The Centre for Enterprise, Markets and Ethics

Enterprise and Faith Series

Ethics in Global Business

Building Moral Capitalism

Andrei Rogobete

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Introduction

On the morning of 15 September 2008, Lehman Brothers filed for Chapter 11 Bankruptcy protection. The fourth-largest US investment bank cited over $639 billion in losses, making it the largest bankruptcy in US history. The consequential economic recession saw $15 trillion wiped off the global financial markets, countless job losses and business foreclosures.[1] Western capitalism would never be the same again.

Yet at heart the financial crisis was not just a crisis of finance but of morality – reckless behaviour was driven by greed and the pursuit of ever faster and larger profits. This was well illustrated in the gross and artificial overvaluation of the US subprime mortgage market. Hidden beneath packages of securitised mortgages and excessive leverage, it made the perfect formula for global economic collapse. Collectively, the major banks have paid over $300 billion in legal fees since 2008.[2]

‘At heart the financial crisis was not just a crisis of finance but of morality’

Against this backdrop there has been a widespread loss of public confidence in big business – particularly in major corporations and the bulge bracket banks.[3] This publication is therefore an explorative study on how global businesses can redefine and rebuild themselves through a genuine commitment to several core principles, such as:

- Establishing a purpose that goes beyond profit;
- Adopting a holistic approach to business management;

- Implementing good governance and transparency;
- Truly upholding an ethical code of conduct built on a foundation of moral values.

Despite all the challenges faced, the free market economy remains the most effective form of wealth creation: more people have been lifted out of poverty in the last century than during any other time in recorded history. The UN Millennium Development Goals website reports that extreme rates of poverty have been cut by more than half since 1990.[4] A market economy gives people hope, purpose and a genuine sense of achievement – but clearly problems remain, namely greed and misconduct.

Sadly, greed and misconduct are often shown in companies' behaviour. This poses an interesting question: 'Is human greed manifest institutionally in companies' behaviour or is it just the behaviour of individuals within companies?' In its very essence, a company is no more than the people it comprises. Although in purely legal terms a company may have a different status from a private individual, this should not deter us from recognising the consequences of unethical behaviour from within. It is no surprise, then, that every month there is a different scandal in the news, whether it's a bank accused of fraudulent activity or a carmaker facing charges of deceit. A twisting of morality and a suppression of conscience are at the core of these issues.

What would a solution to the problem of greed look like? Should government impose tighter rules and regulations on private-sector activity? Should the penalties be so high that no company would risk deceiving its stakeholders, both internal and external? Would a highly regulated market economy protect consumers without stifling innovation and growth? These are approaches that have been tried and tested, and have led to systematic government failures within the

market economy time and time again. In the period from May 2012, France's tax policy under President Hollande is a good example of how excessive taxation stagnated the economy and grew unemployment to over 10 per cent. In 2014, after only two years, Monsieur Hollande was forced to withdraw some of his tax policies, particularly the 75 per cent 'supertax'.[5] Loopholes will always be found, and while some regulation against excessive risk is certainly welcome, government simply cannot promote a growing economy and guarantee absolute fairness and safety within the marketplace in equal measure. The real change must come from within companies themselves. They must recognise that by paying lip service to issues of ethics and morality, they do so at their own peril. David Jones, a leading business analyst, writes:

> Before the financial meltdown, the fastest-growing trend in business was the move towards social responsibility, and the economic crisis has only served to accelerate this. The world saw all too clearly that the ruthless pursuit of profit at all costs almost led to the total collapse of the global financial economic system. Doing well and doing good are no longer seen to be mutually exclusive.[6]

The ruthless pursuit of short-term profitability comes not only at the cost of the environment or wider society but also at the cost of the long-term stability and financial growth of the company itself. Companies with the scope and reach must take a holistic approach to doing business if they are to succeed in the 'big data', social-media-driven environment in which twenty-first-century capitalism is currently operating – and not least one in which employees increasingly demand a responsible employer.

The future of free enterprise will belong to companies that adopt such a holistic management approach to conducting their business –

taking serious account of issues of moral purpose, corporate culture and ethics. This means truly striving to live out the values that many of them proclaim to uphold. In many cases they must be stewards of the values established by the company's founders. Companies that will excel in twenty-first-century capitalism will be those that pursue shareholder returns and ethical behaviour with equal vigour, effectively managing the expectations of all stakeholders.

What follows will build the argument for holistic business in broadly three parts. First, it will lay down a brief historical and theoretical foundation. In doing so it will look at the Quaker community and the values that drove their business success throughout the seventeenth to nineteenth centuries. It will show how the Quakers were in effect practising a form of 'stakeholder theory' long before it became an academic topic.

Second, it will try to understand the financial and reputational damage incurred by companies that chose to ignore matters of ethics and their root causes. Here the focus will be on the Volkswagen emissions scandal in particular, arguably the defining corporate story of 2015.

Third, it will seek to bring together the historical, theoretical and practical perspectives in trying to understand the lessons that can be learnt for today, and will look at the current business environment and its defining forces, focusing predominantly on the dramatic rise of social media and what this means for business conduct. The question of why morality and ethics are so important for the future of business will be considered. How can a company minimise the risk of finding itself in the middle of a corporate scandal, and what are the consequences of ignoring issues of business ethics? Far from being exhaustive, the primary aim of this study is to frame the argument for a free market economy that is built on, and driven by, a framework of ethical thinking and moral behaviour.

Notes

[1] Al Yoon, 'Total Global Losses From Financial Crisis: $15 Trillion', *The Wall Street Journal*, 1 October 2012 – http://blogs.wsj.com/economics/2012/10/01/total-global-losses-from-financial-crisis-15-trillion.

