THAILAND'S SEVENTH ANNUAL CONFERENCE ON COLLECTIVE ACTION AGAINST CORRUPTION

OCTOBER 18, 2016

KEYNOTE ADDRESS

ETHICAL LEADERSHIP: WINNING WITH INTEGRITY

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My subject is a timely one "Ethical Leadership – Winning with Integrity". The title of this speech is especially significant to a person who has been working on these issues for 30 years. In 1986 when I first introduced the subject in a Conference Board report the prevailing view was that business leadership was honest. In the words of Shylock, The Merchant of Venice, a company's "word was [its] bond".

Although the word ethics was seldom mentioned, adherence to ethical obligation was defined by the parties within the four corners of the written contract. No one discussed as we are doing today, the need for business institutions to take a leadership role in defining ethical business conduct within a global community. Further, the phrase "winning with integrity" which is also part of this Conference's conversation affirms the importance of process in achieving ethical outcomes. Our discussion needs to be about means as well as ends – a concern that was seldom acknowledged 30 years ago.

Business Ethics – a Brief History

When I first introduced the subject in a 1986 Conference Board research project the idea generated some puzzlement. As many of you know The Conference Board which I served for 32 years before becoming a Senior Fellow in 2010 is a business membership organization dedicated to facilitating ongoing dialogue on how business can improve its performance on issues of common concern and ethics was not yet an explicit part of this conversation.

In 1986 adherence to the narrow contract ethics concept that I have described was accepted as essential to business success. What was lacking was an understanding of the need to think about ethics beyond the fundamental requirements of good faith and strict performance of the contract. Events during the next 30 years would expose the narrowness of this view – particularly when companies began to operate in a global arena.

Many business leaders believed the concept of Business Ethics was borderline accusatory. For them the primary if not exclusive responsibility of business, in Milton Friedman's memorable phrase, was to make money. Friedman's attitude persists. The 1970 *New York Times* article in which he made that statement remains his most famous written work and it continues to be one of the most popular reading assignments in my course. Even today, when I tell people that I work in business ethics, they often say “isn’t that an oxymoron?” seeming to think that this is the first time that I have been confronted by such a clever and worldly response.

Yet 30 years ago, there were many people who did not think business ethics was an oxymoron and had been waiting for an opportunity to be heard on the subject. The survey I conducted generated a very large response and demand for the resulting report was unusually strong.

In the years since I wrote the study, a project in which most of the participant were US companies, The Conference Board has achieved a rough parity of US-non-US participation in its ethics research and its Global Council on business conduct has many non- US members.

A Business Professional

There are two reasons why business ethics has become a subject of global interest: (1) the expanding notion of proper individual and company business conduct beyond the limited notions of contract adherence and requirement of profit making success – a phenomenon to which business itself has made a substantial contribution; and (2) the global arena of business practice which has confronted companies with new challenges – particularly in less developed countries.

Let us begin with the first point. Business practitioners are now viewed as “professionals” and the meaning of professionalism in a business context has changed. In earlier days, a business professional was someone who had earned collegial respect through experience and quality of performance. (Or in US Supreme Court Justice Benjamin Cardozo’s elegant formulation, an individual “skilled and careful in his calling”.) Unlike medicine and law, business had no standards for admission or rules of conduct – the violation of which could subject the perpetrator to sanctions or expulsion.

One anecdote from my career illustrates the prevalence of the view that professionalism was little more than an accumulation of necessary skills. In 1995 when teaching my first business ethics course at The Stern School of Business Administration, NYU, I asked the class if they had expected that business ethics would be a required part of the curriculum and no student in a class of 40 raised his or her hand. Today, I still ask that question -- and add “regardless of the business school you chose to attend did you think that you would be learning this material” -- and everyone says yes.

Why do students now expect to be required to take a course in ethics, as lawyers and doctors have done for centuries? In fact, business ethics study is consistent with the ambitions of Wharton – one of the US’s most famous business schools. Its devout Quaker founder Joseph Wharton believed “that commerce had a crucial role to play in solving the social problems of the day, namely growing inequality, job disruption, and urbanization.”[1] Wharton’s aim was to graduate a cadre of business people who would deploy their skills not only for their own benefit but for the betterment of the entire community. For Wharton, a serious sense of civic responsibility that was at the core of professional conduct. To this objective, Abraham Flexner, a Wharton Dean in the early part of the last century added further requirements that “a profession has established criteria for admission and legitimate practice”.

Second, to a significant degree there is an increased emphasis on the privatization of norm making. Governments are increasingly delegating the tasks of prevention and detection of harmful conduct to companies. Instead of waiting for the police to knock on their door, companies are expected to have systems for preventing and detecting improper conduct. Further, the US Sentencing Guidelines (2004) offers businesses an incentive for doing so. Disclosure of bad practice and full cooperation in the government’s investigation can earn you a lighter sentence or, in some cases, a deferred prosecution under the Federal Corrupt Practices Act (1977).

[1] Rana Faroohar, ***Makers and Takers***, Crown Business (2016), p. 99.

