'.

Thus managements need to be concerned with the reality of integrity in their organisations not simply window dressing to build a false image of trustworthiness. Credibility is crucial. Unless trustworthiness is believed it will not just have no strategic effect (i.e. not enable firms to engage in mutually advantageous collaborations), it would work to actively exclude firms from such collaborations.

Firms have therefore to be very careful not to take actions which damage credibility. The potential impact, on the firm's image, of actions and decisions should therefore be assessed on the assumption that the 'truth will out'. Thus management needs continually to be considering 'what if the truth were known about this?'

8.4 Characteristic or Style

In assuming that integrity can be calculated, rather than being a passionately held conviction, it might also follow that it could be adopted as a style of management, rather than necessarily being a fundamental characteristic of the organisation's culture. As a style it might be adopted in calculated fashion to reinforce the perceptions of stakeholders as would be most cost effective. Since there are so many different stakeholders, it might therefore be feasible to adopt one style for some stakeholders and perhaps a different style for others. Thus the organisation might benefit from the fruits of being perceived as trustworthy with one group of stakeholders, but be saved from the expense of preserving the same trustworthy image with other less critical stakeholders.

Does perception of the organisation's integrity with regard to one set of stakeholders affect other stakeholders' perceptions of the organisation's trustworthiness? Is it possible, for example, to enjoy the fruits of high integrity with the customers and mercilessly exploit your employees? What would have been the impact on Body Shop if it had been known that Anita Roddick, far from being an energetic, inspirational idealist, was actually a dishonest, exploitative employer? It might be unimaginable, but there have been many less stark examples of such discontinuity. The City of London, once known for its watchword 'my word is my bond', is now regarded in the popular imagination as a centre of sophisticated financial crime. The destruction of earlier perceptions will take an extremely prolonged period of purity and virtue to rebuild the City's reputation in the general population. The same goes for the City's key activities in banking which is still in 2015 collecting massive fines for previous frauds only now being brought to justice.

Can a company adopt and promote one level of integrity in one area, but not in others? The answer is necessarily circumstantial. There are examples both ways. At the very least it would be an extremely high risk strategy. Perhaps the best answer is to suggest that, in the short run, a business might succeed with such a tactic. But not in the long run.

In the strategic time frame, businesses have to try and perform to the same conventional level with all stakeholders. Lack of integrity with one set of stakeholders, will be perceived by other stakeholders as being evidence of a general lack of integrity. Integrity is a searching commodity, leaking from one relationship to another. Moreover, this leakiness is very much facilitated by the increasing intrusiveness of the media and openness of communications, especially the social media.

Previous assumptions that personal matters such as remuneration levels and taxation arrangements would not become public knowledge, are clearly no longer tenable. Information which might previously have been confidential to one set of stakeholders is today known by all stakeholders and the question which managements must be concerned with is 'what if all stakeholders knew about it?'

Managements must proceed on the assumption that all stakeholders will in due course find out anything which is in the slightest bit newsworthy. Thus integrity should be regarded as an organisational characteristic, rather than a style that can be calculated to fit particular circumstances. As an organisational characteristic it will be known, understood and acted on by all employees at all times and therefore applied equally to all the organisation's transactions with its various stakeholders.

8.5 Calculation or Value

So enlightened self-interest requires management to be concerned with the questions 'what if the truth were known about this?' and 'what if all stakeholders knew about it?' Putting these two questions together suggests that, in order to ensure their business is perceived as being trustworthy, management must be concerned with 'what if all stakeholders knew the truth about this?'

Business integrity has to be calculated, rather than a value which might be passionately held by some people and not others. It is calculated in the sense that it is the perception of a firm's trust worthiness that affects its stakeholders' behaviour rather than the reality so it is the perception which is calculated. Moreover, Axelrod's requirements of clarity, niceness, provocability and forgiveness, which support the approach, are all clearly calculations.

It has been argued that if a perceived image is to be long lasting it must be supported by the reality – a false image is unlikely to be upheld. It has also been argued that integrity must be maintained consistently at the same level for all stakeholders – otherwise the perception will most probably fall to the level of the lowest common denominator – i.e. integrity is a basic characteristic not a style that can simply be adopted as and when appropriate.

Thus by calculation, rather than by using some extraneous value system, we have reached the point where it is tenable to suggest that, a business which adopts the strategic perspective needs to behave with real integrity at all times and to all stakeholders. Thus we come to the position suggested by Gauthier, that the principle of trust, i.e. integrity, needs to be internalised. In the case of an organisation, rather than an individual, integrity needs to be internalised by the organisation's members.

Integrity, as a key aspect of a company's culture is all pervasive and vital to effective management. *'Hands on, value driven'* was one of Peters & Waterman's much derided excellent characteristics, but is relevant to the more loosely structured organisation forms where the value driven organisation outperforms Ghoshal's *'ruthless, command and control focused, shareholder value obsessed, win-at-any-cost'* organisations.

With no integrity, communications in the hands-on, value-driven organisations would be entirely counter-productive; individuals would be unable to make wholehearted commitment to the organisation; and, the formulation and implementation of strategy would become much less effective. Without integrity it would be extremely difficult to complete the executive tasks first outlined by Chester Barnard:

- Maintenance of organisational communication
- Securing of essential services from individuals
- Formulation of purpose and objectives

Thus, integrity, though identified as a calculation, is an essential component of the organisation's culture. The constancy and consistency required to ensure that the firm's integrity is truly perceived by stakeholders are only likely to be achieved if it is absorbed deep in the organisation's culture.

8.6 Transcultural Integrity

Each organisation's culture is unique, like an individual's character or personality, but is influenced by the national, geographic, social and economic characteristics in which it is located. What is true of organisations in the United States is not necessarily true of organisations in China, India or Egypt. What individuals perceive as important, varies from country to country. Customs and practice in different countries vary so much that a compliment in one country might well be construed as a calculated insult in another. Language, body language, even assumptions about personal space, all highlight the different ways of doing things humans have developed in different circumstances. Even life itself is valued differently, as Bophal's victims would testify following the Indian government's agreement of Union Carbide's compensation scheme.

These differences, which include many issues of ethics and integrity, are to varying degrees understood and taken into account by the multi-national corporation. The question is how are management to accommodate for the fact that what is regarded as perfectly normal in, say, Asia is generally regarded as wholly unacceptable in Anglo-America? Also what is acceptable in the UK and US is not so in parts of Asia?

There are no simple answers. Management must make a judgement. But what does it judge? Business ethicists might suggest that they should judge whether the action, for example, bribery, is in principle right or wrong? Or they might suggest management consider whether the action increases, or diminishes, the general good. If judging the matter on principle, it might be very difficult to know where to draw the line. Some quite trivial acts of courtesy, or expressions of support or esteem, might be regarded as bribes. If judging the matter in terms of its consequences, it might also be highly complex. In the case of a straightforward payment to a critical individual in order to gain a large order, it is not clear if anyone loses, while the briber's employees stand to gain. Business ethicists offer no definitive answers.

Neither is the enlightened self-interest model completely unambiguous, but it does highlight a crucial question for management. *'What would be the effect on our perceived trustworthiness if all stakeholders knew the whole truth?'* For some companies the consequences have been catastrophic, even terminal. If a company asked this question before committing itself to paying the bribes, it might recognise the need for an alternative course of action. Even accompany operating at Kohlberg's pre-conventional level and therefore expected to indulge in bribery so long as it believed it would not be detected, might be dissuaded by asking itself that question. If the answer is disaster, even though the probability is low, a pre-conventional operator would still be dissuaded from such behaviour.

That question about *all* stakeholders suggests that management needs to consider stakeholders in all the markets in which it operates, not simply its home base, nor even the particular market in which the action or decision is going to be operative. Quite clearly it needs to consider both. This implies that the company must adhere to courses of action which will not damage its perceived trustworthiness in any markets, or cultures, in which it operates. The organisation must thus raise its performance to a level which would be regarded as consistent with the required level of integrity in every served market.

This may sound extremely onerous, but in practice it is becoming less problematic. As products, markets, technologies and industries are becoming increasingly globalised, so too are business practices and standards of integrity. Differences are actually becoming less pronounced and understanding of those differences is becoming more universal. It remains a matter for management judgement, but the judgements are becoming both less significant and easier to make.

8.7 Levels of Integrity

Integrity is a dimension, or continuum, rather than a single point characteristic. There are levels of integrity analogous to Kohlberg's levels of moral development. At the conventional level, firms maintain standards of integrity which are generally regarded as sufficient to be trusted in partnership. The pre-conventional level suggests behaviour which would normally exclude a business from partnership, but which in competitive or survival circumstances might be regarded as comprehensible and to some extent predictable.

This analysis is entirely general and makes no distinction between businesses or non-business organisations. Yet it is clear that different businesses require to achieve different levels of integrity. The simple dichotomy between businesses which are out to make a quick killing and those that have a strategic perspective is too simple. There are different categories of business having a strategic perspective. Some simply regard the achievement of a minimum level of integrity as necessary in order to make themselves acceptable to others, i.e. as a hygiene factor. Others look at corporate integrity in a more positive light, as a corporate strength to be utilised for the strategic gain of the firm. These firms recognise integrity as a motivator.

The hygiene factor approach defines a level of integrity below which the performance of internal stakeholders would be badly affected and external stakeholders dissatisfied. Thus it needs to be maintained at the level at which it would not to be the source of dissatisfaction for existing stakeholders and at which the firm would not be excluded from partnerships, i.e. it suggests a minimum level of integrity to be achieved. For such firms, over-achieving in terms of integrity would simply be wasteful. For firms using integrity as a motivator, however, the approach is quite different. For these firms, corporate integrity is recognized as a priceless strategic asset, which while not a balance sheet item, is there to be exploited like any other asset. Even within these 'motivator' firms there are different categories, having different socio-moral perspectives.

Kohlberg suggested it was important to understand the socio-moral perspective of the actor before judging the morality of his or her behaviour. Here we are not so much concerned to make judgements as to provide a way of looking at situations. It is up to particular management's to know their own organisation's socio-moral perspective and decide the level of integrity they need to achieve. Integrity might be categorised as falling into four levels as depicted in Figure 6.2 (page 80) and described below:

- ***Negative*** – in some industries firms are not expected to operate with integrity. Legality is a sufficient criterion. The general public would not be surprised if firms involved in these activities were not also engaged in illegal operations. Examples might include junk bond operators, pornography shops, etc.
- ***Neutral*** – many industries or firms are expected to behave with any particular regard for integrity. Their products may be used by the general public and yet the firms that manufacture or sell them are recognised separately from their products. Financial conglomerates are typical of this level. They might own the shares in many businesses which supply products well known to the public, yet the subsidiary businesses themselves would only be expected to behave in line with the parent's own standards of integrity, which are most widely recognised as being opportunistic and self-interested, without too much enlightenment. High Street banks are also now widely perceived as being at this level. Previously they were thought to act with scrupulous honesty, but since 1986 are tainted with the high profile criminality of their speculative investment banking activities as well as the excessive bonus payments they all indulge in.

- ***Positive*** – Some firms are, for various reasons, recognised as being positively oriented to integrity. The global co-operative movement maintains high standards of integrity, encouraging movements such as the Soil Association, organic produce, Fairtrade, etc. The UK co-operative history stretches back to Robert Owen with traditions in retail giving value for money, reliability and quality. Co-operatives generally might be expected to completely fulfil Axelrod's requirements of clarity, niceness, provocability and forgivingness. Other examples include inheritors of Quaker and other religious traditions, such as Cadbury and Rowntree though no longer independent, and firms whose competitive strength is built on product quality, typified by Rolls Royce Plc. Firms in 'life and death' industries, e.g. pharmaceuticals, would benefit from a positive orientation to integrity. Their frequently being in the news for the reverse, highlights the neoclassical orthodoxy approved monopolistic tendencies of big pharma.
- ***Dependent*** – Some businesses base their competitive strength on a dependence on integrity. Their particular ethical approach is their source of differentiation. A number of investment trusts have been so focused and have generally outperformed competitors with no particular ethical orientation. Members of the co-operative movement might position themselves as integrity dependent. Body Shop is a further example of a business which deliberately made itself ethically dependent.

The level at which a particular business is oriented is a matter of management judgement and should result from an explicit management decision process, just as does business strategy itself. In practice, it may well emerge, like strategy, as a result of continued trial and error, or even by accident. Management needs to decide what level is appropriate for their particular business and then to follow through the implications in terms of subsequent actions outlined in the next chapter.

