Why Business Ethics?

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Everyone agrees that business managers must understand finance and marketing. But is it necessary for them to study ethics?

Managers who answer in the negative generally base their thinking on one of three rationales. They may simply say that they have no *reason* to be ethical. They see why they should make a profit, and most agree they should do so legally. But why should they be concerned about ethics, as long as they are making money and staying out of jail?

Other managers recognize that they should be ethical but *identify* their ethical duty with making a legal profit for the firm. They see no need to be ethical in any further sense, and therefore no need for any background beyond business and law.

A third group of managers grant that ethical duty goes further than what is required by law. But they still insist that there is no point in studying ethics. Character is formed in childhood, not while reading a college text or sitting in class.

These arguments are confused and mistaken on several levels. To see why, it is best to start with the question raised by the first one: why should business people be ethical?

Why Should One Be Ethical?

There is already something odd about this question. It is like asking, "Why are bachelors unmarried?" They are unmarried by definition. If they were married, they would not be bachelors. It is the same with ethics. To say that one *should* do something is another way of saying it is ethical. If it is not ethical, then one should not do it.

Perhaps when business people ask why they should be ethical, they have a different question in mind: what is the *motivation* for being good? Is their something in it for them?

It is perfectly all right to ask if there is a reward for being good, but this has nothing to do with *whether* one should be good. It makes no sense to try convince people that they should be good by pointing to the rewards that may follow. One should be good because "good" is, by definition, that which one should be.

As for motivation, good behavior often brings a reward, but not every time. Think about it. If it were always in one's interest to be good, there would be no need for ethics. We could simply act selfishly and forget about obligation. People invented ethics precisely because it does not always coincide with self interest.

Doing Well by Doing Good

Although ethics is not the same as self interest, business executives often want to be assured that it *is* the same. They want to make certain that "one can do well by doing good," meaning that one can succeed in business by being ethical.

There is no denying that one can often do well by doing good. An ethical company is more likely to build a good reputation, which is more likely to bring financial rewards over the long term. But good behavior cannot be grounded in tangible reward alone. People who are interested only in reward will behave ethically when it suits their purpose, but they will go astray whenever the incentives change.

There is a deeper confusion here, too. To look to ethics for motivation is to misunderstand what ethics is all about. It is like studying finance to find a reason to make money. Finance does not teach one to want to be rich. It teaches one how to be rich, assuming one wants to be rich. So it is with ethics. Ethics teaches one how to be good, assuming one wants to be good.

It is important to know that one can normally do well by doing good. Otherwise ethical people could go into business only with a high risk of failure. Business ethics, however, addresses the opposite question: *how can one do good by doing well?* It begins with the premise that managers want to do something good with their lives and investigates how to accomplish this through business. In other words, it treats profit and business success as means to a greater end: making the world a little better.

The Duty to Make Money

Granting that a business person's ultimate objective is to make the world better, how is this best achieved? A common view is that it is achieved by making as much money as possible. The best thing business people can do for society is to be good business people, which is to say, to maximize the company's profit. They should therefore stick to finance, marketing and operations management rather than waste time with ethics.

Economist Milton Friedman articulates this view in an essay that is quite popular with business students, "The Social Responsibility of Business Is to Increase its Profits."[1] According to Friedman, corporate officers have no obligation to support such social causes as hiring the hard-core unemployed to reduce poverty, or reducing pollution beyond that mandated by law. Their sole task is to maximize profit for the company, subject to the limits of law and "rules of the game" that ensure "open and free competition without deception or fraud."

Friedman advances two main arguments for this position. First, corporate executives and directors are not *qualified* to do anything other than maximize profit. Business people are expert at making money, not at making social policy. They lack the perspective and training to address complex social problems, which should be left to governments and social service agencies.

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[1] Milton Friedman, "The Social Responsibility of Business Is to Increase its Profits," *New York Times Magazine* (September 13, 1970). Reprinted in Thomas Donaldson and Al Gini, eds., *Case Studies in Business Ethics*, 4th ed., Prentice-Hall (19xx) 56-61.