The US dependence on companies for procedures and systems that improve company conduct has become an important element in other countries efforts to improve business conduct. The 1997 OECD Anti-Corruption Convention which now has at least 40 signatories, mandates that they find ways to embed self-enforcement in their own laws. The OECD Convention has a peer review process in which participating countries review each other's laws and enforcement efforts. There is no way of know for certain, but Peer Review of their own practices by judges and attorneys from other countries may be partially responsible for the dramatic increase in recent years of US FCPA prosecutions and in the British Bribery Act, which has broadened the definition of corrupt practices.

Response to self-enforcement expectations, the global scope of business practice and legal enforcement under the principle of "extra territoriality" which permits prosecution of companies outside of their home country for crimes in third countries, now requires global corporations to be much more vigilant regarding the ethical performance of their own employees and in some cases, suppliers and customers. Siemens, for example, is a German company that was prosecuted in the US for activities in Argentina and Bangladesh. Call it risk management if you prefer, it is nonetheless clear that ethics has become an essential element in the job description for anyone who aspires to "lead with integrity" in their company.

Globalization

The globalization of business practice has expanded the scope and range of issues that require ethical leadership. The UN Global Compact's Principles for Responsible Management Education initiative -- of which I am one of its Anti-Corruption Working Group's co-facilitators -- recognizes five areas of concern in which aspiring business leaders need to be conversant: (1) corruption; (2) poverty; (3) gender equity; (4) human rights; and (5) environmental responsibility. It is hardly surprising that wherever you find problems in one of these areas – particularly corruption, there will be serious abuses in the other four.

Decision-making in this new business environment requires an ethical framework for both aspiring and current leaders. But the question arises can ethics be taught and if so, how? Rules can be taught but can leaders be equipped with the ethical judgment that ethical behavior requires? To answer this question, particularly in a global context, necessitates a firm grasp of the Market Failure economic concept.

Market Failure

In the Scottish economy of 1776, Adam Smith found much to confirm the earlier and positive view of human nature that had been the subject of ***The Theory of Moral Sentiments*** a book that he wrote in 1759 as a professor at Glasgow University. Men he believed were motivated by self- interest but sympathy for others was also part of human nature because people wanted to think well of themselves and equally importantly they wanted the community to share that view.

And when Adam Smith walked the streets of Glasgow and Edinburgh he liked what he saw. For the most part, merchants, tradesmen, and farmers dealt honestly with one another in a marketplace that was reasonably efficient and did not inflict avoidable harm on others. In most situations, a self-governing marketplace was the best way to advance the economic well-being of the entire population.

Smith argued that such an economy has (1) perfect competition; (2) no externalities; (3) equitable sharing of and contribution to the benefits and costs of public goods; and (4) perfect information. It can be largely self-regulating or, minimally regulated because it limits or avoids infringement of the rights of others.

For example, perfect competition prevents price gouging. Limiting externalities avoids expenditures on the adverse social and impact of industrial by products such as air pollution and hazardous working conditions. When participants in the economy pay their fair share of the cost of public goods (national defense, roads, bridges, education) the economy grows and income and welfare gaps are significantly reduced. Perfect information avoids abuses such as insider trading and deaths and injuries from the sale of unsafe products. In the absence of these self-regulating market conditions, there is Market Failure that can violate the rights of individual parties. If business people have a clear understanding of market failure concepts they can recognize and analyze situations that infringe on basic human rights.

Were Smith alive today, he would see that the income inequality between the developed and developing world, citizens of most countries and even employees of single firms and he would conclude that markets had failed to achieve the four criteria that he had set for its self-governance.

Of course, Smith would acknowledge the need for some exceptions to his requirements. If there were perfect competition Apple might enjoy no more success than its competitors. But the law encourages innovation and recognizes through patents that Apple has a right to period of exclusive enjoyment of its engineering and design success. Patents are a legitimate example of limited but permissible market failure.

Still, the inexcusable violations are arguably the norm. Bangladeshi garment manufacturers have little or no competition from other enterprises for the labor of the people they employ. Their employees have few if any alternatives of industries seeking to employ them at comparable or higher wages in safer working conditions. The Bangladesh garment industry is an example of a market failure that has infringed upon a fundamental right – safe working conditions. An economist would describe this situation as monopsony buying power. The labor market has a single buyer– take it or leave it.

Externalities is the second form of market failure. In 1954 our family and many others bought a new Chevrolet. It cost roughly $2000. In constant dollars that's nearly $18,000. Today most Chevrolets cost between $17-26 thousand. Our Bel Air model was at the high end of the Chevrolet price range. Everybody won in that transaction. General Motors' stock prices soared, assembly line workers were so well paid that many of them had weekend retreats. GM's CEO Harlow Curtice was Time Magazine's Man of the year. And our far from wealthy family got one of the best cars ever made.

