Philosophy 104, Business Ethics, Queens College, Spring 2007
Russell Marcus, Instructor
email: philosophy@thatmarcusfamily.org
website: http://www.thatmarcusfamily.org/philosophy/Business_Ethics/BEHome.htm

Lecture Notes, February 2

I. Is there room for ethics in business?

Whether ethics should play any role in business is the big question for this course.
Milton Friedman argues that we should not think about ethics when conducting business.
He argues that thinking about ethics is both harmful to a company, and immoral.
We shall try to investigate his claim, without prejudice.
First, we need some brief historical background for his position, and his claim.

II. The History of Business Ethics

In the 17th century, the dominant view in Europe concerning economics and trade was that economies should be controlled by the state, which should try to improve the wealth of the country, compared to its neighbors/competitors, by increasing its bullion (gold reserves).
This view has come to be known as mercantilism, and it usually meant developing a positive trade balance (i.e. lots of exports, which brought in cash, and few imports, which sent cash out of the country.)
But, the rise of political liberalism, especially in the work of John Locke (1632-1704), sought to reform centralized control over the individual, by the church, and the state, and even in philosophy and science, in favor of increased personal freedom.
The increased emphasis on individual liberties opposed mercantilism's state-control of business and trade, including high tariffs.
We will see explicit applications of political liberalism to economic issues in Mandeville's *Fable of the Bees* (1723), and in Adam Smith's *Wealth of Nations* (1776).
Smith promoted what has come to be known as laissez-faire economics, which urged that the government should relax or eliminate restrictions on businesses, leaving them alone to allow the market to regulate itself freely.

With the relaxation of state control, some individuals were able to amass great wealth.
Political liberalism led to wars of independence, in the Americas especially, in the 1770s-1820s.
But it also led to the robber-baron era of the late 19th Century.
The influence of evolutionary theory was felt in political and economic arenas with the rise of Social Darwinism.
Briefly, 'social darwinism' is the term applied to theories, like those of Herbert Spencer, which applied the theory of evolution to competition within social groupings, including corporations.
Social darwinism gave a certain legitimacy to crass accumulation of wealth, and a foundation to the idea that greed is good.
In particular, the steel magnate Andrew Carnegie defended his accumulation of wealth on social darwinist principles.
In the early 20th century, electricity had been harnessed, among many technological improvements which seemed to emanate from increased liberalism and laissez faire economic theory.
While the influence of social darwinism waned, the robber-baron, greed-is-good era lasted well into the roaring 20s, and dominated much of American thought until the stock market crash of 1929 and the dust bowl era, which had begun a decade earlier.

In the 1930s, the United States entered an era of widespread urban and rural poverty.
The government responded both by expanding social programs and increasing restrictions on businesses.
This rise of increased social concern lasted through World War Two, in the late 1930s and 1940s, and beyond.
In the 1950s and 1960s, business leaders saw that it was in their interests to sell themselves as concerned about the poor, and as being socially relevant.
Milton Friedman, in the 1970s urged a return to free-market liberalism.
He argued that businesses which try to be socially responsible are neglecting their primary goal, which is increasing profits for shareholders.
In neglecting their primary goal, socially responsible business are acting immorally.
Friedman's liberalism was embraced in the 1980s by Reagan/Thatcher neo-conservatives.
So, we had a return to the 'greed-is-good' mentality of the social darwinists of the late 19th and early 20th centuries.
Still, business ethics over the last twenty-five years has become a sizable industry, with journals, corporate positions, and consulting firms.
In the last five years, it has become even more prominent, given the scandals at Enron, Tyco, Worldcom, Adelphia, Andersen, Sunbeam, Prudential, etc.