It is worth noting, in passing, that the subject area of corporate philanthropy is not regarded here as relevant to business. By definition it is not related to the business interest – if it was it would not be philanthropy. Early corporate philanthropists tended to be either those driven by religious conviction, such as the Quaker businesses, or those driven by personal motivations, such as the robber barons having made their fortunes wondering what to do with them. This is not to denigrate the excellent and important work done by philanthropists and and charitable foundations, merely to set it aside as not relevant to the present purpose.

8.8 Conclusion

Integrity has been examined from different business perspectives in order to see how different organisations, in different circumstances, are likely to regard integrity, and how the different approaches to integrity are related to different levels of long term business success. Nevertheless, no clear ethical standard has been proposed.

It has been acknowledged that on the one hand, it is the perception of a firm's integrity that determines the behaviour of potential partners, but on the other hand if the perception is different from reality it is unlikely to be long lasting. Thus the reality of a firm's integrity is what really matters.

It has been acknowledged that it is perfectly possible for a firm to operate with high integrity towards one set of stakeholders and be much less ethical with others; that integrity might thus be like a management style that could be decided on and adopted to fit particular circumstances. However, perceptions of integrity determine behaviour and so if the firm behaves unethically towards one set of stakeholders, it would be perceived as generally unethical by all stakeholders aware of its unethical behaviour. This perception would then determine stakeholder behaviour.

Thus the level of a firm's integrity must be adopted consistently across all its transactions. It must be developed as a fundamental characteristic rather than a style. For it to be maintained consistently over time and between all stakeholders, it must be carefully developed as an essential aspect of the firm's culture. Only then is it likely to be perceived by all stakeholders to be both real and consistent.

Corporate integrity has been recognised as a continuous variable measured on a continuum from negative to highly positive. Four broad regions on this continuum were identified – negative, neutral, positive and dependent. Examples of firms in each of these general areas have been provided, but there is no definitive mechanism for identifying a particular firm's position. This whole area is riddled with ambiguity and uncertainty. However, managers are increasingly used to handling ambiguity, and will be familiar with the problems inherent in this analysis of integrity.

It has been concluded that there are considerable benefits in being, and being perceived to be, at a high level of corporate integrity. From the point of view of Gauthier's model of mutually advantageous collaborations and partnerships, the higher the level the better.

Despite all the caveats and limitations that must be placed on generalised statements, it appears that successful businesses place considerable importance on behaving with high integrity in all transactions with all their stakeholders. This is not new. Such firms establish a high integrity culture. This is not new either. Moreover, it may sound disappointing to have set out with an approach which was determinedly as value free as possible and to have reached such a conclusion. However, the starting point is important and the route taken to reach this conclusion is also important. Because of these, it is possible to identify the actions necessary to achieve this high integrity culture as a result of dispassionate analysis, rather than as the imperatives of fervently held, but possibly idiosyncratic, systems of personal morality.

9 Action on Trust and Integrity

Learning Objectives:

To understand that management of trust and integrity takes place in an immensely ambiguous environment.
To understand that effective trust and integrity management depends on the organisations culture rather than the personal values of leading managers.
To understand that progressive organisations require a culture of openness.
To understand the origins and limitations of corporate governance codes of best practice.
To understand the potential power of internal codes of ethical practice will only be realised if they are supported with live and regular action to monitor, report and act on ethical performance.
Finally, to understand that the trust and integrity of every business organisation is unique to its particular situation and its culture is as individual as human personality. There are no universal truths, except that management is responsible.

9.1 Introduction

Leading business ethicist De George prefaced his book on 'Competing with Integrity in International Business' by highlighting various themes which underlay his approach. The first, and perhaps most crucial, of these was that the business could be no more ethical than the persons who ran it. This is a basic tenet of most business ethicists and has long been part of the orthodox wisdom:

> *"What matters most is where we stand as individual managers and how we behave when faced with decisions which combine ethical and commercial judgments."*[89]

This approach to business ethics is personal, the intention being to inform, educate and indoctrinate so that the ethical standards of the individual recipients are raised and the business organisations in which they operate are therefore also 'improved'.

The enlightened self-interest approach to organisational integrity, on the other hand, recognizes that business organisations have an existence above and beyond the individuals who run them. It is not just that business are legal entities with duties and responsibilities that are akin to personal individuals. But businesses develop long lasting cultures, akin to personalities, which may or may not coincide with the values and beliefs of individual managers who from time to time may lead the organisation. The business personality is ongoing and, in most cases, far outlasts the reign of any individual manager.

This is seen in the strong ongoing personality of companies such as Cadbury. Up to and beyond its sell-off to Kraft Corporation, Cadbury's Quaker origins still permeated the company. Nevertheless, Cadbury must certainly have employed senior people whose personal standards were less ethical than those of the company that employed them. In order to survive and prosper in that culture, such individuals would have to behave at the Cadbury's level of integrity. If instead they, had tried to lower Cadbury's standards to their own, there would almost certainly have been a disputation, resulting most probably in the rejection of the individual concerned. A strong corporate culture is more robust than the personal values of an individual manager or director.

Moreover, despite the high ethical standards of some individuals they do not necessarily impose their standards on the organisation. An example of such a high integrity individual is described in Box 9.1, highlighting the very strong cultural pressures which can persist long after they are demonstrably inappropriate, but how an individual can achieve a high integrity outcome.

Box 9.1 – "Still no Oscar for Sugihara's List"

Chiune Sugihara was 40 years old and serving as Japan's consul-general in Lithuania when the Jews from Poland arrived. It was the summer of 1940, the Nazis were on the rampage in Europe, Jews were being rounded up, and the only escape route was across the Soviet Union to Japan and then to the United States. But first they needed a visa.

Japan did not go to war until its attack on Pearl Harbor in December 1941, but already its military government was leaning towards an alliance with Germany. When the terrified Jews queued up at Sugihara's residence and begged for transit visas, the Japanese consul was faced with a dilemma. Three times he cabled Tokyo asking for permission to issue visas, and each time he was refused. But he knew the Jews faced internment and likely death if they returned to Poland.

Sugihara decided to defy instructions and issue hand-written visas: in 28 days he processed 1,600 permits which allowed some 6,000 Jews passage through Japan. More people were applying, but then the Foreign Ministry in Tokyo ordered Sugihara to move to Berlin. Sugihara had already saved more than four times as many people as Oskar Schindler – celebrated in Stephen Spielberg's film. And he had not made a single yen or pfennig, unlike the industrialist Schindler.

When Sugihara returned to Tokyo after the war, he was fired by the Foreign Ministry. The humanitarian concerns were never entered into: he had disobeyed orders. Although he received the Yad Vashem Prize for Righteous Gentiles from Israel in 1985, he died in 1986 without receiving any official recognition from Japan.

It was not until 1991, when a top diplomat was preparing Japan's first official visit to newly-independent Lithuania, that the case of Sugihara came up again. He was still the most famous Japanese figure in Lithuania, and protocol demanded some gesture on Japan's part. After much high level debate, a Foreign Ministry official was dispatched to visit Sugihara's family, and although no apology was issued, the official expressed his "regrets" that Sugihara had been cold-shouldered by the Japanese Establishment for five decades. The prime minister at the time, Kiichi Miyazawa, mentioned Sugihara in a speech in the Diet (parliament), but also refrained from issuing any apology.

In the popular imagination: Japan in the 1930s was caught up in a battle for supremacy with the West. This was a racial confrontation between whites and the only Asian nation capable of resisting them. Japan had no choice but to go to war. If tens of thousands of civilians in Nanking had to be sacrificed to consolidate Japanese advances in China, that was just part of war. And wars are inhuman and full of atrocities. But everyone was following orders.

The issue of moral accountability again gets pushed aside, overridden by uncontrollable historical forces, racial prejudices, "national destiny" and the power of fate. They are irresistible, that is, to all but a few individuals like Chiune Sugihara.

De George and the business ethicists want to create managers with 'moral imagination and courage' – the Sugiharas of this world. But the real world of business is populated by people who are much the same as people in any other walk of life: far from perfect, riddled with inconsistencies and ambiguities, with the potential for both huge achievement and ignominious failure.

For every Sugihara there is likely to be at least one Bernie Madoff in the making. But most businesses do not depend on Sugiharas or Madoffs. They depend on energetic entrepreneurs who get their kicks from building a successful long term business, who enjoy their working life and like their people to have fun at work. Moral imagination and courage are not necessarily part of their repertoire.

Rather than seeking personal conversions, the enlightened self-interest approach to organisational integrity seeks to create organisations which are seen as trustworthy and attractive as potential allies and partners. It therefore starts out from a position which is, as far as possible, free from extraneous values, and defines a course of action aimed at making the business behave so that it is perceived as having high integrity. Thus it seeks the most effective way of establishing an organisational culture which has high integrity embedded in it, so that all individuals in the business, no matter what their personal standards, are encouraged to behave in accord with the values of the organisation. Organisational integrity embedded in a strong corporate culture would build conditions where Madoffs would be less likely to prosper and Sugiharas more likely to be rewarded.

This chapter examines the essential characteristics of a high integrity culture and identifies actions managements can take to develop their organisation's culture. The outlines of management action are developed from the surveys of firms referred to in chapter 4.

Three main broad findings of trust and integrity surveys are:

1. That the vast majority of major/successful businesses are not particularly interested in investing in good works which are unrelated to their business activities (i.e. in altruism) – business success is their prime motivation.
2. That they are, nevertheless, very much concerned with integrity and ethical issues and regard being ethical as crucial to business success.
3. That while this concern appears to be genuine and the majority of firms express it formally as a code of behaviour or at least refer formally to such ethical issues in other documents, only a minority of firms take positive action to ensure the required standards of integrity are maintained in practice in all their dealings.

Firms recognise the need to take action, for example, to assess how well they performed against their published code of conduct, but have not decided what action should be taken. There is a reluctance to embark on a course of monitoring and reporting, not because they are fearful of what they might find, but because they fear they might be setting up a whole new bureaucracy which would only serve to reduce focus on the prime business objectives.

The actions outlined later in this chapter have all been undertaken by firms in practice. While they are not universal solutions, they clearly work in particular circumstances. It is the manager's job to recognise the most appropriate initiatives for their organisation, balancing the need for some element of formality on the one hand with the necessity to avoid adding to the bureaucratic jungle on the other.

9.2 A Culture of Openness

Sir Adrian Cadbury discussed the very real problem of bribe payments. Having considered the issue in the context of differing national cultures he proposed two simple tests of acceptability:

1. *Is the payment on the face of the invoice?*
2. *Would it embarrass the recipient to have the gift mentioned in the company newspaper?*

He explained the value of these two simple tests as being the connection between openness and ethics – actions are unethical if they will not stand scrutiny.

The sequence of questions which were raised in the previous chapter are based on very similar concerns:

> *'What if the truth were known about this?'*
> *'What if all stakeholders knew about it?'*
> *'What if all stakeholders knew the whole truth about this?'*
> *'What would be the effect on our perceived trustworthiness if all stakeholders knew the whole truth?'*

Openness is overwhelmingly the most important characteristic of a high integrity culture. The incident recounted in Box 3.6 (page 56) which satisfies Cadbury's first question, after a fashion, but singularly fails the second. Exposing the same incident to the series of questions above sheds further light on it, particularly the final question. What would be the effect on the firm's perceived trustworthiness as an employer, if employees, for example, knew that the Managing Director was stealing in that way? The answer to this question is rather more specific than the answer to the Cadbury questions and suggests some possible ways of dealing with the situation.

The Box 3.6 incident is taken a stage further in Box 9.2 overleaf.

The S.T.P. saga of chapter two was based on a combination of true cases and the actual events referred to in Box 9.2 are also real and the consequences were also true. This is emphasised simply to highlight the position of whistleblowing. The aim in a high integrity culture should be to ensure that there should never be any need for whistleblowing. The fact that people are placed in a situation where the only way they can get grievances aired is through whistleblowing, indicates a closed and repressive culture.

Support for whistle blowers is unreliable and even where there is support it may fail to stay the course. Donkin described how Jim Smith blew the whistle on his firm's excess profiteering out of the Ministry of Defence. His allegations were highlighted by parliament's Public Accounts Committee and following support by more than 300 MPs who signed an early day motion calling for his compensation. Despite being finally vindicated, Smith became a corporate outcast, penniless, evicted from his home of 20 years, ostracised by companies which once courted his talents, ignored by government that valued his help and all but forgotten by the professional bodies to which he once belonged.[90]

Though there is more legal protection today than previously, its effectiveness is unclear and whistleblowing remains high risk. Companies need therefore to ensure through openness that whistleblowing is never necessary.