But there were Externalities – costs that were paid by society that were not included in the product cost. Many people were killed or seriously injured when a seat belt might have prevented this fate. Smog became a fact of life in most American cities. And poorer factory safety conditions exposed assembly workers to serious health hazards. If the cost of addressing this impact had been included in the price of the car, it would have been much more expensive. Addressing these social costs over time has been expensive and today's high end Chevrolet still costs more than the 1954 model but the social costs have been significantly reduced. The reduction of these social costs was largely the work of government. The US built a national highway system, instituted miles per gallon requirements, mandated seat belts and factory safety standards. Until the multiple recent outbreak of unsafe and deceptive automobile products one might have been tempted to let governments take their place in the back seat and let market competition motivate automobile manufacturers to compete for excellence in safety, reliability, and minimal externalities arising from product use.

Inequitable costs and benefits for Public Goods is the third form of Market Failure. Business relies on roads and railroads to transport its goods, land and water to maintain its facilities and schools to educate the children of its employees and future workers. Does it pay its fair share of the cost? If not, it is profiting at the expense of the taxpayer, the subsistence families whose land is taken to build factories and warehouses, and the children whose education suffers because there is little money left to pay teachers and keep schools in good repair. Such inequalities endanger long-term enterprise sustainability. If schools are poor, will the employees of the future have the needed skills? And if communities do not produce skilled workers, who will have the money to buy their cars?

The fourth market failure is asymmetric information. Manufacturers know more about their products than consumers. We would not have it any other way. I want the pharmaceutical companies whose aspirin I buy to know more about its ingredients than I do – unless they know that it is dangerous or defective. In contrast, insider trading, another form of assymetric information, harms investors who are not privy to non-public information and it undermines confidence in financial markets. We want the pharmaceutical company to recall dangerous products and the insider to avoid unfair exploitation of knowledge that is not available to other investors.

When there is little danger that these problems can be discovered or the odds are that the penalty will be no more than the cost of doing business, business leaders are confronted with an ethical dilemma. They can exploit the market failure and accept the fact that bad stuff happens but it is more cost effective to proceed because the risks are slight and the penalties for failure are small. Such reasoning requires a failure of imagination. Evidence of this failure is not hard to find – oil spills and defective pharmaceuticals to cite just two examples. An ethical failure is above all a failure of moral imagination. The alternative to this purely utilitarian approach is to exercise moral restraint and take the necessary steps to restore some degree of market equilibrium. This outcome may result in short term loss but it is at the core of principles of business sustainability.

Touchstones for Ethical Leadership

As these examples illustrate, ethical leadership requires recognition that there is an "ethics space" for decision making that affects the rights of others and procedures for doing so with integrity.

Market failure enables the ethical leader to identify and define ethical dilemmas. The next steps are to conceive and implement a solution and, having done so, monitor it for effectiveness.

We have two touchstones for identifying and framing ethical dilemmas. First, universal principles. They do exist. The UN's Universal Declaration of Human Rights which affirms the rights to personal security, education, and basic human nutritional and health needs is at the very least implicitly endorsed by its 193 members. Although, everyone in this room can cite examples where one or more of these principles were violated by or in a member country, that is somewhat beside the point. These perpetrators knew or should have known that they were acting in contravention of universal norms.

The second touchstone is the moral legislation arising from millions of daily business transactions, the overwhelming percentage of which adhere to standards of proper conduct established through trial and error over centuries.

Moral legislation is, as US Justice Oliver Wendell Holmes said, derived “not through logic but experience”. What kind of experience? First there is history – the usable past – both macro and micro. The macro standard is better known – what are the applicable laws and industry standards of business practice. Micro standards are less widely recognized but more important in the long run. What stories do people tell around the campfire about situations when they have been proud of themselves and their company? A recent example is WalMart. The company used its deservedly legendary supply chain system to get water to the people in New Orleans who were cut off from aid delivery by Hurricane Katrina. WalMart fulfilled Joseph Wharton’s ambitions for business by using its competency to fulfill a desperate need for which the community lacked the skills and competence.

Company use of these ethical touchstones ultimately entails a conversation about what kind of organization it wants to be and whether ultimately it will judge itself by the benefits it bestows on the most disadvantaged stakeholder.

In sum, there is a need for business leaders – or for that matter – all leaders-- to be morally articulate. Or as Pascal put it eloquently, “think as men of action, act as men of thought”.

But as our keynote speech title acknowledges it is not enough for ethical leaders to win – they must do so with integrity. Integrity is the recognition that the means employed are as important as the outcomes they achieve. Integrity in resolving ethical dilemmas requires a process that demands an insistence on the truth and accuracy of facts and the humility to acknowledge that the most important decisions are those that are made where the facts are incomplete or in dispute.

To “win with integrity” also requires the decision process and outcome to recognize the essential requirement of justice which, as Robert Jackson, the US prosecutor at the Nuremburg Trials said “is the tribute that power pays to reason”. And last, integrity requires a fairness of the decision-making process which is insistent on good faith and results that are solicitous of rights and rigorous in their imposition of duties.

The requirements for ethical leadership are easier to state than to exercise because we cannot teach the character that moral reasoning requires. Character in the broadest sense is the ability to understand the connection between our experience which is what we see and know and the rules by which we live and act toward others. In sum, it is empathy -- which is the essential quality for the ethical leader who seeks to win with integrity.