[2] Ben McLannahan, 'Banks' Post-crisis Legal Costs Hit $300bn', *The Financial Times*, 8 June 2015 – https://next.ft.com/content/debe3f58-0bd8-11e5-a06e-00144feabdc0.

[3] 'Bulge bracket banks' refers to the largest global investment and retail banks.

[4] *Millennium Development Goals Report 2015* – www.un.org/millenniumgoals/2015_MDG_Report/pdf/MDG 2015 rev (July 1).pdf. Among other findings, the UN concluded that, '1. The target of reducing extreme poverty rates by half was met five years ahead of the 2015 deadline. 2. More than 1 billion people have been lifted out of extreme poverty since 1990. 3. In 1990, nearly half of the population in the developing regions lived on less than $1.25 a day. This rate dropped to 14 per cent in 2015' – www.un.org/millenniumgoals/poverty.shtml.

[5] Hannah Murphy and Mark John, 'France Waves Discreet Goodbye to 75 Percent Super-tax', Reuters, 23 December 2014 – www.reuters.com/article/us-france-supertax-idUSKBN0K11CC20141223.

[6] David Jones, *Who Cares Wins: Why Good Business is Better Business*, Harlowe: Pearson Education, 2012, p. 1.

Chapter 1

The Quaker example

The idea that businesses represent something deeper than profit is not a new one. There is, however, nothing intrinsically wrong or 'immoral' about the pursuit of profit. After all, a business can only exist in the long run if it remains profitable. Whether a private company should pursue profitability is not the question here – the answer is clear. Rather the questions are how a private entity ought to pursue profitability, and how to reconcile the legitimate interests of different stakeholders, including but not exclusively the shareholders.

'Whether a private company should pursue profitability is not the question here'

An initial step in addressing this question takes us back to the Quakers of seventeenth-century England. Here it will be seen how deep-rooted values played a critical role in business success. The Quakers effectively emerged amid great internal conflict during the English Civil War of 1642–51, which provided fertile ground for new ideas not just in the political but also in the religious, private and social spheres.[1]

Central to Quaker convictions was the idea of an 'inner light', the 'powerful, life-changing force present in all people, and the Spirit that guided believers into the true interpretation of Scripture'.[2] It was from God and through the study of Scripture that a personal relationship with God would enable the inner light to be present in all Quakers, guiding their moral conduct, conscience and love for others. They established many of the UK's household brands, including Lloyds and Barclays Bank, Clarks Shoes, Cadbury's Chocolate and many others.

How then did their core beliefs translate into highly successful business practices? The Quakers established a number of principles that shaped these practices.

The first and fundamental belief is that all humans are of equal value. Equality of value should not be confused with uniformity. Clearly, human beings are different, each unique in his or her own traits. However, historically Quakers believed that 'There is that of God in everyone.'[3] In addition, they understood the creation of wealth as a moral responsibility – one where commercial success could help the individual, the family and the community to flourish.[4] So the Quakers were very wise in understanding the wider implications of wealth creation. They viewed the pursuit of profit holistically.

The belief that all humans are of equal value effectively translated into a practice of equality and respect within the workplace. This was in stark contrast to the customary hierarchical structures of the time. Today a 'flat' organisational structure may be promoted and even seem like clichéd business jargon, but in the eighteenth and nineteenth centuries, treating all employees with a minimum standard of dignity and respect was quite revolutionary. It not only allowed Quaker businesses to be effective organisations on the inside, it also enabled them to build long-lasting relationships with external stakeholders such as clients, contractors, customers and so on. The reputation Quaker businesses established in society would go before them in the marketplace, almost guaranteeing their success in building a network of trust and, ultimately, ensuring profitability.

'The reputation Quaker businesses established in society would go before them in the marketplace'

The second core Quaker belief is in a genuine, personal relationship with God. In claiming that each individual can have a direct, personal

relationship with God, the Quakers found themselves under systematic persecution from the church authorities, who effectively saw them as a threat to their relevance and existence. It was their personal relationship as well as guidance from Scripture that established the foundations of a moral business code of conduct. To be effective, Quakers needed both the 'objectivity of the Scriptures as a guiding force (hard ethics)' as well as a 'subjective conscience (soft ethics)', in applying their behavioural code. It was 'neither simply conscience nor rule-bound, but a dynamic appropriation of both'.[5]

The third and final core belief is in love and respect for one's neighbour. This core Quaker belief is rooted in a strong sense of community with other human beings – all sharing together in God's creation. This led Quakers to organise in fellowships and larger groups where they would meet on a regular basis to share in the faith that united them. In business terms, it translated into a great sense of responsibility and stewardship both internally towards employees and management as well as externally towards customers, collaborators and the environment itself.

The Quakers understood the importance of employee well-being and, more importantly, how it is intricately linked with the commercial success of the business.

> There was a direct relationship between employers and employees which, in family businesses, was not mediated through intermediate levels of management.[6]

Whether in work or privately, a sense of collective compassion and respect permeated all aspects of life, and gave the Quakers a significant competitive advantage in the marketplace.