Box 9.2 – Whistleblowing at S.T.P.

Having established a modus operandi with Gerald Smith, his Chief Accountant, Charles Kirtchin took advantage of the situation, his relatively minor abuses quickly increasing in scale and frequency. Over an eighteen month period he had an extension to his house, his country cottage re-roofed and central heating installed, purchased a new bathroom suite, kitchen equipment and a hi-fi plus an exotic Chinese carpet. In addition he had two vintage motor cycles restored to concours condition, plus holidays in Greece and America for himself and his wife. Smith, feeling extremely unhappy but powerless, arranged for all these items to paid by the company and coded according to Kirtchin's instructions.

These purchases were known about by staff in the company and the Personnel Manager was anonymously given copies of all the above invoices and many more with the request that something be done about it. He took them to his immediate boss, the Manufacturing Director, who considered his possible courses of action. None were without risk to his job, prospects and pension. It was his family that concerned him most, not simply his own position. It was also clear that blowing the whistle on these abuses would put Gerald Smith in similar jeopardy and he sympathised with Smith's position. The most obvious course of action, reporting the abuse to Kirtchin's immediate boss in the parent company, appeared also to be the most risky since Kirtchin and he appeared to be very close and might even be "in it" together.

In the end he decided to raise the issue formally at a board meeting under *Any Other Business*. There were two non-executive parent company representatives on S.T.P.'s board, and they would presumably be forced to take notice. However, before he could do this, the Manufacturing Director was summarily fired, given a generous compensation package including two years salary plus his company car. The real reasons for this were never made clear, his departure being minuted as resulting from 'differences over manufacturing policy'.

Openness should be deliberately designed so that structures and processes are in place that the would be whistle blower is encouraged to use, so that a 'grievance' is aired and appropriate action taken long before it becomes a substantial problem. Such an open culture would of course eliminate most of the practices that could become the subject of whistleblowing. If corporate integrity was explicit and up front, the only way corruption could prosper would be by explicitly changing the rules and culture back to being secretive, closed and repressive – a process which is not easy to achieve.

9.3 Corporate Governance

The term, corporate governance, is short-hand for a raft of initiatives, some statutory, some voluntary, which are intended to help the process of openness in order to 'clean up' the private sector and inhibit fraud and corruption. The Cadbury initiative on corporate governance was the first major attempt to achieve this.

The 1972 Cadbury code of best practice[91] is included in Box 9.3. These recommendations were amplified by a series of notes intended to assist application to the particular business. The intention was to encourage, through a process of independent audit and review, the spread of the board-room practices of the best run companies. The main thrust is to reduce the opportunities for abuse of personal power by company leaders, by setting certain specific limitations on it, by making its exercise more open and more subject to independent audit and review.

Adoption of the Cadbury code was not mandatory but it was required that all companies quoted on the London Stock Exchange should include a statement in their annual report identifying the extent to which Cadbury has been implemented, and where implementation was incomplete, the reasons why should be explained. It was the first 'comply or explain' code of practice.

Box 9.3 – Cadbury Report on Corporate Governance – Code of Best Practice

1 Board of Directors

1.1 The board should meet regularly, retain full and effective control over the company and monitor the executive management.

1.2 There should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognised senior member.

1.3 The board should include non-executive directors of sufficient calibre and number for their views to carry significant weight in the board's decisions.

1.4 The board should have a formal schedule of matters specifically reserved to it for decision to ensure that the direction and control of the company is firmly in its hands.

1.5 There should be an agreed procedure for directors ill the furtherance of their duties to take independent professional advice if necessary, at the company's expense.

1.6 All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are followed and that applicable rules and regulations are complied with. Any question of the removal of the company secretary should be a matter for the board as a whole.

2 Non-Executive Directors

2.1 Non-executive directors should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct.

2.2 The majority should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement, apart from their fees and shareholding. Their fees should reflect the time which they commit to the company.

2.3 Non-executive directors should be appointed for specified terms and reappointment should not be automatic.

2.4 Non-executive directors should be selected through a formal process and both this process and their appointment should be a matter for the board as a whole.

3 Executive Directors

3.1 Directors' service contracts should not exceed three years without shareholders' approval. (Note 8)

3.2 There should be full and clear disclosure of directors' total emoluments and those of the chairman and highest-paid U.K. director, including pension contributions and stock options. Separate figures should be given for salary and performance related elements and the basis on which performance is measured should be explained.

3.3 Executive directors' pay should be subject to the recommendations of a remuneration committee made up wholly or mainly of non-executivc directors.

4 Reporting and Controls

4.1 It is the board's duty to present a balanced and understandable assessment of the company's position.

4.2 The board should ensure than an objective and professional relationship is maintained with the auditors.

4.3 The board should establish an audit committee of at least 3 non-executive directors with written terms of reference which deal clearly with its authority and duties.

4.4 The directors should explain their responsibility for preparing the accounts next to a statement by the auditors about their reporting responsibilities.

4.5 The directors should report on the effectiveness of the company's system of internal control.

4.6 The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.

The Cadbury Report's prime purpose was to address the Financial Aspects of Corporate Governance rather than any wider concerns.[92] It approached the task having fully accepted the Friedmanite position on the relationship between company directors and shareholders.

> *'The formal relationship between the shareholders and the board of directors is that the shareholders elect the directors, the directors report on their stewardship to the shareholders and the shareholders appoint the auditors to provide an external check on the directors' financial statements. Thus the shareholders as owners of the company elect the directors to run the business on their behalf and hold them accountable for its progress. The issue for corporate governance is how to strengthen the accountability of boards of directors to shareholders.'*

Thus, the agency relationship, which is based on completely false premises, was foundational to the Cadbury code, even though there was no explicit mention that 'to run the business on their behalf' meant maximising shareholder value. This is an example of how the Friedmanite perspective had been adopted in preference to the law which requires directors to *'promote the success of the company'*.

The code largely reflected what was already widely accepted as good practice. Nevertheless the London based Institute of Directors led objections to the code and many quoted companies opted for explanation rather than compliance, there being limited guidance as to what constituted a satisfactory explanation.

The extent of implementation among *The Times* top 100 UK companies was reviewed, after the first year, focusing on six of the key Cadbury recommendations:[93]

- Separation of responsibilities of chairman and chief executive (20% non-compliant).
- Disclosure of pay packages of chairman and highest paid UK director (66% n-c).
- Appointment of at least three non-executive directors (1% n-c).
- Appointment of audit committee composed of at least three non-execuitives (12% n-c)
- Appointment of remuneration committee composed of at least three non-execs (11% n-c).
- Appointment of nomination committee composed wholly of non-execuitives (88%n-c).

Implementation remained uneven. Moreover, as has been demonstrated many times conformance with 'comply or explain' is no guarantee of good behaviour. Not only that but the question of what constitutes a satisfactory explanation for non-conformance has never been fully specified. The result is that 'comply or explain' remains a weak requirement.

Since Cadbury, successive British enquiries and reports have resulted in various revisions to codes of practice, culminating in 2010 with the publication by the Financial Reporting Council (FRC) of the UK Corporate Governance Code which was developed in the light of experience during and after the 2007–8 credit crisis which was accompanied by excessive remuneration for top managers and traders, as well as massively expensive taxpayer funded bale-outs for the banking sector and 'quantitative easing' intended to revive the broader economy. Despite that severe learning experience, the code focused its main attention on tying the company ever tighter to its shareholders, advocating that a senior independent director should meet with major shareholders in order to gain '*a balanced understanding of the issues and concerns of major shareholders*'.

However, the nature of shareholding has radically changed since the mid 1980s deregulation and computerisation of stock exchanges. It has become increasingly concentrated in the hands of fund managers who themselves exercise control largely without ownership. It has been estimated that institutional shareholders were responsible for less than 7% of the total share value of quoted companies in Britain and the United States in 1960. By 2003 this figure had reached around 60% and by 2010 was estimated at over 75%. When shares were mainly owned by widely dispersed individual holders, who may or may not have had a long term interest in the companies in which they were invested, there was little opportunity for them to have a very active relationship with their investee companies. But that is no longer true and the stewardship role of those controlling the shareholdings has attracted increasing attention.

Of the three aims cited for the original Cadbury code, two were explicit – to inhibit corporate criminality and to address excessive board room pay – while one was unstated – to reinforce the neoclassical free market idea that corporate governance should focus exclusively on shareholder satisfaction. While the two explicit aims appear to have been spectacular failures, the unstated aim appears to have been achieved in that its focus has been so widely accepted. Later code amendments projected the idea of shareholder primacy above all other considerations.

With share ownership control concentrated in so relatively few hands, active share ownership is more feasible, and the 2010 FRC UK Stewardship Code provided guidance on good practice for *'firms who manage assets on behalf of institutional shareholders such as pension funds, insurance companies, investment trusts and other collective investment vehicles.'*

The Stewardship Code focused on means of monitoring investee companies and to establishing *'clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.'* The aim is clearly to address 'the agency problem' of company directors not focusing exclusively on maximizing shareholder value, and the role institutional shareholders might play in solving the problem.

However, the real problem with this now dominant form of share ownership is that control of shares is held not by their ultimate owners, but by investment professionals and traders whose interests are in making quick money to achieve a high rating as traders, while the ultimate owners of shares, the members of pension funds and the like, may prefer stability of employment rather than, for example, a quick return from an opportunistic takeover. Stewardship codes ignore this aspect of control without ownership. They also ignore the fact that around 75% of trades are now made through ultra-fast automated and algorithmic trading systems with limited human involvement.

The positive contribution made by the Cadbury code and its successors increased openness protected by a form of independent audit and review, the independence being assumed to be inherent in the position of non-executive directors (NEDs). This is spelled out in paras 2.1 to 2.4 of the Cadbury code which are supported by explanatory notes which suggest that it is up to the board to decide whether the definition of independence has been met, but that relevant interests of the NEDs should be disclosed in the Director's Report; that NEDs should not participate in share option schemes, should not be pensionable and that their letters of appointment should specify their duties, term of office, remuneration etc. Nevertheless, as Box 9.4 indicates, they still face problems in the execution of their duties.[94]

The spirit of Cadbury is again clear and if companies wish to use genuinely independent NEDs, Cadbury suggests useful ways to help this process. However, if directors choose the traditional route of mutual back-scratching on the old boy network, they can also do so and still comply with the letter of Cadbury.

Box 9.4 – Non-execs fail to learn the facts of company life

Non-financial performance measures may be all the rage among management theorists, but they have apparently yet to reach non-executive directors, according to a survey by KPMG Peat Marwick, the accountants and consultants. The study finds that while non-execs generally receive the necessary information on such traditional indicators as profit and loss, cash-flow statements and external auditors' reports, they tend to be short of data relating to newer performance measures, such as customer satisfaction, management ability and quality.

While more than half said these criteria were important in helping them do their jobs, two-thirds of the 235 non-executives questioned in the survey of the 1,000 biggest companies in Britain did not receive details of customer satisfaction levels, 58 per cent were given no information on quality indicators and 52 per cent were not told about the results of management appraisals. Further, despite the current enthusiasm for benchmarking, 58 per cent were not told how their companies' performance compared with that of market leaders.

Gerry Acher, KPMG's head of audit and accounting, added that it was surprising that a large minority relied entirely on internal information. "I urge them to use external sources to give a broad view of their companies," he said.

The survey also finds evidence of patchy adoption of the Cadbury Committee call for non-executive directors to be appointed by a nomination committee rather than the chairman. Mr Acher said that with 51 per cent of those surveyed appointed in the old way, "it will be interesting to see if, in the future, the chairman's influence wanes in this respect".

At the same time, there is a clear indication that many non-executives face twin – and possibly conflicting – demands to give strategic advice and represent shareholder interests.

Mr Acher said: "They appear comfortable with this dual role, but are clearly not getting sufficient information on some of the key strategy areas that one might expect.

"There are areas where matters of strategic importance and the receipt of vital information need to be brought into line. The non-exec role should be to add shareholder value rather than just protect it."

Only a small minority of firms have adopted the nomination committee criterion in Cadbury. The use of genuinely independent NEDs remains a rarity. It seems clear that NED appointments will continue to be approved by the CEO and in practice will need to retain that approval, unless their independent status is protected by law.