Second, and more fundamentally, corporate officers have no *right* to do anything other than maximize profit. If they invest company funds to train the chronically unemployed or reduce emissions below legal limits, they in effect levy a "tax" on the company's owners, employees and customers in order to accomplish a social purpose. But they have no right to spend other people's money on social welfare projects. At best, only elected representatives of the people have such authority. Sole proprietors can spend the company's money any way they want, since it is their money, but fiduciaries and hired managers have no such privilege. If they contribute corporate money to arts or community development, it must be with an eye to increasing profit, perhaps by attracting better employees or improving the company's image. If they want to contribute to other social causes, they are free to join civic organizations and donate as much of their own money as they please.

It would be nice if the world were so simple. What happens, for example, when laws permit anti-social behavior? Should businesses not restrain themselves voluntarily, even if it imposes a cost on company stakeholders? Friedman's reply is that they must not, again on the libertarian principles just described. But suppose a hurricane hits a town and cuts off routes to the outside world. There is a desperate need for portable electric generators, and the only local seller takes the opportunity to charge an exorbitant price. (Something like this happened when Hurricane Andrew hit southern Florida.) Since this sort of price gouging is legal, the store manager has no right, on Friedman's view, to "tax" the owners by charging less than the market will bear. He does, however, have a right to ask the buyer to pay more, since the purchase decision is voluntary in a free market.

This little example reveals two fallacies of Friedman's position. One is the idea that company officers somehow usurp authority when they act ethically at the expense of owners. To refute this idea, let us agree that it is wrong for an *individual* to exploit hurricane victims by demanding a high price. (If we cannot agree on this, we can change the example.) Friedman admits that it is perfectly all right for a sole proprietor to sacrifice potential profit in order to be a decent human being. But suppose the owner has turned the business over to professional managers. Does ethical obligation to victims suddenly vanish? Is it permissible for the owner to exploit victims of disaster through agents, when it would be wrong to do it personally? Of course not. The owner cannot escape obligations simply by hiring someone to run the business. One might as well argue that an organized crime boss can avoid responsibility for murder by hiring a hit man to do the deed. Agents who act ethically at company expense therefore do not usurp the authority of owners. On the contrary, they carry out duties that the owners are bound to observe, whether they run the business themselves or through agents.

This is not to say that managers should use company funds to support any cause that strikes the owners' fancy, such as the Irish Republican Army or the Sierra Club. The reason is that the owners have no obligation *as business people* to support these causes. They may have such an obligation as human beings, but it is not part of business ethics. Since owners hire managers specifically to run a business, they transfer only their business-related obligations, such as the obligation not to exploit disaster victims by price gouging. Managers must of course know how to recognize what sorts of obligations are imposed specifically by business ethics. This is precisely why they should study business ethics as well as finance, marketing and operations!

The second major fallacy in Friedman's position is his misapplication of libertarian principles. He states that spending the owners' money in the service of ethics is coercion and therefore wrong, while operating in a free market to increase their wealth compromises no one's freedom and is therefore permissible. The electric generators provide a clear counterexample. Although no one compels hurricane victims to purchase generators, price gouging is coercive. It

forces the victims to choose between paying ridiculous prices and letting a warehouse full of food spoil. It takes money from them no less surely than lower prices take money from the owners.

The point is even sharper when a company decimates a community by moving a plant abroad. No one forced these people to work for the company in the first place. Yet the company limits their choices by putting them out of work, particularly the older ones, more than it limits stockholders' choices by reducing their dividends. To limit choices is to reduce freedom.

It is clear that maximizing profit can "tax" the broader community no less than ethical choices can "tax" the owners. The business executive has a special obligation to owners, but it is not grounded in libertarian principles. It is based simply on the fact that the executive acts on behalf of the owners.