III. Scandals

The scandals at Enron and other companies were largely rooted in the presentation of false financial reports.
The value of a company is tied to its stock price.
The stock price is affected by evaluations of the company made by Wall Street analysts.
Wall Street analysts are more likely to evaluate a company positively if earnings are increasing.
So, Enron worked very hard to make sure that their earnings reports continued to show growth, even when the company was faltering.
To meet or exceed earnings expectations, and thus keep the stock price up, Enron manipulated their reports.
They also created special-purpose entities which took debt off of Enron's books and transferred it to supposedly independent companies.
The special-purpose entities were propped up by Enron stock.
As long as Enron stock was overvalued, the pyramid was stable.
Once the scandal broke, and earnings reports were adjusted, Enron's stock price tumbled, and the company went bankrupt.
Another advantage of inflated stock prices is that executives who earned increasingly popular stock options were able to trade them for millions of dollars, even while the company was near bankruptcy.
An auxiliary element of the scandals of the early oughts is that some executives have been allowed to back-date their options, so that they could cash in at a higher rate, even after stock prices have fallen.
Other scandals also essentially traced to misreported earnings intended to placate analysts and thus maintain stock prices.

IV. Several types of responses to the scandals

Politically, Congress passed the Sarbanes-Oxley act in 2002.
Perhaps most importantly, Sarbanes-Oxley requires that executives certify financial reports, which makes them responsible for the company's financial reports, even if they are not aware of the details of those reports.
Sarbanes-Oxley also created the Public Company Accounting Oversight Board (PCAOB, or "peekaboo") which regulated auditors.
Enron's public auditor, Arthur Andersen, had played a significant role in that scandal, tracing to the manipulation of financial reports, and the use of mark to market accounting.
Andersen had largely become a consulting firm, which conflicted with its auditing role.
Andersen was implicated in other scandals, as well, involving Waste Management and Sunbeam.
There has been pressure for accounting firms to separate their consulting practices from their auditing work.

Internally, many companies established or began to emphasize their ethics programs.
During the business boom of the late 1990s, internal ethics programs were routinely often ignored under pressure to increase profits and stock prices.
Most large corporations now have Corporate Responsibility Officers, or CROs (although the title often varies).

Additionally, many companies, scared by both the scandals and Sarbanes-Oxley have sought to hire ethics consultants to evaluate their corporate cultures and processes, and to recommend changes.
The increase in journals and ethics rankings has encouraged greater corporate social responsibility.
For example, Business Ethics Magazine, which was founded after the scandals (especially the S&L scandals) of the mid-1980s, puts out an annual list: The 100 Best Corporate Citizens.
See http://www.business-ethics.com/whats_new/100best.html
Firms on this list are ranked on performance in eight categories: shareholders, community, governance, diversity, employees, environment, human rights, and product.
Ethics consulting has become a profitable field, and looks to continue to be profitable until the next boom.
(Interest in ethics in business comes in response to particular cataclysmic events. Once things settle down, ethics tends to be ignored.)

On another front, most business schools have started to require ethics courses.

V. Stockholders and Shareholders

One of the major changes made by the business ethics movement is the replacement of stockholder interest by stakeholder interest as a measure of a company's value.
Traditionally, it was accepted that a good company was one that increased its value for its stockholders, or, for privately-held companies, for its owners.
A stockholder is any one who owns a portion of the company by virtue of owning some of its stock.
Now, corporations tend to be evaluated on their relationships with various stakeholders.
Stakeholders are any one affected by the company, any one who has a stake in the actions of the company.

For example, stakeholders include stockholders, but also may include: employees, managers, suppliers, clients and customers, creditors, the community at large, the environment, and even competitors.
The shift from stockholder theory to stakeholder theory shifts corporate responsibility from profit maximization to the balancing of a wide range of interests.
Clearly, this shift makes corporate governance much more complicated.
But, the ethicists urge, the focus on stakeholders and social responsibility will improve society.
Opposing social responsibility, Friedman argues that it is a subversive, shortsighted, and suicidal doctrine.
"Businessmen who talk this way are unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades." (1)

VI. Friedman's argument against business ethics

Briefly, Friedman's argument is as follows:

1. Corporations are made to maximize profits.
2. Social responsibility sacrifices profits in order to attain goals which are unrelated to profit maximization.
3. Sacrificing profits for secondary goals acts as a tax on stockholders, and weakens the company's competitive standing.
4. To tax stockholders and weaken a company's competitive standing is wrong.

So, corporate social responsibility is immoral.