The impact of codes of corporate governance appears to have been limited. From their beginnings with the Cadbury Report in 1992 they have accepted the economic orthodoxy that business is owned by shareholders like any other item of private property and that as such business exists to serve the interests of those shareholders, rather than the interests of all its stakeholders. Subsequent revisions of the codes made little practical difference, while the Financial Reporting Council's 2010 UK Corporate Governance Code and UK Stewardship Code clearly aim to provide voluntary restraints on business in the interests of shareholders. The Stewardship Code provides guidance on good practice for 'firms who manage assets on behalf of institutional shareholders such as pension funds, insurance companies, investment trusts and other collective investment vehicles', presumably including hedge funds and the like.

While the original Cadbury initiative may have had genuine interest in protecting the integrioty of business, it seems clear that it has been dominated by the economic orthodocoxy and all subsequent amendments have sought to protect shareholder interests against all other stakeholders.

9.4 Internal Codes of Ethical Practice

The majority of FTSE100 index companies have produced written codes of practice, and almost all have statements which include reference to such issues. Some universal codes provide generalised statements such as that by the Chartered Institute of Management (CIM) which has a code of conduct and practice:

> *'As a member of the Institute we expect you to demonstrate the highest standards of ethics and professionalism…behaving in an open, honest and professional manner, acting in the best interests of your organisation, customers, clients and/or partners, continually developing and maintaining professional knowledge and competence, respecting the people with whom you work, creating a positive impact on society, upholding the reputation of the profession and the Institute.'*[95]

The CIM is addressing its own members, so the code's approach is essentially personal and therefore necessarily general. The members in turn may choose to interpret the code as they see fit, to accept or ignore it. Whether such a document would be of assistance to a member in conflict with his or her own organisation is highly questionable. It seems most probable that such a code will have no practical effect.

Less generalised and therefore potentially of more practical value are the codes related to specific trades or professions. The medical profession's Hippocratic oath was the original example. Trade and research associations might include items specific to their particular technology or market served.

Business school faculty, guilty as charged by Sumantra Ghoshal, of producing management graduates absolved of moral responsibility, have begun to react. Harvard Business School, for example, invited its MBA students to sign up to a voluntary pledge that as practising managers they would act responsibly, sustainably, honestly and ethically. That pledge, co-authored by Professors Rakesh Khurana and Nitin Nohria, became the MBA Oath (see below) which was developed by a team of 30 HBS MBAs, led by Max Anderson, Peter Escher Teal Carlock and Jon Swan. By mid 2015, around 10,000 students and alumni from many different MBA programs had signed the oath as their commitment to a more enlightened future.

THE MBA OATH

As a business leader I recognize my role in society.

- *My purpose is to lead people and manage resources to create value that no single individual can create alone.*
- *My decisions affect the well-being of individuals inside and outside my enterprise, today and tomorrow.*

Therefore, I promise that:

- *I will manage my enterprise with loyalty and care, and will not advance my personal interests at the expense of my enterprise or society.*
- *I will understand and uphold, in letter and spirit, the laws and contracts governing my conduct and that of my enterprise.*
- *I will refrain from corruption, unfair competition, or business practices harmful to society.*

- *I will protect the human rights and dignity of all people affected by my enterprise, and I will oppose discrimination and exploitation.*
- *I will protect the right of future generations to advance their standard of living and enjoy a healthy planet.*
- *I will report the performance and risks of my enterprise accurately and honestly.*
- *I will invest in developing myself and others, helping the management profession continue to advance and create sustainable and inclusive prosperity.*

  In exercising my professional duties according to these principles, I recognize that my behavior must set an example of integrity, eliciting trust and esteem from those I serve. I will remain accountable to my peers and to society for my actions and for upholding these standards.

  This oath I make freely, and upon my honor.

The MBA oath has the strapline 'Responsible Value Creation.' Many of the commitments are unavoidably open to some interpretation, but the overall intent is clear and entirely compatible with this text. It is nevertheless inevitably general. Whereas organisational codes, on the other hand, can be more specific in how they relate to the particular organisation's circumstances. By being more specific, an organisational code can serve two significant purposes:

- Firstly, it can contribute to the establishment of an organisation's culture and thereby impact on the way people in the organisation behave.
- Secondly, it can identify items of business behaviour which are in some way measurable or monitorable and which might form the basis for audit and review of performance.

The most effective codes would serve both purposes equally, the least effective remain as simple statements of intent with no attempt being made to make further use of them.

It is sometimes argued that the purpose of such statements is really no more than public relations, the creation of an illusion that might be perceived and acted on. If such statements are upheld by the related practice, they might serve as the foundation of a high integrity culture. The key is implementation. As Cadbury pointed out:

> *'The ethical standards of a company are judged by its actions, not by pious statements of intent put out in its name. This does not mean that those who head companies should not set down what they believe their companies stand for – hard though that is to do. The character of a company is a matter of importance to those in it, to those who do business with it, and to those who are considering joining it.'*[96]

Developing a code which is going to be of practical use, demands that it is pertinent to the distinctive features of the particular industry. For example, firms in an industry which involves a known health risk, must pay particular attention to the way they control and monitor their performance in regard to that particular issue. Practically valuable codes should also focus on factors which differentiate the individual business from its competitors. Practical usefulness also demands that the various statements of practice are as far as possible measurable, or capable of being monitored in some qualitative way.

Thus management's role in developing an effective code of ethical conduct is not simply to follow the guidance of the Institute of Business Ethics, or the examples of other companies, but to make their code strictly relevant to their own organisation, and ensure that performance against it is effectively monitored.

9.5 Making Integrity Explicit

Management initiatives that can be taken to ensure a business is perceived as being ethical fall broadly into three areas:

1. Being explicit about corporate integrity with all stakeholders. Making widely communicated statements about the standards of performance to be achieved.
2. Setting up the structures and processes by which ethical performance can be monitored and controlled.
3. Taking well publicised actions to punish transgressors, and – wherever possible – publicly reward achievers.

Contemporary trust and integrity survey data as well as useful case evidence tends to be fragmentary. The original 1994 survey reported in Appendix III provided a number of useful insights. More recent surveys are indicative only, but suggest that little real progression has been achieved over the past two decades. While some examples of progressive practice have been reported in this book, the overall picture is one of regression, it appears practice having succumbed to the imperatives of the FNEBS. The original survey and contemporary cases therefore remain relevant.

The well-known Nynex saga illustrated how one firm reacted to integrity lapses. It had been discovered that a number of executives were inviting senior representatives of their suppliers to sleazy parties in Florida.[97] In the hope that it could be dealt with quietly, Nynex initially treated the matter as an isolated incident and quietly sacked or disciplined the culprits. But the New York press got hold of the story and all of a sudden Nynex employees found themselves in the embarrassing situation of not knowing who of their colleagues was involved, and who they could really trust. The company's subsequent response was thorough and decisive. It established an office of ethics at its headquarters, run by a senior executive with direct access to the chairman and responsible to the board's audit committee. Similar offices were established in each of its leading business units, with hotlines for people to report misconduct. They also drew up a code of business conduct and then began company-wide training in business ethics.

The lessons drawn from Nynex's experience:

1. There is a huge difference between 'compliance' with ethics codes and a genuine commitment to them.
2. Face-to-face communication is helpful in getting people to accept ethics codes.
3. Ethics has to be a continuing commitment, not just a 'programme of the month'.
4. Leadership on ethics begins at the top.

Nynex showed how a firm could react, setting up ethics offices to make ethics explicit thereby removing the whistle blower culture, and establishing a code of business conduct and communicating it through company-wide training programmes. The initial approach of quietly sacking or disciplining culprits was inadequate. Subsequently the high profile given to ethical issues meant that disciplining would be similarly high profile and any sackings given the full symbolic weight needed to reinforce the required standards of behaviour.

The communications and training programme of General Dynamics had a similar impact in opening up the culture so that occasions for whistleblowing would be unlikely to arise because individuals had the opportunity, even encouragement, to address issues through organised channels before they became significant problems. Vice-president for business ethics and equal employment opportunities, Kent Druvvesteyn , stressed "We're not in the business of replacing missing virtues in our employees, but we owe it to them to tell them about slippery spots inherent in the business process."[98]

Approaches to making ethics explicit in order to create and maintain a high integrity culture are various. There is no one best way. The structures and processes which work best for one organisation may be quite inappropriate for another. Respondents to the original trust and integrity survey reported the following approaches:

1. Annual published review of the organisation's ethical performance (20% of respondents)
2. Establishment of a body with specific responsibility for assessing the organisation's past ethical performance (50% of respondents).
3. Establishment of a body with specific responsibility for reporting on the organisation's past ethical performance (35% of respondents).
4. Establishment of a body with specific responsibility for improving the organisation's past ethical performance (25% of respondents).
5. Setting measurable targets for ethical performance (18% of respondents)
6. Annually assessing the organisation's ethical performance (40% of respondents, 30% more frequently)
7. Parent board annually assessing the organisation's ethical performance (40% of respondents, 10% more frequently)
8. Provision of business ethics training for new employees (20% of respondents)
9. High profile dismissal of any employee breaking the code of ethical practice (45% of respondents)
10. Recognition in some other formal way of the organisation's ethical performance (15% of respondents)[99]

During interviews detail was provided on how the bodies (i.e. individuals or groups) set about their tasks of assessing, reporting and 'improving' ethical performance. Firstly, there appeared to be distinct differences in the terms of reference for such bodies, some being specified by top management, others evolving from a negotiation process. In all cases they were agreed between the body and top management. Terms of reference included what was to be monitored and how and when it was to be reported.

'Improvement' in practice referred to recommendations for management action. The negotiation of terms of reference was itself an important part of the process which both added credibility to the body and increased the knowledge of top management.

In addition to these approaches, a number of companies repeated the Nynex claim that 'leadership in ethics begins at the top'. Two quotes from the survey indicate this strongly held view:

- "Leadership is key. Rules and regulations only go so far."
- "Example from and leadership by top management is essential – without that 'rules' and 'codes' are useless."

There were also several firms that used formal communications programmes to get their message to different stakeholders.

- "The values of the organisation must be communicated to help employees in shaping their behaviour."
- "Our corporate communications programme informs customers and shareholders as well as employees about how well we are performing against our code of practice."

Such programmes can successfully develop external stakeholder perceptions of the organisation's integrity, while the training approach is appropriate for internal stakeholders. Training was not widely used among employees, possibly because business ethics education was perceived by practitioners as too theoretical or impractical. Business ethics training is clearly often seen as a contradiction in terms.

Industry and organisation specific training in organisational integrity, on the other hand, could be so designed as to be highly practical. Training employees on the way the organisation does business, i.e. how it conducts relations with all its various stakeholders, can be entirely centred on the development of practical skills and competencies.

There are thus a variety of approaches to making integrity explicit. Some firms are very concerned to avoid setting up any systems which might become bureaucratic and instead favour a minimised review and control process but a high profile, symbolically deterrent punishment of transgressors. One respondent suggested, no doubt tongue in cheek and aware of the paradox:

> *'Chopping heads off for wrongdoing is the simplest and most effective way of making people behave ethically.'*

Other organisations adopt a carefully planned system of audit and control, based on the establishment of business ethics committees or officers whose sole task is to monitor and review performance against the published code of practice, publish their assessments and recommend improvements. A few organisations have managed to define some aspects of ethical performance in strictly measurable terms and are consequently able to report performance in quantified terms.

A further possible approach that is currently receiving widespread attention, is for auditing bodies to be proactive in developing a wider more balanced approach to their audit role, to include not just the truth and fairness of published accounts, but also some assessment of ethical performance. However, the big four auditors that dominate over 80% of global audits, and have audit approved the criminal activities of BCCI, Edencorp, Polly Peck, Maxwell, Worldcom, Enron and the rest, as well as the massively excessive payments for doing not very much to Barclays Bank's Bob Diamond, Glencore's Ivan Glasenburg, Blackstone's Steven Schwarzman, JP Morgan Chase's Jamie Dimon, and thousands of others. With that record, progressive managements would seem well advised not to expect positive support from the audit sector.