This approach has a striking similarity to 'stakeholder theory', a term first coined in 1984 by R. Edward Freeman in his book *Strategic*

Management: A Stakeholder Approach, in which he describes stakeholder theory as 'addressing morals and values in managing an organization'.[7] Stakeholder theory holds that both internal stakeholders (such as employees, management, shareholders) as well as external stakeholders (customers, the local community and even governmental or non-governmental organisations) all have the power to significantly damage and in extreme cases even bankrupt a business that mistreats them. As such, the ethical management of all stakeholders becomes critical to the success of the business as a whole. Freeman's theory brought a new and somewhat radical approach to the study of organisational management and business ethics – radical in the sense that it became the first academic, theoretical framework to secure a prominent position for the interplay of values, responsibilities and ethical decision-making in business management. In contrast to the traditional shareholder maximisation view, stakeholder theory promotes a way of business conduct that takes into account all parties that come into contact with a company's ecosystem, from shareholders and employees to customers, suppliers and the local community. A number of oversight and regulatory bodies such as the International Organization for Standardization (ISO) as well as the Global Reporting Initiative (GRI) have recognised the significance of stakeholder relationships and started integrating it as part of their evaluation methodologies.[8] Although it was not called 'stakeholder theory' at the time, the Quakers understood the importance of maintaining good stakeholder relationships long before it became theory.

'The Quakers understood the importance of maintaining good stakeholder relationships long before it became theory'

The Quakers offer a clear, historical case that highlights the positive impact a moral culture built on strong ethical foundations can have on

the success of a business, particularly in the long term. However, the Quakers were not admired in their time – far from it. They suffered tremendous persecution from both the Church and the state from the early 1650s until the Toleration Act of 1689.[9]

It is curious that a group of dissidents, outcasts and rebels went on to establish many of the UK's household brands across a spectrum of industries: Barclays and Lloyds in banking; Cadbury and Rowntree in confectionary; Clarks in shoe manufacturing and even the electronics giant Sony, who's first Chairman, Tamon Maeda, was a Japanese Quaker.[10] In a sense they were somewhat 'pushed' into business by their circumstances at the time. Alongside systemic persecution, they were denied work in the public sector, in academia, medicine or the judiciary. This forced them to enter the only field open to them; that is, becoming entrepreneurs and business owners – at which they proved very successful. If their story proves anything, it is that ethics and moral values have a significant positive impact on business performance.[11]

1.1 Where are we now? The market economy of the twenty-first century

Fast-forward some 340 years, and following a recession that shook the very foundations of modern capitalism, ethics and morality have taken a central role in the debate about how private companies ought to conduct business in this 'post-crisis' era. As mentioned in the Introduction, the market crash of 2008 exposed excessive human greed and how it can significantly damage the dynamics of a market economy. In consequence of this, the idea that businesses should go beyond the narrow measures of shareholder value maximisation and embrace a wider role of a 'responsible citizen' who cares about the society it operates in has started to re-emerge. The Quakers were successful precisely because ethical behaviour and a deep understanding of their responsibilities in the pursuit of profit were

the foundation of how they conducted business. They understood that, far from hindering performance, responsible behaviour actually increased profitability.

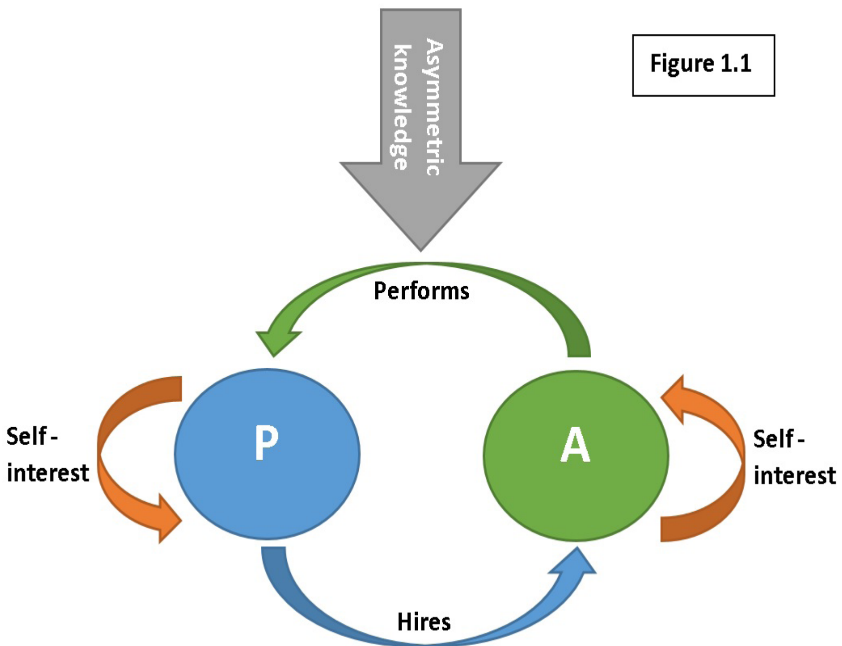
However, most Quaker companies, founded from the seventeenth century onwards, are no longer owned or run by Quakers. Many of them have either become publicly listed entities on the stock exchange or, through mergers and acquisitions, have evolved into larger, multinational groups (Lloyds, Barclays, Cadbury, for instance). This brings us to the question of long-term company responsibility under a more 'diluted' form of ownership.

One of the disadvantages of 'going public' – or holding an initial public offering (IPO) – is that over time it can blur the relationship between the company owners (shareholders) and the business itself (the employees/managers). When ownership becomes as diverse as hedge funds, mutual funds, private investors and so on, the company loses its hands-on, responsible owner-managers who hold the long-term interest of the company at heart. Who really owns the company? What impact will the dilution of ownership have on the moral culture of a company? While the main aim here is not to provide an evaluation of the advantages or disadvantages of publicly listing a company, it must be said that the dilution of ownership that comes with it can lead to a severe 'principal–agent' problem.[12]

The principal–agent theory[13] was first established in 1976 by Michael Jensen, a professor at Harvard Business School. He defines it as 'a contract under which one or more persons (the principal) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent'.[14]

Also known as the 'agency dilemma', the theory serves as a tool in

better understanding the dynamics between two actors: the principal and the agent. The general premise of the theory is that the first actor (the principal) hires the second (the agent) to perform a task or service that the principal is unable to undertake himself/herself (for whatever reason). As shown in Figure 1.1, the principal and the agent have asymmetric levels of information; that is, the agent may have access to information or knowledge that the principal does not, and vice versa. The problems arise when the principal's and the agent's self-interests are in conflict.