The inadequacy of Friedman's philosophy is particularly evident in international business, where there are fewer legal restrictions. A famous case study describes how the Nestlé Corporation marketed its infant formula in parts of Africa by hiring nurses in local clinics to recommend formula over breast feeding. The nurses convinced mothers that using formula was sophisticated and Western, while breast feeding was primitive and third-worldish. Unfortunately clean water was often unavailable to mix with the powdered formula, and babies often became ill. The company continued its marketing efforts despite worldwide protests and relented only after years of massive consumer boycotts of its products. On Friedman's theory, the company's intransigence was perfectly justified. Its directors had no right to withdraw a profitable and legal product, even though it caused innocent babies to suffer, until boycotts changed the financial equation. Similar examples abound, such as pollution in Nigerian oil fields, worker exploitation in Southeast Asia sweat shops, and bribery around the world.

There is clearly an important element of truth in Friedman's position. Business people are not only at their best when making a profit, but in doing so they make an enormous positive contribution. Although Friedman says little about this in his essay, businesses provide a vast array of products and services that make life far better for millions worldwide. They can accomplish this largely through the expertise of managers who can run an efficient operation in a competitive environment. The primary ethical duty of managers is to apply their business skills and keep up the good work. At the same time, however, they must pay attention to whether their business in fact has this kind of positive effect. They are not experts in social policy, and it is often unobvious how far their social obligations extend. But this is one reason we have business ethics.

The Rules of the Game

The task of business ethics, then, is to identify the duties that business people have as business people. What are these duties? One can begin with the most basic ones mentioned by Friedman: the duty to obey the law and the "rules of the game," which provide for "open and free competition without deception or fraud."

Yet even these basic obligations are disputed. Albert Carr's very popular essay, "Is Business Bluffing Ethical?" argues that deception, for example, is a legitimate part of business.[2] Business, he says, is like a poker game. There are rules, but within the rules it is permissible to

[2] Albert Z. Carr, "Is Business Bluffing Ethical," *Harvard Business Review* (January-February, 1968) 2-8.

bluff in order to mislead others. In fact one must do so or lose the game. The ethical rules of everyday life therefore do not apply to business.

Using examples from the 1960s era in which he wrote the paper, Carr defends:

- "food processors" that use "deceptive packaging of numerous products";
- "automobile companies" that "for years have neglected the safety of car-owning families," as described in Ralph Nader's famous book *Unsafe at Any Speed*;
- "utility companies" that "elude regulating government bodies to extract unduly large payments from users of electricity."

"As long as they comply with the letter of the law," he says, "they are within their rights to operate their businesses as they see fit."

Carr tells of a sales executive who made a political contribution he did not believe in, to keep an important client happy. When the executive told his wife about it, she was disappointed with her husband and insisted he should have stood up for his principles. The executive explained to her how he must humor clients to keep his job. She understood the dilemma but concluded that "something is wrong with business." Carr analyzes the incident as follows:

> This wife saw the problem in terms of moral obligation as conceived in private life; her husband saw it as a matter of game strategy. As a player in a weak position, he felt that he could not afford to indulge an ethical sentiment that might have cost his seat at the [poker] table.[3]

Carr not only expects the executive to make such choices but cautions him not to agonize over them. "If an executive allows himself to be torn between a decision based on business considerations and one based on his private ethical code, he exposes himself to a grave psychological strain."

Carr, like Friedman, has a point. Bluffing is expected in many business contexts, no less than in poker. No one expects negotiators to put all their cards on the table, or advertisers to tell the whole truth about their product. What the poker analogy actually tells us, however, is that "deception" is not really deception when everyone expects it as part of the game. Nobody is deceived when advertisers say their product is the best on the market; everyone says that. So Carr does not actually defend deception. Hiding a card up one's sleeve, on the other hand, is truly deception because it breaks the rules of poker and no one is expecting it. Carr agrees that this sort of behavior, which he calls "malicious deception," is wrong.

One problem with Carr's poker analogy is that he overextends it. In a poker game everyone knows the rules, but business situations can be very ambiguous. If a food processor places false labels on packaging, it is highly unclear that consumers are "in on the game" and expect this sort of thing. If Mom and Dad take the kids to school in the family car, it is hard to argue that they "expect" the car to be unsafe, as was the Ford Pinto with its famous exploding gas tank. Such practices are now illegal precisely because they genuinely deceived customers, sometimes with deadly results.