In summary, many management initiatives have been taken to achieve required standards of ethical performance. From these examples, it appears that a high integrity culture might be achieved through the following:

- Establish bodies (individuals or teams) to have responsibility for monitoring, reporting and 'improving' the organisation's integrity in its relations with all stakeholders.
- Initiate these bodies in developing a code of practice covering integrity with stakeholders. The body itself to develop and agree its terms of reference with top management (CEO or board) to cover what should be in the code, what should be monitored and how and how it should be reported.
- Make the code as industry specific and organisation specific as possible, and include at least one objectively measurable criterion for each stakeholder category.
- Publish results at least annually.
- Have a formal top board minute to discuss integrity at least twice yearly. Different stakeholder categories can be discussed on separate occasions, thus increasing frequency but avoiding too broad a focus.
- Ensure appropriate examples are provided for all stakeholders including an appropriate role model by top management, all transgressors being publicly punished and, wherever possible, achievers publicly rewarded.
- Develop a corporate integrity communications programme for external stakeholder groups.
- Develop a corporate integrity training programme for internal stakeholder groups.

The above indicates initiatives that various organisations have taken. The broad principles implied above appear to have wide validity, but the best approach for any particular organisation can only be decided by its own management.

9.6 Conclusion

This book started with an overview of the imminent fatal crash between the finite nature of earth, its exploding population and the dominant economic orthodoxy which appears blind to the unsustainabilities which can't for much longer be ignored.

It expressed the view that moral philosophy is hardly applicable to real business. The philosophers on whose work it rests had no knowledge or understanding of modern business. Business ethicists reject the possibility that business might act ethically and at the same time act from self-interest and make a profit. Similarly, the well-meaning arguments of those expounding extraneous value systems, are unlikely to be of much practical use in establishing robust corporate integrity.

Business exists to perform a myriad of purposes and in so doing to create a surplus from which we all benefit. In order to make that surplus, businesses need to be efficient and competitive. This necessarily leads them to seek a reputation for trustworthiness and integrity so as to be fully participant in the modern, interconnected globalised business world. Business will only achieve and maintain such a reputation though the establishment of actually behaving with such integrity and trustworthiness.

This book has considered the basis for enlightened self-interest as a foundation for organisational integrity, and has suggested practical steps to achieving that self-interested integrity.

10 Alternative Economic Systems

Learning Objectives:

To understand there is still some plurality of economic systems being researched and promulgated.

To understand something of the nature and potential of those alternatives to the Friedmanite neoclassical economic belief system (FNEBS)

10.1 Introduction

Economics, according to John Ruskin 150 years ago[100], like its sister disciplines, astrology and witchcraft, is based on a most curious delusion which possesses the minds of the great mass of the human race. That delusion is that the most advantageous code of social action is achieved through the entirely self-interested actions of the masses. As with all pseudo sciences it has a plausible idea at its root. That is that social affections are accidental, disturbing elements in human nature, compared to the constants of avarice and desire for progression. They can therefore be eliminated from consideration, so that economics can focus exclusively on the constant of human nature which is that of the ever more covetous human machine. It is up to the individual, if and by how much, they wish to break with that norm.

That is not so very much different from the Friedman inspired 1980s Thatcher-Reagan takeover of Anglo-America. Prior to that, a plurality of economic perspectives was taught in university departments and business schools. Today, the FNEBS may still be the dominant economic belief system, but alternatives remain, and, in the light of the FNEBS failings in the face of sustainability imperatives, they appear finally to be gathering some momentum.

The following sections, based on a previous analysis,[101] consider some of these alternatives which might have different, more progressive outcomes. They are considered as far as possible on their merits, without prior orientation to any particular ideology or set of values, other than to the pragmatic perspective of what might work. Of these alternatives, the most accessible to non-specialists is that of Cambridge economist Ha-Joon Chang, whose Little Blue Book comprises the final section.

10.2 Welfare Economics

From its beginning, industrialisation created both great wealth and great poverty. Consequently there has always been concern for achieving greater equity in the distribution of the economic benefits from industry. Despite being largely ignored by the economic mainstream, concern persists for social welfare and its distribution in a population. Welfare economics was concerned to address this issue, by focusing on the welfare outcomes of policy decisions.

It is an explicitly normative, prescriptive study, as opposed to the avowedly descriptive, predictive nature of the neoclassical frame, which is sometimes referred to in this context as positive economics. Welfare economics is concerned with the economic wellbeing of individuals, households, cities, regions or whole countries with each category being the summation of welfares of individuals comprising the category.

Its foundation is in positive economics. It accepts the basic assumption of market efficiency, that resources will be allocated by the 'invisible hand' of market forces in such a way that full employment will be achieved and overall income maximised, or at least that no alternative allocation would result in a greater income for anyone with no-one being worse off. Implicit in this model is the assumption that social welfare might also be maximised by that resource allocation and welfare economics seeks to achieve that maximisation through a variety of means which adjust resource allocations.

There are various theoretical approaches to the assessment of maximised welfare. The distribution of social welfare among citizens can theoretically be measured. The social welfare of all individuals could be assessed in terms of monetary value, making no distinction between the pound of a rich person or that of a pauper. These could then be added together to establish the social welfare of the whole society. Alternatively welfare could be assessed making allowance for the fact that a pound is of less value to the rich than it is to the poor. This difference might be taken into account in assessing distributive efficiency, which would be assumed to be maximised when welfare was distributed to those who would gain the greatest utility. The differently valued individual welfares could then be added to measure the social welfare of the whole society.

Clearly these ideas are theoretical. The possibility of measuring distributive efficiency is extremely limited, with little prospect of being practically implemented with any degree of real accuracy. Consequently while the aim of welfare economics is laudable, its practical effects on policy in improving social welfare have been slight. It has developed as a branch of theoretical study, spawning an extensive literature, and with some methodological threads promising practical outcomes. For example it has targeted the measurement of externalities by explicitly assessing the costs of actions including those incurred by, or inflicted on, public goods such as the atmosphere or climate.

Studies of the management of common pool resources such as pasture among rural African communities and village irrigation systems in Nepal[102], may be indicative. Such an approach could, in principle, also be applicable to studying, for example, rain forest destruction, or coal and oil shale extraction. As well as costs such as these, which are normally externalised, the approach could also be applicable to situations where consumption of a limited resource is not yet reflected in its market price because of the essentially short term emphasis of discounting techniques.

Input-output analysis makes explicit the assessment of such costs and benefits, including external costs not normally included in private profitability calculations. While the various methods available for assessing these costs and benefits remain more theoretical than practical, making the issues explicit was a significant step.

Welfare economics seeks to evaluate economic policies in terms of their effects on the well-being of the community. However, its assessments of social welfare and of the impacts of different resource allocations, are necessarily expressed subject to so many unrealistic assumptions, as is the positive economics model on which it is based, that it offers little of practical value in measuring social wellbeing.

The more pragmatic approach resulting from the review of empirical studies presented by Wilkinson and Picket,[103] might be of more practical use. Their measures are real and policy recommendations derived from them would be clear, subject to agreement of an appropriate objective function for social welfare.

10.3 Social Balance

Social balance was the term used by Galbraith to express the desirable combination of private goods provided by the market, with the public provision of necessary and desirable goods that the market would, or could, not provide. Galbraith expressed it as the balance between private wealth and public squalor. The idea of balance contrasted with the simple market fundamentalist idea of minimising public provision.

Galbraith argued that classical economic theory had developed in a world of poverty whereas by the second half of the 20th century it was being applied to a world of affluence. The rapid growth of automobile ownership was one sign of this continually increasing affluence, but their use required more and better publicly funded roads, if increasing congestion and consequent waste of fuels and time were to be avoided.

Galbraith exampled the problem of social balance with the city of Los Angeles as it was in the late 1950s. The citizenry was by and large affluent with conspicuous, conspicuous consumption, but with no public provision of waste collection, people were forced to use home incinerators which rendered Los Angeles air almost unbreathable.[104]

Clearly, it would not be feasible to eliminate public provision of such goods as public roads. Nor did it prove desirable to avoid public provision of goods such as waste collection and disposal. If such items were privatised and made chargeable, some citizens might not afford the luxury of collection and disposal, or even home incineration, and so the environment would be damaged for all citizens. The problem of social balance is real enough; public provision of some goods is necessary and for others may be regarded as desirable.

Galbraith raised similar arguments for the public provision of education, health and social security. An educated population would be better fitted to work a competitive post-industrial economy which would be ever more reliant on personal skills and expertise to develop technological innovation and intellectual capital. Rather that young members of the unemployed reserve army be educated to work in the new economy than to remain uneducated and a cost and liability on the state.

The most efficient social balance lay somewhere between no public provision and all provision being public. The fundamentalist argument that any small step in the direction of public provision would lead inexorably to full-on socialism, was clearly nonsense. Galbraith quotes democratic socialist RH Tawney drawing attention to the fact that high private incomes will not make the mass of people immune to disease and ignorance, whereas public provision for universal healthcare and education would produce a more enlightened, healthy and progressive society.

Just where public provision should stop and private begin, was a question of political choice. Galbraith argued for increased spending on more and better public goods such as schools, parks and recreation facilities as well as hospitals and improved social housing. So much was subjective opinion, but the balance Galbraith would have drawn would have excluded private provision of goods for which there was no fundamental need or want, except that which was created artificially by aggressive and invasive marketing. His fear was not simply that such goods made no contribution to a better society, but that such artificially created demand would not be robust and its collapse might trigger or amplify recession.

That fear might well be valid, but it would be a problem that would be solved by the normal workings of market forces, albeit not without pain. The provision of more and better public goods, especially ones deemed desirable on purely subjective grounds, is less easy to justify unless they are explained in terms of benefiting the future development of the economy.

Galbraith does not, and could not, develop a mathematical model to explain and justify social balance. Nor does he completely reject the quantitative analysis of neo-classical economics. But he explicitly acknowledged that value of non-mathematical, qualitative expression in economic decision making.

10.4 Behavioural Economics

Adam Smith suggested that human behaviour was motivated, at the highest level, by the desire to become proper objects of respect, '*deserving and obtaining this credit and rank among our equals*'.[105] Behaviour which includes elements of generosity and altruism is not simply to be denigrated as self-serving or irrational, as is the necessary neoclassical assumption. Behavioural economics seeks to get closer to the truth of what motivates human behaviour.

Behavioural economics argues against the idea of individuals behaving so as maximise their utility on the grounds, not of their intention to be satisfied with less, but of their inability to maximise because of their 'bounded rationality'.[106] Thus, satisficing was an alternative to maximisation as a descriptive and predictive variable, offered on the grounds that maximisation was neither descriptive nor accurately predictive. Similarly, melioration[107] was also offered as an alternative behavioural proposition. Both offered the opportunity to escape the confines of mathematical modelling, but it would appear that rejection of the spurious quantitative witchcraft was a step too far for behavioural economics.

Cyert and March's behavioural theory of the firm developed a theory which reflected real behaviour more accurately than profit maximisation. Satisficing was certainly more realistic. Within the firm, satisficing was applied to the workings of coalitions such as the board of directors. Each coalition member required the fulfilment of some minimum performance level, all of which might be met through negotiation, rather than performance being maximised on one category but minimum levels on others not being achieved.

This version of satisficing more accurately reflected the perspective of Smith's artisans and entrepreneurs focused on making a living from their working occupations. They were prepared not to maximise profits, but to achieve a level which allowed them to provide a service to their customers and to pay their suppliers a sufficient price to justify their continuation in business. The satisficing concept is also consistent with firms building up some 'spare' resource as 'organisational slack' which might be held in reserve for future investment or emergency.

Behavioural theory applied to the firm provides some insights which confirm common sense, but does not extend far into the psychology of human behaviour, which has been a fertile field for academic economic research. Studies of economic decision making under conditions of uncertainty and how behaviour differed from the neo-classical prediction, challenged the notion of economics as a 'science'. Ideas such as equity, generosity, altruism, were built into models of decision making and appeared under various circumstances to be significant influencers. Research also addressed the problem of decision taking over extended time periods, where again irrationality was offered as a neoclassical explanation of decisions which did not fit with discounted values. Behaviourists were able to offer more psychologically informed explanations.

Behavioural economists have also used neoclassical methodology and assumptions to analyse a wide variety of human behaviours. Areas to have been studied include crime and punishment, marriage and fertility, government and democracy, health, religion and mass behaviour,[108] consumer choice and marketing, fertility and migration, entrepreneurship, psychology of hazards and stress, tax evasion, and labour economics.[109] This breadth of subject matter suggests that the approach of behavioural economics, adapting the neoclassical model to the analysis of different behaviours, has been a fertile field for academic publication. However, the practical outcomes have been limited.

