

## Lecture 2

### Theories and foundations

#### **1. Business and the need for ethics**

Anti-business philosophies have shaped most historical discussions of business.

There is a strong view that capitalism's history is a story of 'robber barons' who grew rich by 'exploiting the poor'.

However, there is an important distinction between entrepreneurs who make profits by providing cheaper/better goods and services, and those who do so by capitalising on loopholes and opportunities which we identify as having a bad moral reputation.

#### **Corporation**

The major organisational innovation in the history of business is the development of the corporation.

Corporations are distinguished from single proprietorships and partnerships (traditional forms) by two features:

- Separation of ownership and management
- Legal limitation of owners' liability to the amount of the investment

However, the success of the corporation has attracted strong criticism.

#### **Financial markets**

Growth of corporations would not have been possible without the corresponding growth of the financial markets.

- Equity markets allow shareholders to liquidate their holdings, thus making available to corporations the capital of those who are not necessarily interested in long-term investments
- Derivative markets allow sellers and purchasers of assets to reduce risk by locking in some of their costs/revenues now. Speculators play a crucial role by assuming this risk.

However, financial markets are open to criticism, from charges that speculators are merely making 'paper profits', to claims about unfair insider trading.

#### **Business relationships**

##### Business/consumer relations

Moral problems include

- Advertising and the use of bluffing (increases sale volumes but harms customers)
- Bribery in negotiation
- Price fixing – monopolistic and cutthroat pricing (predatory pricing)
- Drawing the line between *caveat emptor* and product liability

##### Employer/employee relations

In a free market, the relationship between the two is a voluntary exchange of values on terms acceptable to both sides.

However, oftentimes employees are in an inherently weaker bargaining position, so there has been a push to intervene.

- Role of unions
- Affirmative action (policy where members of minority groups are given preference over members of more common or bigger groups)
- Mandatory benefits (minimum wage, superannuation)
- Privacy rights
- Whistle-blower protection

**Business ethics** – principles and standards that guide behaviour in the world of business. It defines right or wrong, acceptable or unacceptable behaviour within the organisation.

Key statistics

- 50% of surveyed employees indicate that they have done something unethical/illegal
- Annual cost of these activities in the US = \$400bn

### Ethics and economics

In a free market economy, firms optimally allocate scarce resources or factors of production to produce output.

Firms maximise their preferences/utility by producing output to the point where marginal revenue equals marginal cost.

In competitive settings, this leads to economic efficiency.

However, **ethics** considers many other reasons beyond maximising utility.

### Ethics and the law

Government interventionist school of thought assumes that

- Law prevails in public life and ethics in private life
- Law is a minimum, ethics is icing on the cake

However, these assumptions are flawed.

Well-developed legal systems embed ethics within the law for business conduct. Less-developed legal systems highlight the lack of this embodiment.

However, the law is not comprehensive in the whole of morality.

- The law is inappropriate for regulating some parts of business activity
- The law usually lags ethical developments (e.g. cannot catch up with new developments ecommerce and new platforms for securities trading)
- The law uses opaque moral concepts (e.g. good faith, best efforts, due care) – difficult for individuals within businesses to take these concepts into account into their day-to-day decision-making

Therefore, it is insufficient to screen employees at the door for their ethical behaviour, it requires strategic planning beyond delegating to subordinates.

It is the key responsibility of senior management, and requires the development of a corporate culture that values ethics and compliance.

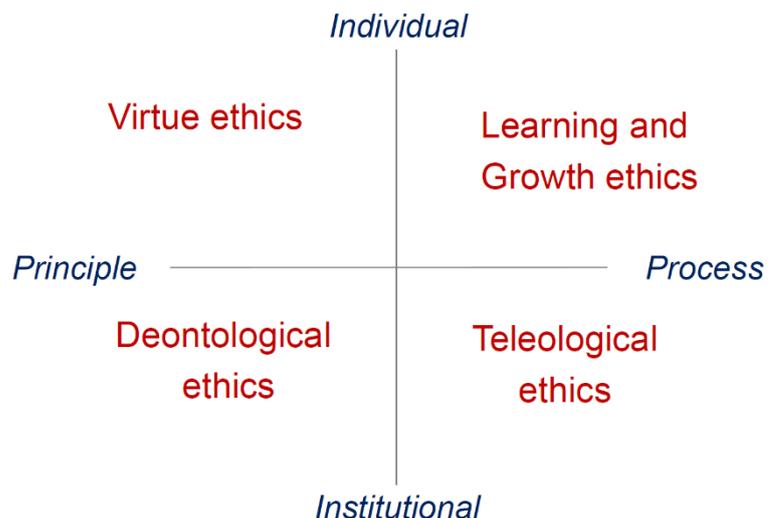
Courts, law and society hold top management responsible for misconduct.

## 2. Welfare, rights and justice

There are several theories:

- Teleology (Utilitarianism)  
An act is considered morally right or acceptable if it produces a desired result (pleasure, knowledge, career growth, self-interest, utility).

The moral value of behaviour is assessed by looking at its consequences (consequentialism).



There are two teleological philosophies:

- Egoism – right or acceptable behaviour entirely framed in the context of the consequences for the individual (self-interest)
- Utilitarianism – concerned with consequences for the greater good of the greatest number of people (all those affected by the behaviour)
  - Act-utilitarianism – an action is right if it produces the greatest balance of pleasure/pain for everyone
  - Rule-utilitarianism – an action is right if it conforms to a set of rules, the general acceptance of which would produce the greatest balance of pleasure/pain for everyone

Four elements:

- Consequentialism – only ends matter
- Hedonism – only pleasure is good
- Maximalism – greatest amount of pleasure is best
- Universalism – consider the aggregate

**Economic argument of market efficiency** – markets will lead to Pareto optimality – but this may not necessarily be a fair/just outcome

### 3. Equality, liberty and virtue

- Deontology

Deontology focuses on the rights of the individual and on the intentions underlying the behaviour, not its consequences.

Believes there are some things we should not do, regardless of the utility derived from them.

#### **Kantian ethics**

Kant's principle – Act only on rules that you would be willing to see everyone follow; respect for other people (and ourselves) as rational beings

#### **Rawls' egalitarian theory**

Questions of justice arise when free and equal persons attempt to advance their own interests conflicting with other pursuing their self-interests.

Social justice enables persons with conflicting ends to interact in mutually beneficial ways.

We should aim to achieve the greatest benefit of the least advantaged.

#### **Libertarianism**

Hayek emphasises individual liberty, property rights and limited government – strong arguments favouring a market system.

Nozick's entitlement theory – A distribution is just if everyone is entitled to the holdings they possess

- Principle of just transfer
- Principle of just original acquisition

Supports a market system with absolute minimum of government intervention.

- Virtue ethics

Virtue – an acquired character trait that manifests itself in **habitual action**; a state of character; an admirable trait

Virtues are means to happiness, character traits that lead to a good life

**Morality is not something we think about, but do out of habit.**

- Relativist perspective – ethical learning and growth

Personal growth in emotion, human relationships and character formation – personal moral development