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RESEARCH NOTES AND COMMUNICATIONS

A NOTE ON ETHICS AND STRATEGY: DO GOOD ETHICS ALWAYS MAKE FOR GOOD BUSINESS?

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Viewing business ethics as enlightened self-interest that always *pays in the long run is too easy. While reputation* can *be a valuable asset, not being tied to a particular code of ethics has an option value. The need for widespread laws and regulations that restrict behavior confirms this. Being ethical may cost—it is still worth pursuing if we believe in goals that transcend shareholder value.*

In his recent and insightful article in this Journal, Hosmer (1994) argued that ethics are a good business investment, essentially because they entail positive externalities. They are a prerequisite for building trust with various inside and outside stakeholders. Such trust, in turn, is a prerequisite for loyal and innovative long-term cooperation. Synergies are only possible through cooperation, and in areas where actions of others are difficult to supervise, trust built on long-term ethical behavior becomes the only practical way to capture such synergies.

Hosmer's argument is convincing and valid. In my view, however, it only conveys a partial aspect of ethics. If the issue of business ethics could, in fact, be reduced to a cost–benefit analysis at the level of the firm, enlightened self-interest would become its sole foundation. There is no question that long-term self-interest often does dictate ethical behavior, as convincingly exposed by Hosmer. It often pays to treat employees, customers, and others well even if this entails short-term costs, as this can be viewed as an investment in future loyalty. The question here, however, is not whether ethical behavior *may* be good for business, but rather whether long-term self-interest *always* leads to ethical behavior and vice versa; that is, whether the two are in fact synonymous. In this note, I will argue that they are not.

For one, business behavior of questionable ethical standards is common, and one should always be careful to invoke irrationality in explaining commonly observed competitive behavior, ascribing all of it to short-term myopia. Examples include widespread corruption in many parts of the world, lax environmental standards including willful pollution, less than truthful advertising, exploitation of monopolistic powers, and outright organized criminal activities. This is not to say that business is inherently unethical—fortunately many of our businesses do indeed abide by high ethical standards. It is simply to observe that good ethics are not universally viewed as good for business, and that deviations from good ethics are common enough to lend credibility to the view that, at least in certain circumstances, they may in fact be in conflict.

Second, and related to the above, if good ethics always led to good business, we would require much less in terms of laws, regulations, and enforcement than what we typically observe in our societies. One of the reasons for increasingly elaborate rules is to prevent unscrupulous operators from making inordinate gains at the expense of others.

Conceptually, a lack of ethical standards can

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be viewed as giving the decision maker an option: he or she may, if advantageous, break ethical rules, but clearly does not have to do so as long as they convey benefit. Options have an inherent value because they provide added flexibility, giving the decision maker a broader set of alternatives to consider. We can, for example, build the new and profitable plant producing ozone-destroying hydrofluorocarbons in China, or bribe an official to obtain a contract, but we do not have to if we perceive that adverse public relations may negate any overall benefits. Since ethics invariably take away choice and, hence, flexibility, they must ential a cost, which probably increases in an increasingly complex and uncertain global environment.

Finally, if the value of ethical behavior resides in the fact that it signals to others that we are trustworthy and, hence, a good partner to do business with, ethics become driven by public relations. Ethical behavior only obtains value when it is visible to others, and any 'ethical' action should be milked for all it is worth through wide publicity. Essentially, ethics becomes an exercise in public relations. If, for example, we could be absolutely sure than an unethical but profitable action would never see the light of day, what would be the incentive to continue to hold the high ground? Similarly, would a firm facing likely bankruptcy still have incentives to retain ethics that only pay off in the long-run, when the long-run has become almot meaningless or at least heavily discounted?

At the level of the individual, the danger of viewing ethics in the context of public relations certainly has received attention and has been condemned: it is one of the major criticisms that Jesus levels against the Pharisees of his days. The limitations of viewing ethics as simply enlightened self-interest, at least in this life, have equally been recognized: good and rich are not synonymous, and the just may well have to suffer.

Where does this leave us? Ethics are certainly good for society as they foster cooperation and promote social welfare. Ethics can be good business, and often are, but they do not have to be. This causes tensions between the individual and the common good, whose management and resolution have always been a key issue of any culture and social order. The existence of these tensions can, in fact, be viewed as one of the major reasons why codes of ethical conduct (and laws and regulations) have evolved in the first place. It is also the reason why ethics are not simple and ethical conduct not costless, neither in private nor in business. The thorny and difficult situations are the ones involving trade-offs: giving up personal or corporate gain (and ultimately one's life) for maintaining ethical standards.

Even at the individual level, resolving such trade-offs is not easy, but at least the choice is a personal one. At the corporate level, the manager faces the added complexity of having to make this choice for and on behalf of others: his or her ethical conduct may cost jobs and profits. Probably the only reasonable way to deal with this burden is to be very explicit from the time of hiring what the CEO stands for, and to formalize this in corporate guidelines for ethical business conduct, which are becoming increasingly common. These guidelines, credibly pursued, not only become a message to stakeholders that builds trust, and hence, may enhance business. They also may guide managers on when and where to sacrifice business, both short term and long term, in order to uphold higher goals. When stakeholders are unwilling to accept this, the ethical CEO may have to resign. Being ethical is not always easy, and it may cost.

REFERENCE

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