For example, neoclassical methodology is used to study the practice of democracy, in particular the activities of lobbyists and pressure groups as the means to getting representatives to do the bidding of constituents.[110] The analysis appears to justify the activities of lobbyists largely on ideological grounds that lobbying limits the extent to which representatives would pursue their own personally held ideals. The problem of lobbying perverting the normal democratic process is not pursued. Yet American companies, sometimes combining as an industry (e.g. the pharmaceuticals industry), charge sufficient for their products to cover the tax allowable costs of lobbying the government in pursuit of their own interests. It was estimated that in 2009, for example, federal lobbyists and their clients spent more than $3.47 billion.[111]

This approach still accepts the assumption that human beings seek to maximise their own self-interest, even though their behaviour may not achieve maximisation. Market forces are assumed to allocate resources efficiently. And individuals' preferences are assumed to be fairly stable. While acknowledging all three of these assumptions are actually false, the approach nevertheless asserts they are sufficiently right to provide insights into human behaviour.

It has however been forcefully argued that any deviation from the neoclassical model, for example, deviation from maximisation behaviour, would invalidate the model, just as any information asymmetry in an otherwise perfectly competitive market would severely damage competition. Moreover, if the model from which insights are drawn is invalid, then the insights themselves are likely to be worthless.

10.5 The New Economics

These various challenges to the neoclassical orthodoxy have been prompted by its long term dysfunctions and the short term crises to which it has given rise. Many of the changes and corrections presented by these alternative models are included in what has been labelled as The New Economics (TNE)[112]. This approach recognises the dysfunctional outcomes of the neoclassical mainstream and addresses them, one by one, and in so doing proposes what is referred to as a new economic model.

Perhaps the most fundamental change is the rejection of gross domestic product as the key measure of an economy, and its growth as the all-important target of economic management. Such a change would have basic and widespread implications. The justification for this is twofold. Firstly, it is the continuing chase for growth which causes the depletion of resources, pollution and climate change. Secondly, the achievement of growth does not appear to increase 'happiness'. These, surely are powerful, if apparently simple, arguments. Rather than focus on growth TNE's focus is on social and individual well-being. In this it appears to be sharing the objectives of the welfare economics model, though it is not clear whether TNE follows the welfare model in seeking to maximise well-being, in which case it would be drawn into the mathematical contortions that have frustrated the application of welfare economics.

TNE recognises the finite stock of the planets resources and the damage being done by economic activity, particularly in terms of climate change. It also recognises inequalities of income and wealth as a major problem. Also the growing importance of intellectual capital and the decline in importance of monetary capital in support of the real economy.

The well-being objective has to be identified in specific terms if it is to be made operational. Expressing it as a clear and simple target, as is maximising GDP growth, poses some difficulty. The objective of individual and social well-being is also constrained by the planet's limited capacities. The TNE model would therefore focus on achievement of specific measures of well-being for all, subject to mandatory achievement of environmental sustainability and fairness in the distribution of income, wealth and non-monetary benefits.

TNE treats the role of the financial sector as supportive of the real economy and the environment, and industry's role as constrained by the need to be sustainable in its treatment of the environment and local communities. The New Economics Foundation refers to a variety of proposals and initiatives under the TNE banner, including the localisation of enterprise, the regulation of banks, and especially the promotion of localised and micro-banking and the limitation of speculative investment banking and trading, the taxing of pollution and subsidizing of green investment, and the equalising of economic development between regions. In addition TNE advocates measures to end food speculation, to regulate off-shore tax havens, to regulate and supervise financial actors and products, and to reforming exchange rates and global reserve systems.

Finally, the New Economics Foundation recognises the world is increasingly interdependent, that the wealthy West 'over consumes' and over pollutes to the disadvantage of poorer parts of the world. Moreover,

> *'Rising levels of consumption have not delivered dramatically increased life satisfaction in wealthy countries. Getting off the consumer treadmill will be chance for liberation and the discovery of what really matters to us. And with consumption in the rich world reduced, there will be more space in the global commons for other people, who don't yet have enough, to meet their basic needs.'*[113]

This is not a neat and simple packages as is the neoclassical model. It has all the messiness of the real world. And it addresses the most pressing economic issues confronting the real world. But for it to succeed, the neoclassical ideology must first be displaced.

10.6 What They Don't Tell You About Economics

Around two years after the 2007–8 crash, Chang published *'23 Things They Don't Tell You about Capitalism'*[111] rejecting the free market institutional truth.

The first three '*things*' were:

> 'There is no such thing as a free market',
> 'Companies should *not* be run in the interest of their owners', and,
> 'Most people in rich countries are paid more than they should be'.

The 23rd *'thing'* was,

> *'Good economic policy does not require good economists'.*

That was followed four years later by '*Economics: the Users Guide*',[114] which is accessible – and is tuly accessible to non specialist economists – at https://www.pelicanbooks.com/economics-the-users-guide That important publication included reference to a small, seductive volume entitled The Little Blue Book of Economics which the author agreed to being reproduced here:

* * *

10.6.1 The Little Blue Book by HaJoon Chang

Five Things They Don't Tell You About Economics:

1. **95% of economics is common sense**
   You don't need a degree to understand it
   We've got this profession wrong; a lot of professional economists think what they do is too difficult for ordinary people. You'd be surprised how often these people are stupid enough to say things, at least in private, like 'you wouldn't understand what I do even if I explained it to you'. If you cannot explain it to other people, *you* have the problem.

   People express strong opinions on all sorts of things despite not having the appropriate expertise: climate change, gay marriage, the Iraq War, nuclear power stations. But when it comes to economic issues, many people are not even interested, not to speak of not having a strong opinion about them. When was the last time you had a debate on the future of the Euro, inequality in China or the American manufacturing industry, despite the fact that these issues can have a huge impact on your life, wherever you live?

2. **Economics is not a science**
   Despite what the experts want you to believe, there is more than one way of 'doing' economics
   People have been led to believe that, like physics or chemistry, economics is a 'science', in which there is only one correct answer to everything; thus non-experts should simply accept the 'professional consensus' and stop thinking about it.

   Contrary to what most economists would have you believe, there isn't just one kind of economics – Neoclassical economics. In fact there are no less than nine different kinds, or schools, as they are often known. And none of these schools can claim superiority over others and still less monopoly over truth.

   I accept that being suddenly asked to taste nine different flavours of ice cream when you had thought that there was only one plain vanilla can be quite overwhelming. In order to help, I attach here a simple table that will help you overcome your initial fear.

3. **Economics is politics**
   Economic arguments are often justification for what powerful people want to do anyway
   Economics is a political argument. It is not – and can never be – a science.

   Behind every economic policy and corporate action that affect our lives – the minimum wage, outsourcing, social security, food safety, pensions and whatnot – lies some economic theory that either has inspired those actions or, more frequently, is providing justification of what those in power want to do anyway.

Only when we know that there are different economic theories will we be able to tell those in power that they are wrong to tell us that 'there is no alternative' (TINA), as Margaret Thatcher once infamously put it in defence of her controversial policies.

4. **Never trust an economist**
It is one thing not to foresee the financial crisis; it's another not to have changed anything since
Most economists were caught completely by surprise by the 2008 global financial crisis. Not only that, they have not been able to come up with decent solutions to the ongoing aftermaths of that crisis.

Given all this, economics seems to suffer from a serious case of megalomania.

The financial crisis has been a brutal reminder that we cannot leave our economy to professional economists and other 'technocrats'. We should all get involved in its management – as active economic citizens.

5. **We have to reclaim economics for the people**
It's too important to be left to the experts alone
You should be willing to challenge professional economists (and, yes, that includes me). They do not have a monopoly over the truth, even when it comes to economic matters.

Like many other things in life – learning to ride a bicycle, learning a new language, or learning to use your new tablet computer – being an active economic citizen gets easier over time, once you overcome the initial difficulties and keep practicing it.

Unless you are willing and able to challenge the professionals, challenge the experts, what's the point of having a democracy?

There is no excuse for complacency. If you organize and demand reforms then a lot of amazing things happen, but it won't come easy – we have to fight for it.

10.7 Conclusion

The following notes are drawn from the posting, '*The Utility of Economics*' (http://gordonpearson.co.uk/2010/08/17/the-utility-of-economics/#more-515).

Economic theory, in particular the FNEBS, gives the misleading impression of being practically useful.

As an academic subject its great virtue is in training the mind, a component of what Newman referred to as a liberal education, in the same way as Latin used to be. For some time the mind training role of Latin appeared to be being taken over by computer programming. That had the same hard, rule-based logic, and for most people who, three decades ago or more, learned Fortran or C and their various derivatives, there was the same lack of practical utility. Now, that role has been usurped by the study of economics.

Beyond training of the mind, and beyond what common sense already provides, economic theory can have most unfortunate results. For example, the problems of recession and how to deal with them. Following the 2007–8 crash the the UK government, being committed Friedmanite free market idealists, pumped trillions of taxpayers' money into the economy to keep it buoyant. But it did so by funding banks which might otherwise have collapsed in terms of shareholder value. The government then tried to persuade the banks to pass the funding on to real economy businesses so as to maintain employment. But the banks were reluctant to pass the money on because they needed to rebuild their own balance sheets, having themselves made such a mess of them. The phrase 'quantitative easing' was really bank balance sheet easing, and had limited impact on real business and real jobs beyond the financial sector.

Fisher's famous equation, $MV=PT$, might have been helpful. In that expression M is the total amount of money, V the velocity of its circulation, P the price level and T the amount of monetary transactions. If money doesn't circulate then V is zero and the whole thing collapses, which is what happened when banks just hung onto the quantitative easing money. That is the common sense in the Fisher equation. Friedman's focus on the quantity of money, (M in the above equation), completely ignores the question of V, i.e. whether the money circulates and if so how fast. This continues to blight government economic policy which continues to pour money in to the financial sector which invests for the quckest and highest returns. Inevitably, these are provided by the speculative ultra-fast bets, rather than investing in the real economy to provide real jobs.

The reality is that money invested in the poorest members of society circulates fastest because they have no option but to spend it. That is how to achieve the biggest bang per buck. The FNEBS justifies an elaborate argument of passing money to the wealthiest members of society who will invest it in long term development which will benefit the whole economy eventually trickling down to common good. Prior to the computerisation and deregulation of the financial sector there may have been some truth in this trickle down argument because alternative investment opportunities were limited. Since 'Big Bang' however, there is no truth at all in trickle down. Money poured into the financial sector has little relevance to the real business of real business. One way quantitative easing could be invested in long term real economy projects would be for the state to do the investing, as Roosevelt did with the New Deal in the 1930s. Alternatively, and with greater potential for the common good, investment in future development and sustainability could be made by corporate entities which made sure they were not vulnerable to the predatory financial sector.

Bibliography

Alchian, AA, & Demsetz, H, (1972), 'Production, Information Costs, and Economic Organisation', *American Economic Review,* Vol 62. December): 777–795.

Axelrod, R, (1984), *The Evolution of Co-operation,* New York: Basic Books.

Barnard, CI, (1948), *'Organization and Management'*, Cambridge, Mass: Harvard University Press.

Beatty, J, (1998), *The World According to Drucker',* London: Orion Publishing Group.

Bentham, J (1789), *Introduction to the Principles of Morals and Legislation* republished by Dover Philosophical Classics 2007.

Body Shop 2014 Values Report: http://viewer.zmags.co.uk/publication/61c41367#/61c41367/2

Burns, T & Stalker, GM, (1961), *The Management of Innovation,* London: Tavistock Institute.

Cadbury, A, (1987), 'Ethical Managers make their own rules', *Harvard Business Review*, September–October.

Cadbury code, extracted from the Final Report of the Committee on the Financial Aspects of Corporate Governance, published by Gee, South Quay Plaza, 183 Marsh Wall, London E14 9FS.

Caulkin, S, (2009), Individuality can banish the downturn blues, *The Observer, Business & Media,* p. 6, 24.5.09.

Chang, Ha-Joon, 2010, *23 Things They Don't Tell You about Economics*, London: Allen Lane.

Chang, Ha-Joon, 2014, *Economics: The User's Guide,* London: Pelican.

Chartered Institute of Management 2015 code of conduct and practice: http://www.managers.org.uk/policies/code-of-conduct-and-practice

CocaCola website: http://www.coca-colacompany.com/our-company/mission-vision-values

Colby, A & Kohlberg, L, (1987), *The Management of Moral Judgement Vol 1,* Cambridge: Cambridge University Press.