A clear and simple example of the principal–agent theory would be a car owner taking his or her vehicle to the mechanic for repairs. Due to a lack of knowledge or ability, the principal (the owner) hires the agent (the mechanic) to perform a task: repair the vehicle. The principal's self-interest is to have the vehicle repaired at a lower cost,

while the agent's self-interest is to repair the car at the highest possible cost to the principal. Given the asymmetric level of information between the two actors, the mechanic can leverage his or her higher level of knowledge in mechanics and choose higher-priced vehicle parts that would otherwise be unnecessary. The vehicle owner is often unaware and pays the overpriced bill for the repairs. We thus have a principal–agent problem. The application of this theory can take numerous forms and expose a wide variety of discrepancies between the principal and the agent.

However, the true value in applying it here is that it helps us focus on the importance of aligning self-interests and the consequences of failing to do so. For instance, in the case of the Barclays Libor scandal, a weak and diffuse principal (the board, shareholders) systematically failed to unite and control the agent (the CEO, senior management), who in turn often failed to lead their employees.[15]

Back in 2012, Barclays admitted wrongdoing in the 'Libor rigging' scandal in which Barclays employees were accused of manipulating the London Interbank Offered Rate (Libor – the rate at which banks loan to each other). The responsibility fell on Bob Diamond, CEO of Barclays Group at the time.

Within the principal–agent theoretical framework, the dilemma appeared when there was a misalignment of interests between the principal and agent (i.e. Board–Mr Diamond). As mentioned previously, in such cases the agent can act in his or her own self-interest rather than the principal's. In this case the senior management and the board suffered from a misalignment of interests. In the wake of the crisis, the Barclays share price dropped by more than 15 per cent, wiping over £3 billion off its market value.[16] The price paid was financial as well as reputational.

‘A company’s values can only be promoted from top to bottom on the corporate ladder’

A company’s values can only be promoted from top to bottom on the corporate ladder – rarely can it work the other way around. And unfortunately for Mr Diamond, this process starts with the CEO but also the board, who probably should have been tougher on emphasising the importance of long-term values. Whether Diamond was or was not aware of the Libor rigging, or with whom the blame lies, is for the authorities to decide. Anthony Jenkins replaced Diamond as CEO of Barclays in the effort to re-establish the bank’s ‘founding’ culture. In an internal email sent to all 120,000 Barclays employees, Jenkins expressed his firm commitment to changing the bank’s culture:

> Let me be quite clear. The notion that there must always be a choice between profits and a values-driven business is false. Barclays will only be a valuable business if it is a values-driven business. Unless we operate to the highest standards and our stakeholders trust us to behave with integrity, no business – and certainly no financial institution – can continue to be successful. Nor do they deserve to be. There is no choice between integrity and profit in this business, and to pose them as opposites fundamentally misunderstands the problems the banking sector faces. This is the difference between generating short-term profits and long-term shareholder value.[17]

Jenkins’ tenure as CEO of Barclays Group was relatively short-lived. Despite his efforts to re-establish the moral backbone of the bank, he was replaced in July 2015 by Jess Stanley over concerns that the investment bank was underperforming.[18] Whether Stanley manages to increase financial profitability and continue the bank’s commitment to

becoming a 'values-driven' business remains to be seen.

However, it is not only the banking industry that is prone to moral failure. The recent collapse of British Home Stores (BHS) showed the power of individual greed in the bankruptcy of one of the UK's largest high street retailers, shaking the very nature of capitalism in Britain. According to a House of Commons Report (commissioned jointly by the Work and Pensions and the Business, Innovation and Skills Committees), the ultimate responsibility lies with the former owner of BHS, Sir Philip Green. The report found that:

> The evidence we have received over the course of this inquiry has at times resembled a circular firing squad. Witnesses appeared to harbour the misconception that they could be absolved from responsibility by blaming others. The worst example was Sir Philip Green, despite his protestations to the contrary. Sir Philip adopted a scattergun approach, liberally firing blame to all angles except his own, though he began his evidence by saying he would do the opposite. The truth is that a large proportion of those who have got rich or richer off the back of BHS are to blame. Sir Philip Green, Dominic Chappell and their respective directors, advisers and hangers-on are all culpable. The tragedy is that those who have lost out are the ordinary employees and pensioners. This is the unacceptable face of capitalism.[19]

The report further goes on to note how Green's family 'accrued incredible wealth during the early, profitable years of BHS ownership' and how 'Sir Philip cut costs, sold assets and paid substantial dividends offshore to the ultimate benefit of his wife.'[20]

Surprisingly, not many eyebrows were raised when Sir Philip sold

BHS in 2015 for £1. After all, he was considered one of the most revered and well-established figures within the retail industry. Known as the 'King of Retail', he had a track record of business success with companies such as Topshop, Topman, Dorothy Perkins and many others, making him one of the UK's wealthiest individuals – accumulating an estimated net worth of over £4 billion.[21]

Green was courted by both sides of the political divide. In 2006 Tony Blair recommended him for a knighthood[22] in recognition of his contribution to charity and British retail. In 2010 David Cameron asked him to carry out a review on the efficiency of government spending, in which Sir Philip concluded that 'The Government is failing to leverage both its credit rating and its scale.'[23]

It is clear then that Green's established reputation opened many doors, not least 10 Downing Street, where politicians of the highest level sought his advice. How then did such an experienced and successful businessperson preside over one of the largest retail bankruptcies in British history? Was it due to pure negligence or was he deliberately ill-intentioned? The House of Commons inquiry and subsequent report points to both, and perhaps places slightly more emphasis on the latter.