The example of the political contribution, as well as several others in his article, suggest that Carr is making an even stronger claim. He seems to argue that the business game justifies a whole range of activities beyond bluffing, such as perversion of the political process. The

[3] Carr, page 8.

difficulty with this argument is that it proves too much. It implies that executives can do anything they want if it is part of a business game in which people play by the rules. But suppose the game is a shakedown racket, and everyone in town understands the rules: one must pay protection money or get roughed up by company thugs. This does not make it all right to participate in the racket, even if it is legal, which it is not. In fact, it is illegal precisely because it is the wrong kind of game to play.

The unavoidable fact is that some business games are good and some are bad. The right kind of competition, for example, can allow everyone to come out ahead, while the wrong kind can be destructive. When one plays the wrong game, then indeed "something is wrong with business." How does one know which game to play? There is a field that deals with this issue, and it is called ethics.

Carr compounds his error when he advises executives not to agonize over business decisions. He is right to say that they must not let personal sentiment cloud their judgment, particularly when it comes to such unpleasant duties as laying off employees or shutting down a plant. They certainly should not be paralyzed by indecision and doubt. But they must nonetheless struggle with the alternatives. Hard decisions are part of life. Sometimes the game of business requires one to compromise oneself in order to make a larger contribution. Perhaps the sales executive can promote an exciting new product only by putting up with little indignities like kowtowing to his clients. But he should never compromise his values without soul searching, which is to say, without carefully reviewing the ethical situation. Carr's assertion to the contrary is profoundly unwise.

Why Study Ethics?

Even granting that business ethics is important, many seem to believe that there is no point in studying the subject. Ethics is something you feel, not something you think. Finance, marketing, operations, and even business law lend themselves to intellectual treatment, but ethics does not.

The idea that ethics has no intellectual content is odd indeed, considering that some of the most famous intellectuals in world history have given it a central place in their thought (Confucius, Plato, Aristotle, Maimonides, Thomas Aquinas, etc.). Ethics is in fact a highly developed field that demands close reasoning. The Western tradition in particular has given rise to sophisticated deontological, teleological and consequentialist theories of right and wrong. No one theory explains everything satisfactorily, but the same is true, after all, in the natural sciences.

Even when they grant that ethics has intellectual content, people often say that studying the field will not change behavior. Character is formed in early childhood, not during a professor's lecture.

If the suggestion here is that college-level study does not change behavior, we should shut down the entire business school, not only the ethics course. Presumably the claim, then, is that studying finance and marketing can influence one's conduct, but studying ethics cannot. This is again a curious view, since ethics is the one field that deals explicitly with conduct. Where is the evidence for this view? The early origins of character do not prevent finance and marketing courses from influencing behavior. Why cannot ethics courses also have an effect?

Ethics courses have a number of features that seem likely to influence behavior. They provide a language and conceptual framework with which one can talk and think about ethical issues. Their emphasis on case studies helps to make one aware of the potential consequences of one's actions. They present ethical that theories help define what a valid ethical argument looks like. They teach one to make distinctions and avoid fallacies that are so common when people make decisions. They give one an opportunity to think through, at one's leisure, complex ethical issues that are likely to arise later, when there is no time to think. They introduce one to such specialized areas as product liability, employment, intellectual property, environmental protection, and cross-cultural management. They give one practice at articulating an ethical position, which can help resist pressure to compromise.

None of this convinces one to be good, but it is useful to those who want to be good. It may also improve business conduct in general. How many of the recent business scandals would have occurred if subordinates had possessed the skills, vocabulary and conceptual equipment to raise an ethical issue with their coworkers?

Ethics not only should be studied alongside management, but the two fields are closely related. Business management is all about making the right decisions. Ethics is all about making the right decisions. So what is the difference between the two? Management is concerned with how decisions affect the *company*, while ethics is concerned about how decisions affect *everything*. Management operates in the specialized context of the firm, while ethics operates in the general context of the world. Management is therefore part of ethics. A business manager cannot make the right decisions without understanding management in particular as well as ethics in general. Business ethics is management carried out in the real world. This is why business managers should study ethics.