Corporate Reform Collective, (2014), *Fighting Corporate Abuse: Beyond Predatory Capitalism,* London: PlutoPress (CRC comprised Tom Hadden, Paddy Ireland, Glenn Morgan, Martin Parker, Gordon Pearson, Sol Picciotto, Prem Sikka & Hugh Wilmott).

DeGeorge, RT, (1991), *'Will success spoil business ethics?'* in 'Business Ethics: the state of the art', Freeman, RE (Ed), Oxford: Oxford University Press.

Dickson, M, (1993), 'Baby Bell's bad behaviour'. *Financial Times,* 14th May.

Dixit, A & Nalebuff, B, (1991), *Thinking Strategically: the competitive edge in business politics and everyday life*, New York: Norton.

Donkin, R, (1994), 'Whistleblower's cautionary tale', *Financial Times*, 10th January.

Drucker, P, (1993), *Post-Capitalist Society,* Oxford: Butterworth-Heinemann.

Dunleavy, CA, (1998), *Corporate Governance in late 19th century Europe and the United States: the case of shareholder voting rights*, in Hopt, Kanda et al, (1998) Comparative Corporate Governance, Oxford University Press.

Edelman, 2015, 15th Annual Edelman Trust Barometer, http://www.edelman.com/2015-edelman-trust-barometer/

Emery, FE, (1969), *Systems Thinking*, Harmondsworth: Penguin Books.

Emery, FE & Trist, EL, (1965), 'The causal texture of organisational environments', *Human Relations*, Vol 18, No. 1, 21–32.

Engels, F, (1844), '*The Condition of the Working Class in England*', republished in 1969 by Panther Books.

Fox J and Lorsch JW (2012), 'What good are shareholders?', *Harvard Business Review,* July.

Friedman LM, (1973), *A History of American Law*, New York: Simon & Schuster Touchstone.

Friedman, M., (1962), *'Capitalism and freedom'*, Chicago: Chicago University Press.

Friedman, M, (1976), Address to the Institute of Economic Affairs entitled '*The Road to Economic Freedom: The Steps from Here to There*'.

Galbraith, JK, (1958), *The Affluent Society*, London: Hamish Hamilton.

Garvin, DA, (1987), 'Competing on the eight dimensions of quality;, *Harvard Business Review*, November-December.

Gauthier, D, *Morality and Markets: the implications for business* in Harvey, B et al *Marklet Morality and Company Size*, Dordrecht: Kluwer Academic Publishers.

Ghoshal, S, (2005), 'Bad Management Theories are Destroying Good Management Practices', *Academy of Management Learning & Education*, Vol 4, No 1.

Goldsmith, W, & Clutterbuck, D, (1985), *'The Winning Streak',* Harmondsworth: Penguin Books.

Handy, CB, (1976), *Understanding Organisations,* Harmondsworth: Penguin.

Hayek, FA, (1944), *The Road to Serfdom*, London: Routledge. (This quotation is from the preface to the 1956 edition, p. iii).

Hayes RH, & Garvin, D, (1986), 'Managing as if tomorrow mattered', *Harvard Business Review,* May–Jun.

Heffernan, M, (2011), *Wilful Blindness: why we ignore the obvious at our peril,* London: Simon & Schuster

Herrnstein, R, (1988), *A Behavioural Alternative to Utility Maximisation*, in Applied Behavioural Economics, S. Maital (Ed), Brighton: Wheatsheaf Books.

Hotten, R, (1993), 'Firms reveal they put profits before ethics', *Sunday Times*, 3rd January.

Howard, R, (1990), Values make the company: an interview with Robert Haas, *Harvard Business Review, September–October.*

Jack, A & Dixon, H, (1993), 'What price a corporate halo', *Financial Times,* 17th September.

Jensen, MC, & Meckling, WH, (1976), Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure, *Journal of Financial Economics*, Vol 3 pp. 305–360.

Jönsson, S., (1996), 'Decoupling hierarchy and accountability: an examination of trust and reputation', in R Munro & J Mouritsen (Eds) *'Accountability: Power, ethos and the technologies of managing'*, London: Thomson Business Press.

Keynes, JM, (1931), *Collected Writings,* Vol ix, *Essays in Persuasion,* London: Macmillan.

Koehler, W, (1938), *The Place of Values in the World of Fact*, Kegan Paul Trench Trubner.

Krugman, P, (2007), 'Who was Milton Friedman?', *New York Review of Books,* 17th February.

Lan, LL & Heracleous, L, (2010), 'Rethinking Agency Theory: the View from Law', *Academy of Management Review*, Vol. 35, No. 2, 294–314.

Lei, D, (1993), 'Offensive and defensive uses of alliances', *Long Range Planning*, 26, (No 4), pp. 32–41.

Lorange, P, Roos, J & Bronn, PS, (1992), 'Building successful strategic alliances', *Long Range Planning,* 25, (No 6) 10.

Lucas, RE Jr, (1996), 'Nobel Lecture – Monetary Neutrality, *The Journal of Political Economy, Vol 104, Iss 4.*

Lucas R, (2009), *Robert Lucas on Non-Standard Monetary Policy*: http://www.bradford-delong.com/2009/02/robert-lucas-on-non-standard-monetary-policy.html

Maier, P, 1993, The Revolutionary Origins of the American Corporation, *William and Mary Quarterly*, 3rd Ser, pp. 51–84.

Maital, S, (Ed), (1988), *Applied Behavioural Economics*, Brighton: Wheatsheaf Books.

Maslow, A, (1943), 'A theory of human motivation', *Psychological Review,* 50.

Matsusaka, JG, (1995), *The economic approach to democracy*, in Tommasi, M & Ierulli, K. (Eds), (1995), 'The New Economics of Human Behaviour', Cambridge: Cambridge University Press.

Mill, JS, (1861), quoted in Warnock, G, (1967), *Contemporary Moral Philosophy,* London: Macmillan.

Miller, WF, (1990), 'Technology and global strategy', *Strategic Direction*, January.

Mises, von L, (1962), *The Free and Prosperous Commonwealth,* translated by R Raico, Ed A Goddard, New York: Van Nostrand Co.

Misztal, B.A, (1996), 'Trust in Modern Societies: The Search for the Bases of Social Order', Cambridge: Polity Press

Murray, S, (2013), 'MBA teaching urged to move away from focus on shareholder primacy model', *Financial Times,* 7th July.

Nash, LL, (1990), *'Good Intentions Aside: a manager's guide to resolving ethical problems',* Boston, Massachusetts: Harvard Business School Press.

New Economics Foundation (NEF) website, http://www.neweconomics.org/

Ohmae, K, (1989), 'The global logic of strategic alliances', Harvard Business Review, March–April, pp. 143–154.

Ostrom, E, (1990), *Governing the Commons: the Evolution of Institutions for Collective Action, Cambridge: Cambridge University Press.*

Parker, M, (2002), *Against Management,* Oxford: Blackwell Publishers.

Parker, M & Pearson G, (2005), 'Capitalism and its Regulation: a Dialogue on Business and Ethics', jointly with Parker, M, *Journal of Business Ethics*, Vol 60, No 1, pp. 91–101.

Pearce, JA, (1982), The company mission as a strategic tool, *California Management Review,* Spring.

Pearson, G, (1989), *'Factors which facilitate and inhibit innovation in a mature industry',* PhD thesis, Manchester Business School;

Pearson, G, (1992), *'The Competitive Organisation*, London: McGraw-Hill.

Pearson, G, (1995), *Integrity in Organizations: An Alternative Business Ethic*, Maidenhead: McGraw-Hill.

Pearson, G (1999), *Strategy in Action: strategic thinking, understanding and practice,* Harlow: FT Prentice Hall.

Pearson, G (2009), The Rise and Fall of Management: a brief history of practice, theory and context, Farnham: Gower Publishing.

Pearson, G, (2012), *The Road to Co-operation: Escaping the Bottom Line*, Farnham: Gower.

Pearson, G (2014), *The Corruption of Business: a statement of the contemporary problem*', in 'Contemporary Issues in Management (Eds: Hamilton L, Mitchell, L & Mangan A), Cheltenham: Edward Elgar.

Peters, T & Waterman RH (1982), *In Search of Excellence*, New York: Harper & Row.

Rees-Mogg, W (1987), 'The old City standards driven out be cowboys', *The Independent*, 6th January.

Routh, G (1975), *The Origins of Economic Ideas*, London: Macmillan.

Ruskin, J (1862), *The Roots of Honour*, the opening essay in *Unto This Last.* London: Penguin Classics

Simon, HA (1956), "Rational choice and the structure of the environment". *Psychological Review*, Vol. 63 No. 2, 129–138.

Skinner, W (1986), 'The productivity paradox', *Harvard Business Review*, July-August.

Smith, A (1759), '*The Theory of Moral Sentiments*', published by Dover Publications, New York 2006.

Smith, A (1776), '*Wealth of Nations*', published by Oxford University Press Oxford World's Classics 1998.

Solomon, J (2007), *'Corporate Governance and Accountability'*, Chichester: John Wiley & Son.

Stark, A, (1993), 'What's the Matter with Business Ethics?', *Harvard Business Review*, Vol. 71 Issue 3

Stiles P & Taylor B, (1993), 'Benchmarking corporate governance: the impact of the Cadbury code', *Long Range Planning*, 26 (No5), pp. 61–71

Tett, G (2014), 'Penalise the banks but use the money well', *Financial Times, 14 November.*

Tomasky, M (2010), The Money Fighting Health Care Reform, *New York Review of Books*, April 8th.

Tommasi, M & Ierulli, K (Eds), *The New Economics of Human Behavior*, Cambridge: Cambridge University Press.

Trapp, R, (1993), 'Competitors click in for a better profile', *Independent on Sunday*, 1st May.

White, J (1984), 'Corporate culture and corporate success', *Management Decision*, Vol 22, No 4.

Wilkinson, R & Pickett, K, (2009), *The Spirit Level; why more equal societies always do better*, London: Allen Lane.

Endnotes

1. Pearson G, (2014), *The Corruption of Business: a statement of the contemporary problem*', in 'Contemporary Issues in Management (Eds: Hamilton L, Mitchell, L & Mangan A), Cheltenham: Edward Elgar.
2. Judt, T, (2010), *Ill Fares the Land,* London: Allen Lane, p. 1.
3. Pearson, G, (2012). The Rise and Fall of Management: a brief history of practice, theory and context, Farnham: Gower Publishing, pp. 16–20.
4. Maier, P, 1993, The Revolutionary Origins of the American Corporation, *William and Mary Quarterly*, 3rd Ser, pp. 51–84.
5. Friedman LM, (1973), *A History of American Law*, New York: Simon & Schuster Touchstone, p. 168.
6. Dunleavy, CA, (1998), Corporate Governance in late 19th century Europe and the United States: the case of shareholder voting rights, in Hopt, Kanda et al, (1998) Comparative Corporate Governance, Oxford University Press, p. 15.
7. Smith, A, (1776), '*Wealth of Nations*', Book V, Chapter 1, Part 3, Article 1, original edition p. 506.
8. Drucker, P, (1993), *Post-Capitalist Society,* Oxford: Butterworth-Heinemann, pp. 36–41
9. Keynes, JM, (1931), *Collected Writings,* Vol ix, *Essays in Persuasion,* London: Macmillan, p. 325.
10. Ibid, p. 329.
11. Mises, von L, (1962), *The Free and Prosperous Commonwealth,* translated by R Raico, Ed A Goddard, New York: Van Nostrand Co, p. 19.