The bottom line is that the collapse of BHS is a clear example of how personal greed can become a vicious force in morally corrupting an individual. The evidence in the report shows how Green engaged in widespread cost-cutting, the sale of BHS assets and the subsequent payment of dividends that ultimately benefited the Green family – all while failing to give the necessary long-term attention to the company's pension scheme. Again, the bankruptcy of BHS shows how a lack of moral values can lead to the downfall and reputational destruction of even the most successful businesspeople. By far the most damaging effect of this outcome is that 11,000 employees are now out of work

and with a £571 million hole in their pension fund.[24] Frank Field MP said that Sir Philip's 'reputation as the king of retail lies in the ruins of BHS … What kind of man is it who can count his fortune in billions but does not know what decent behaviour is?'[25]

'The consequences of greed are real'

The consequences of greed are real, and unless leading businesspeople recognise and take the need for ethics and morality seriously, there will be more BHS-like cases to come.

However, for the purposes of this study it is worth asking two broader questions:

1. Has the aggressive pursuit of profit banished the possibility of an ethical, 'values-driven' business model?
2. What impact can the internet, and social media in particular, have on corporate behaviour?

As mentioned in the Introduction, big business has suffered tremendous reputational damage since the financial crisis of 2008. A key contributing factor to this has been corruption and unethical behaviour within big business itself. However, it is important to note the internet's potent role in exposing morally corrupt business practices.

For most of the twentieth century, news information was concentrated within in the hands of a few powerful TV stations and newspaper agencies. By the early 2000s, the arrival of the internet to the masses dispersed the power of information back to the individual. The widespread use of social media and the 'digitalisation' of the workplace and home has radically changed the way we digest information – access to it is instant and available anywhere at any time. What is even

more important is that once information is on the internet, it will probably remain there permanently.

The implications for business reputation and practices are tremendous. If in the 1980s a company accused of fraud could get away with one or two news articles in the printed press, today that company would face a tsunami of online articles and social-media posts – available permanently for anyone with an internet connection to read. The internet can effectively be seen as a sort of 'record book', whereby each search result can yield a permanent transcript of a company's historical behaviour – good and bad.

In an article for *The Economist*, Matthew Symonds said that 'the internet is turning business upside down and inside out. It is fundamentally changing the ways companies operate … this goes far beyond buying and selling … and deep into the processes and culture of an enterprise.'[26] Online media has the capacity to spread information much faster and to a far larger audience than was possible in the past. Through comments, shares and 'tweets' on social networks – any unethical behaviour by companies or private individuals will not go unnoticed. The consequence is that a negative – or positive – business rumour can reach a far larger audience than would otherwise have been possible. The key point here is that companies with the scope and reach have to take an ethical, holistic approach to doing business if they are to succeed in the 'big data', social-media ecosystem (see more on the impact of social media in Chapter 3).

So far we have seen how public ownership may weaken the relationship between the owners – shareholders – and the business itself, often giving rise to principal–agent problems. In this sense it could be argued that any private entity that tolerates or disregards the importance of moral values in guiding its business activity will suffer consequences both in reputation and profitability – the two generally go hand in hand. The next chapter will look at the emissions scandal

that engulfed Volkswagen Group in September of 2015, which shows how ignorance towards establishing an ethical corporate culture has led to what may be decades of financial and reputational damage.

Notes

[1] Friends General Conference, *FGC: Nurturing Faith and Quaker Practice* – www.fgcquaker.org.
[2] Richard Turnbull, *Quaker Capitalism: Lessons for Today*, Oxford: The Centre for Enterprise, Markets and Ethics, 2016, p. 12.
[3] US History, 'About the life of George Fox' – www.ushistory.org/penn/fox.htm.
[4] Turnbull, *Quaker Capitalism*, p. 55.
[5] Turnbull, *Quaker Capitalism*, pp. 26, 27.
[6] Turnbull, *Quaker Capitalism*, p. 73.
[7] R. Edward Freeman, *Strategic Management: A Stakeholder Approach*, Cambridge: Cambridge University Press, p. 52.
[8] Holly Alison Duckworth and Rosemond Ann Moore, *Social Responsibility: Failure Mode Effects and Analysis*, Boca Raton, FL: CRC Press, 2010, p. 14.
[9] US History, 'About the life of George Fox' – www.ushistory.org/penn/fox.htm.
[10] Louis Frederic, *Japan Encyclopaedia*, Cambridge, MA: Harvard University Press, 2002, p. 600.
[11] For a more in-depth discussion of the role of Quakers in business, see Turnbull, *Quaker Capitalism*.
[12] Although 'principal–agent' failures can appear in a wide variety of ownership structures. See Barry M. Mitnick, 'Origin of the Theory of Agency: An Account by One of the Theory's Originators', Pittsburgh, PA: University of Pittsburgh, 2013, p. 3.
[13] 'Principal–agent dilemma' and 'principal–agent theory' will be used interchangeably.
[14] Michael C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, Cambridge, MA: Harvard University Press, p. 3.
[15] A more accurate, multi-layered application of the theory in this

case would be as follows: 1. Shareholders (principal) > Board (agent). 2. Board (principal) > CEO (agent). 3. CEO (principal) > Senior Management (agent). 4. Senior Management (principal) > Employees (agent).

[16] Rachael Cooper, 'Barclays Libor Scandal: As It Happened', *The Telegraph*, 28 June 2012 – www.telegraph.co.uk/finance/newsbysector/banksandfinance/9361646/Barclays-Libor-scandal-as-it-happened-June-28-2012.html.

[17] Mark Scott, 'New Barclays Chief Tells Staff to Accept Changes or Leave', *The New York Times*, 17 January 2013 – http://dealbook.nytimes.com/2013/01/17/new-barclays-chief-tells-staff-accept-changes-or-leave.

[18] Tara Cunningham, 'New Barclays Boss Jes Staley buys £6.5m of Bank's Shares', *The Telegraph*, 5 November 2015 – www.telegraph.co.uk/finance/markets/ftse100/11977411/New-Barclays-boss-Jes-Staley-buys-6.5m-of-banks-shares.html.

[19] House of Commons, Work and Pensions and Business, Innovation and Skills Committees, *BHS: First Report of the Work and Pensions Committee and Fourth Report of the Business, Innovation and Skills Committee of Session 2016–17*, HC 54.

[20] House of Commons, *BHS*.

[21] 'List of Billionaires' – www.forbes.com/profile/philip-cristina-green/?list=billionaires.

[22] 'Philip Green: Blair gave him a Knighthood, Cameron gave him a Job' –
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Chapter 2

Volkswagen emissions scandal:

a story of trust and betrayal

The Volkswagen[1] emissions scandal was arguably the defining corporate story of 2015. It came as a shock not only because millions of customers were deceived – 11 million according to VW – but rather because the culprit was the maker of the original 'peoples' car', the VW Beetle. Since the firm's inception in 1936, Volkswagen has established itself – up until 2015 – as the world's largest car manufacturer.[2] The Volkswagen group has over 550,000 employees and a presence in more than 150 countries worldwide. Over the decades the Volkswagen brand has established a global reputation of reliability, robust 'German' engineering, and value for money. It won a vast array of car awards, from Car of the Year on multiple occasions to Car of the Century for the Type 1 Beetle.[3] Volkswagen has three models in the top-ten list of best-selling cars of all time (the Beetle, Golf and Passat), more than any other car manufacturer in the world. Over the last three decades it has acquired other car manufacturers such as Audi, Skoda, Seat, Bugatti, Lamborghini, Bentley and Porsche – a form of 'horizontal integration' – and formed the Volkswagen Group. But above all, VW built a reputation for being a brand that could be wholeheartedly trusted. The company prided itself on upholding the very highest ethical values and business practices. An excerpt from its sustainability policy claimed that:

'VW built a reputation for being a brand that could be wholeheartedly trusted'

> We aim to be the world's most successful, fascinating and sustainable automobile manufacturer. … For the Volkswagen Group, sustainability means that we conduct

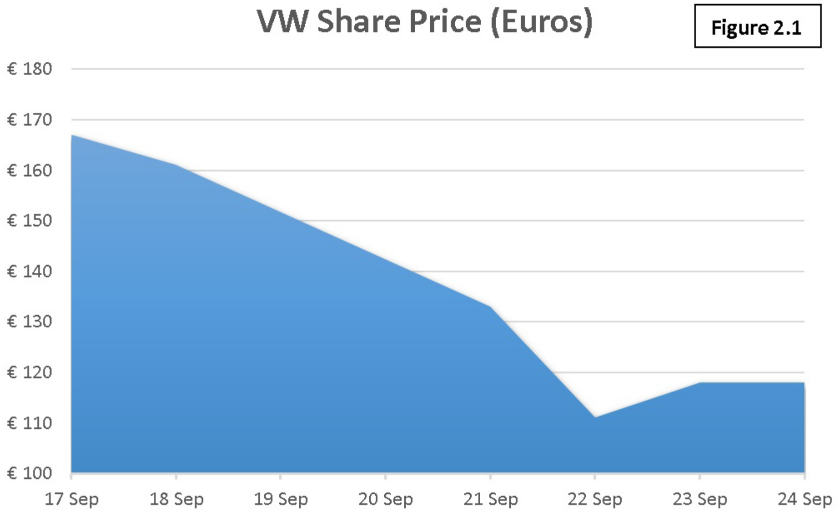
> our business activities on a responsible and long-term basis and do not seek short-term success at the expense of others. Our intention is that everyone should profit from our growth – our customers and investors, society and, of course, our employees. In this way, good jobs and careful treatment of resources and the environment form the basis for generating lasting values.[4]

Whether Volkswagen was truly striving to live up to these standards remains to be seen. It would be wrong to assume that because of the wrongdoing of a few, the entire workforce of the company is morally corrupt. The questions are: 'How high up the corporate ladder were unethical business practices being tolerated?' and 'What does this say about the company's corporate culture?' Volkswagen did indeed become the largest car manufacturer in the world and has invested substantially in green technology over the years, while some employees truly believed that '[VW conducts] business activities on a responsible and long-term basis and [does] not seek short-term success at the expense of others.'[5] How shared and revered is this principle throughout the corporate echelons of VW? The point of this question is to highlight the importance of truly upholding ethical business values and the consequences of neglecting them. The emissions scandal took analysts and investors by surprise – no one really saw it coming. One journalist wrote, 'for many observers, one of the biggest corporate scandals of the century came from nowhere. Seemingly out of the blue …'.[6] To gain a better understanding, let us briefly look at the timeline of events on how the scandal unfolded.