12. Hayek, FA (1944), *The Road to Serfdom*, London: Routledge. (This quotation is from the preface to the 1956 edition, piii.).
13. Friedman, M (1962), *'Capitalism and freedom'*, Chicago: Chicago University Press, p. 133.
14. Alchian, AA & Demsetz, H (1972), 'Production, Information Costs, and Economic Organisation', *American Economic Review,* Vol 62, p. 778.
15. Jensen, MC & Meckling, WH (1976), Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure, *Journal of Financial Economics*, Vol 3 pp. 305–360.
16. Lan, L L & Heracleous, L, (2010), 'Rethinking Agency Theory: the View from Law', *Academy of Management Review*, Vol. 35, No. 2, 294–314.
17. Fox J and Lorsch JW (2012), 'What good are shareholders?', *Harvard Business Review,* July.
18. Tett, G, (2014), 'Penalise the banks but use the money well', *Financial Times, 14 November.*
19. Corporate Reform Collective (2014), *Fighting Corporate Abuse: Beyond Predatory Capitalism,* London: PlutoPress (CRC comprised Tom Hadden, Paddy Ireland, Glenn Morgan, Martin Parker, Gordon Pearson, Sol Icciotto, Prem Sikka & Hugh Wilmott).
20. Smith, A (1759), 'The Theory of Moral Sentiments', Part VI, Section I, republished in the Dover Philosophical Classics imprint by Dover Publications Inc of New York in 2006, p. 213-4.
21. Smith, A, (1776), 'Wealth of Nations', Book I, Chapter 2, p. 22.
22. Smith, A, (1776), 'Wealth of Nations', Book I, Chapter X, Part I: p. 129.
23. Smith, A, (1776), 'Wealth of Nations', Book V, Chapter 1, Part III, Article II, p. 429.
24. Smith, A., (1759), 'The Theory of Moral Sentiments', Part VI, Section I, p. 3.
25. Smith, A, (1776), 'Wealth of Nations', Book V, Chapter 2, Part 2, Of taxes, p. 451.
26. Routh, G, (1975), The Origins of Economic Ideas, London: Macmillan.
27. Lucas, RE Jr, (1996), 'Nobel Lecture – Monetary Neutrality, *The Journal of Political Economy, Vol 104, Iss 4 p. 676–677.*
28. Alchian, AA, & Demsetz, H, (1972), 'Production, Information Costs, and Economic Organisation', *American Economic Review,* Vol 62, p. 778.
29. Jensen, MC, & Meckling, WH, (1976), Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure, *Journal of Financial Economics*, Vol 3 pp. 305–360.
30. Lan, LL & Heracleous, L, (2010), 'Rethinking Agency Theory: the View from Law', *Academy of Management Review*, Vol. 35, No. 2, 294–314.
31. Krugman, P, (2007), 'Who was Milton Friedman?', *New York Review of Books,* 17th February.
32. Friedman, M, (1976), Address to the Institute of Economic Affairs entitled '*The Road to Economic Freedom: The Steps from Here to There*'.
33. Robert Lucas on Non-Standard Monetary Policy: http://www.bradford-delong.com/2009/02/robert-lucas-on-non-standard-monetary-policy.html
34. Cadbury code, extracted from the Final Report of the Committee on the Financial Aspects of Corporate Governance, published by Gee, South Quay Plaza, 183 Marsh Wall, London E14 9FS.
35. Murray, S, (2013), 'MBA teaching urged to move away from focus on shareholder primacy model', *Financial Times,* 7th July.
36. See Emery, FE, (1969), *Systems Thinking*, Harmondsworth, Penguin Books, includes extracts from Koehler, W, (1938), *The Place of Values in the World of Fact*, Liveright, pp. 314–328.
37. White, J, (1984), 'Corporate culture and corporate success', Management Decision, Vol 22, No 4.

38. Handy, CB, (1976), Understanding Organisations, Harmondsworth: Penguin.
39. DeGeorge, RT, (1991), *'Will success spoil business ethics?'* in 'Business Ethics: the state of the art', Freeman, RE (Ed), Oxford: Oxford University Press, p. 45.
40. Ghoshal, S, (2005), 'Bad Management Theories are Destroying Good Management Practices', *Academy of Management Learning & Education*, Vol 4, No 1, p. 76.
41. Parker, M, (2002), *Against Management,* Oxford: Blackwell Publishers, p. 91–114.
42. Pearson G & Parker M, (2005), 'Capitalism and its Regulation: a Dialogue on Business and Ethics', *Journal of Business Ethics*, Vol 60, No 1, pp. 91–101.
43. Bentham, J (1789, *Introduction to the Principles of Morals and Legislation.*
44. Mill, JS, (1861), quoted in Warnock, G, *Contemporary Moral Philosophy*London: Macmillan, 1967
45. Stark, A, (1993), 'What's the Matter with Business Ethics?', *Harvard Business Review*, Vol. 71 Issue 3, p. 38–4.
46. Murray, S, (2013), 'MBA teaching urged to move away from focus on shareholder primacy model', *Financial Times,* 7th July.
47. Engels, F, (1844), *'The Condition of the Working Class in England'*, republished in 1969 by Panther Books
48. Hotten, R, (1993), 'Firms reveal they put profits before ethics', *Sunday Times*, 3rd January.
49. Edelman, 15th Annual Edelman Trust Barometer, http://www.edelman.com/2015-edelman-trust-barometer/
50. Nash, LL, (1990), *'Good Intentions Aside: a manager's guide to resolving ethical problems'*, Boston, Massachusetts: Harvard Business School Press, p. 152.
51. Goldsmith, W, & Clutterbuck, D, (1985), *'The Winning Streak'*, Harmondsworth: Penguin Books.
52. Edelman 2015 Trust Barometer – http://www.edelman.com/2015-edelman-trust-barometer/
53. Misztal, BA, (1996), 'Trust in Modern Societies: The Search for the Bases of Social Order', Cambridge: Polity Press.
54. Heffernan, M, (2011), *Wilful Blindness: why we ignore the obvious at our peril,* London: Simon & Schuster
55. Jönsson, S., (1996), 'Decoupling hierarchy and accountability: an examination of trust and reputation', in R Munro & J Mouritsen (Eds) *'Accountability: Power, ethos and the technologies of managing'*, London: Thomson Business Press.
56. Peters, T & Waterman RH, (1982), *In Search of Excellence*, New York: Harper & Row
57. Barnard, C I, (1948), *'Organization and Management'*, Cambridge, Mass: Harvard University Press, p. 8.
58. Ibid, p. 11.
59. Ghoshal, S, (2006), Bad Management Theories Are Destroying Good Management Practices, *Academy of Management Learning and Education,* Vol 4, No 1, p. 85.
60. Axelrod, R, (1984), *The Evolution of Co-operationI,* New York: Basic Books.
61. Dixit, A & Nalebuff, B, (1991), *Thinking Strategically: the competitive edge in business politics and everyday life*, New York: Norton p. 106–7.
62. Gauthier, D, *Morality and Markets: the implications for business* in Harvey, B et al *Marklet Morality and Company Size*, Dordrecht: Kluwer Academic Publishers.
63. Ibid, p. 60.
64. Dixit, A & Nalebuff, B, (1991), *Thinking Strategically: the competitive edge in business politics and everyday life*, New York: Norton, p. 100.
65. Ibid p. 143

66. Rees-Mogg, W, (1987), 'The old City standards driven out be cowboys', *The Independent*, 6th January.
67. Lorange, P, Roos, J & Bronn, PS, (1992), 'Building successful strategic alliances', *Long Range Planning*, 25, (No 6) 10.
68. Ohmae, K, (1989), 'The global logic of strategic alliances', Harvard Business Review, March-April, pp. 143–154.
69. Miller, WF, (1990), 'Technology and global strategy', *Strategic Direction*, January.
70. Lei, D, (1993), 'Offensive and defensive uses of alliances', *Long Range Planning*, 26, (No 4), pp. 32–41.
71. Burns, T & Stalker, GM, (1961), *The Management of Innovation*, London: Tavistock Institute.
72. Caulkin, S, (2009), Individuality can banish the downturn blues, *The Observer, Business & Media*, p. 6, 24.5.09.
73. Colby, A & Kohlberg, L, (1987), *The Management of Moral Judgement Vol 1*, Cambridge: Cambridge University Press, p. 16.
74. Pearson, GJ, (1989), 'Factors which facilitate and inhibit innovation in a mature industry', PhD thesis, Manchester Business School; Published (1992), as 'The Competitive Organisation, London: McGraw Hill.
75. Emery, FE & Trist, EL, (1965), 'The causal texture of organisational environments', Human Relations, 18.
76. Maslow, A, (1943), 'A theory of human motivation', Psychological Review, 50.
77. http://www.coca-colacompany.com/our-company/mission-vision-values
78. Pearce, JA, (1982), The company mission as a strategic tool, *California Management Review*, Spring.
79. Pearson, G (1999), *Strategy in Action: strategic thinking, understanding and practice*, Harlow: FT Prentice Hall, p. 169.
80. Beatty, J, (1998), *The World Accoring to Drucker'*, Orion Publishing Group, p. 82.

81. Ibid, p. 21.
82. Quoted from Dixit, A & Nalebuff, B, (1991), Thinking Strategically: the competitive edge in business politics and everyday life, New York: Norton p. 142.
83. Howard, R, (1990), Values make the company: an interview with Robert Haas, Harvard Business Review, September–October.
84. Body Shop 2014 Values Report: http://viewer.zmags.co.uk/publication/61c41367#/61c41367/2
85. Garvin, D A, (1987), 'Competing on the eight dimensions of quality;, *Harvard Business Review*, November-December.
86. Skinner, W, (1986), 'The productivity paradox', *Harvard Business Review*, July–August.
87. Hayes RH, & Garvin, D, (1986), 'Managing as if tomorrow mattered', *Harvard Business Review,* May–June.
88. Fox, J & Lorsch, JW, (2012), '**What Good** Are **Shareholders**?' *Harvard Business Review*, Vol. 90 Issue 7/8, pp. 48–57.
89. Cadbury, A, (1987), 'Ethical Managers make their own rules', Harvard Business Review, September-October
90. Donkin, R, (1994), 'Whistleblower's cautionary tale', Financial Times, 10th January.
91. The Cadbury code is reproduced from the Final Report of the Committee on the Financial Aspects of Corporate Governance, published by Gee, South Quay Plaza, 183 Marsh Wall, London E14 9FS.
92. Solomon, J, (2007), 'Corporate Governance and Accountability', Chichester: John Wiley & Son, p. 188.
93. Stiles P & Taylor B, (1993), 'Benchmarking corporate governance: the impact of the Cadbury code', Long Range Planning, 26 (No. 5), pp. 61–71.
94. Trapp, R, (1993), 'Competitors click in for a better profile', Independent on Sunday, 1st May.
95. CIM code of conduct and practice: http://www.managers.org.uk/policies/code-of-conduct-and-practice
96. Cadbury, A (1987), 'Ethical managers make their own rules', *Harvard Business Review,* September-October.
97. Dickson, M, (1993), 'Baby Bell's bad behaviour'. *Financial Times,* 14th May.
98. Jack, A & Dixon, H, (1993), 'What price a corporate halo', *Financial Times,* 17th September.
99. Pearson, G, (1995), *Integrity in Organizations: An Alternative Business Ethic,* Appendix I Corporate Int. egrity Survey.
100. Ruskin, J, (1862), *The Roots of Honour*, the opening essay in *Unto This Last.* London: Penguin Classics
101. Pearson, G, (2012), *The Road to Co-operation: Escaping the Bottom Line*, Farnham: Gower.
102. Ostrom, E, (1990), *Governing the Commons: the Evolution of Institutions for Collective Action, Cambridge: Cambridge University Press.*
103. Wilkinson, R & Pickett, K, (2009), *The Spirit Level; why more equal societies always do better*, London: Allen Lane.
104. Galbraith, JK, (1958), *The Affluent Society*, London: Hamish Hamilton, p. 210.
105. Smith, A, (1790), *The Theory of Moral Sentiments.* Published 2006, NY: Dover Publications, pp. 213–4.
106. Simon, HA (1956). "Rational choice and the structure of the environment". *Psychological Review*, Vol. 63 No. 2, 129–138.
107. Herrnstein, R, (1988), *A Behavioural Alternative to Utility Maximisation*, in Applied Behavioural Economics, S. Maital (Ed), Brighton: Wheatsheaf Books.
108. Tommasi, M & Ierulli, K, (Eds), *The New Economics of Human Behavior*, Cambridge: Cambridge University Press.
109. Maital, S, (Ed), (1988), *Applied Behavioural Economics*, Brighton: Wheatsheaf Books.

110. Matsusaka, JG, (1995), *The economic approach to democracy*, in Tommasi, M & Ierulli, K. (Eds), (1995), 'The New Economics of Human Behaviour', Cambridge: Cambridge University Press.
111. Tomasky, M, (2010), The Money Fighting Health Care Reform, *New York Review of Books*, April 8th.
112. New Economics Foundation (NEF) website, http://www.neweconomics.org/ indicates specific NEF initiatives.
113. New Economics Foundation website http://www.neweconomics.org/projects/interdependence
114. Chang, Ha-Joon, 2010, *23 Things They Don't Tell You about Economics*, London: Allen Lane
115. Chang, Ha-Joon, 2014, *Economics: The User's Guide,* London: Pelican.