In early 2014 the International Council on Clean Transportation (ICCT) commissioned a group of researchers from the University of West Virginia to test the emissions of several Volkswagen vehicles. The ICCT's mission is simple: 'to improve the environmental performance and energy efficiency of road, marine, and air transportation, in order

to benefit public health and mitigate climate change'.[7] The results from the tests found that in some cases the cars emitted 40 times above the legal limit of nitrogen oxide. When presented with the findings, Volkswagen attributed the issue to 'technical problems' and by the end of 2014 it told the authorities that any affected models would be fixed through 'software updates'.[8] In May 2015 the US state authorities and the California Air Resources Board (CARB) undertook a new series of tests, the results of which were still unsatisfactory. Faced with the evidence by the CARB, VW in the USA admitted to intentionally placing a 'defeat device' that would recognise and lower emissions only when the car was being tested.[9] On 18 September the US Environmental Protection Agency (EPA) made the case public. Martin Winterkorn, CEO of Volkswagen Group, made a public statement two days later saying that he was 'deeply' sorry for 'breaking the trust of our customers and the public'.[10] The scandal led to his resignation on 23 September, while maintaining that he was personally 'not aware of wrongdoing.'[11] The scandal caused colossal damage to the Volkswagen Group. To better understand the damage, let us consider two main areas – financial and reputational.

If on Friday, 18 September 2015, VW's shares were trading at €161 per share and the company stood at a market capitalisation of approximately €85 billion, by the end of Monday, 22 September, its share price had dropped to €111 per share, its market value falling almost 30 per cent to €54 billion. That's close to a €30 billion devaluation in one day of trading. Figure 2.1 illustrates the share price plummeting.[12] While the company had around €21.5 billion in cash, the cost of fines and repairs for the 11 million vehicles affected could rise to as much as €18 billion, placing VW in an extremely dangerous situation. One Credit Suisse analyst thought that the €21.5 billion cash pile was 'unlikely to be sufficient to cover potential recall costs, fines or subsidy clawbacks'.[13]



This may be a worst-case scenario outcome, and assuming all runs smoothly, Volkswagen's share price might recover, at least partly. As of 6 June 2016, its share price of €131 per share has recovered less than half of its initial value. It is a hefty price to pay for something that other major car manufacturers such as BMW, Toyota and Mercedes have been able to comply with. Therefore, the conclusion to be drawn is that it was not an issue of technological capacity or lack thereof. Rather it was an attempt to maximise profit – or gain competitive advantage – through, to put it bluntly, highly disreputable and potentially illegal business practices.

As damaging as the financial costs are, the reputational damage may be even greater. It is arguably more damaging than the financial impact in that it may take longer to repair – it will take years for Volkswagen to win back the public's trust. A loss of reputation is often more difficult and takes longer to recover from than a financial loss. As the renowned US investor Warren Buffet once said, 'It takes 20 years to build a reputation and five minutes to ruin it. If you think

about that, you'll do things differently.'[14] It may not necessarily take 20 years to fix Volkswagen's reputation but some experts agree that there will be 'five years of bad PR at least'.[15] So Volkswagen and its new CEO Matthias Müller are faced with an uphill struggle. Upon his appointment, Müller said that his 'most urgent task is to win back trust for the Volkswagen Group by leaving no stone unturned and with maximum transparency, as well as drawing the right conclusions from the current situation'.[16] Similarly, at the latest Consumer Electronics Show (CES, 2016) in Las Vegas, Herbert Diess, Chairman of the Board of Management of Volkswagen, vowed that 'we are now creating a different and better company, a new Volkswagen. We are in the process of re-defining every aspect of Volkswagen.'[17] The truthfulness of their commitment to this goal remains to be seen. Progress thus far, however, has not been looking good. In the UK the House of Commons published a report in July 2016 on the Volkswagen emissions scandal that concluded as follows:

'It will take years for Volkswagen to win back the public's trust'

> The Volkswagen emissions scandal has brought the integrity of the auto sector into disrepute. VW's conduct since the scandal has only served to further damage its reputation. It has communicated poorly with customers which has led to confusion over when and how affected vehicles will be fixed. Furthermore, VW has not been open about the nature of the defeat device software that it installed in millions of vehicles worldwide. Instead of answering many of our questions directly, VW asked us to await the results of an internal investigation by Jones Day. We do not believe that the internal investigation will provide the answers that are needed urgently. VW has used the investigative process to make announcements that only served to exonerate senior management.

> Approval authorities and regulators cannot depend on VW to co-operate and in this report we have called upon the Department for Transport to use its powers and resources to properly investigate VW which we believe it has failed to do, so far.[18]

It seems clear that a shift in the working relationship between Volkswagen and the authorities needs to take place – at least from the UK's governmental perspective. One area also worth considering is Volkswagen's ownership structure. As of 31 December 2014, Porsche Holding SE is Volkswagen's single largest shareholder with 31.5 per cent equity stake in the company. More importantly, Porsche holds 51 per cent of the voting rights within Volkswagen, effectively giving it executive decision-making power. Figure 2.2 illustrates VW's top shareholders in terms of voting rights, while Figure 2.3 shows the equity share breakdown.

Historically, Volkswagen was protected under German federal law against any form of takeover. No single shareholder could hold more than 20 per cent equity share in the company. However, in October 2007 the Court of Justice of the European Union ruled against the 'Volkswagen Law' on the basis that it was protectionist. Moreover, it went against the Single Market core principles of the free movement of goods, people and capital within the Union. On 23 October 2007, the Court issued a press release justifying the decision on the grounds that it 'invokes a breach of the free movement of capital. The Court points out that the EC Treaty prohibits any restriction on movements of capital between Member States.'[19] As a result, Porsche Holding SE gradually increased its stake in Volkswagen and by January 2009 it controlled 51 per cent of shareholder voting rights.[20]

There is no doubt that Porsche and Volkswagen share a deep-rooted history together, entrenched in the struggle of the Second World

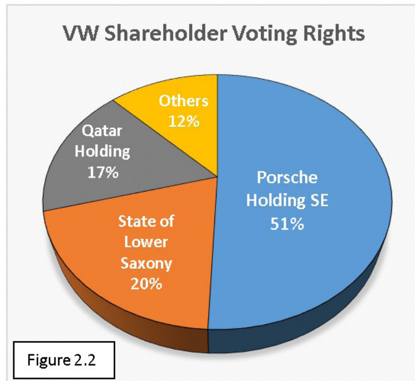


Figure 2.2

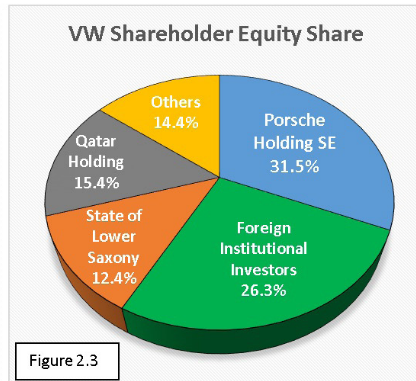


Figure 2.3

War. Indeed, it was Porsche that designed the iconic Volkswagen Beetle for Hitler in the early 1940s. It should come as no surprise, then, that Porsche showed such intent towards Volkswagen. At the time of the acquisition, the *Autocar* journalist Peter Robinson stated that 'The Porsche purchase has everything to do with Ferdinand Piech's[21] obsession with bringing the two independent parts of what he perceives as the Porsche family companies together.'[22] There is a significant heritage behind the long-running Volkswagen–Porsche relationship.

However, in light of the emissions scandal, Porsche's[23] control over VW has brought much criticism. The critical consensus, broadly, is that in effect Porsche holds a monopoly over Volkswagen's management, giving little or no voice to smaller shareholders. Yngve Slyngstad, the Chief Executive of Norges Investment Management, the world's largest sovereign wealth fund and a minority shareholder in Volkswagen (1.2 per cent), was highly critical of Volkswagen's ownership structure. Slyngstad claimed that 'this cannot be a role model for Germany… I don't think the family [Porsche] wants to change anything about the structure. We don't have the impression they want to listen to other Volkswagen shareholders' concerns.'[24] After all, Matthias Müller, VW's new CEO, was previously the Chief Executive of Porsche (the car

manufacturing subsidiary within Volkswagen). Therefore critics could argue that it's 'their man' at the helm of Volkswagen.

The situation with Porsche's control over Volkswagen is something of a paradox. On the one hand, the free movement of people, trade and capital are fundamental principles of the European Union – as such, Porsche SE is perfectly entitled to own 51 per cent of the shareholder votes in VW. On the other hand, the concentration of executive power in a single shareholder may prove to be a risky strategy for the long-term stability of Volkswagen – particularly if the sole owner prioritises short-term rewards at the cost of – not least – moral but legal business practices as well. Is Volkswagen just too big and too important to have a single, 'family' owner? It would be interesting to understand how much direct input Porsche SE had in the scandal, if any. This would of course require inspection of sensitive internal information that only the German authorities could have access to. It could be that Porsche SE had no knowledge of the emissions-cheating device, that it was purely a decision taken somewhere down the corporate ladder. The exact culprit remains unknown.

'Porsche's control over Volkswagen is something of a paradox'

This can also raise questions about the effectiveness of Germany's legally imposed 'dual-board' corporate governance system. First implemented – compulsorily – after the end of the Second World War, the two-tier system was a legal, cautionary measure to protect West German companies as the country made the transition into a free market economy. Unlike the 'single-board' system found in most Anglo-Saxon countries, the dual-board approach effectively has two boards permanently involved in the running of a company. The first is a 'management board' made up of executive directors who oversee the day-to-day management of the firm. The second is a 'supervisory

board', usually charged with providing oversight of the management board and its decisions. The supervisory board ultimately ensures the long-term stability and growth of the firm.

Proponents of the dual-board system claim that the additional checks and balances provide a safer, more stable form of corporate governance. One study found that dual board demands 'less aggressive performance targets from the CEO, but exerts more monitoring'.[25] Critics, however, claim that the structure is outdated and very slow in adapting to the rapid fluctuations of modern, German capitalism. Hans Hirt, Head of Corporate Governance at Hermes, claimed that 'Management boards have changed quite a bit. But supervisory boards remain an unreformed area.'[26] Similarly, Hans Kietel, former Chief Executive of Hochtief, said that supervisory boards today are 'made up of either people from industry who have no time or 67-year-old pensioners'.[27]

It appears, therefore, that Germany's dual-board system may be in need of reform. Indeed, the supervisory board at Volkswagen failed to mitigate the emissions scandal. So can an alternative, more effective structure be found?

The Scandinavian model of corporate governance prides itself on being 'between the Anglo-Saxon one-tier and the continental European two-tier model'.[28] Although corporate legislation is set at a national level (e.g. Sweden, Denmark, Finland), there are shared principles present in Nordic countries. One principle is promoting a more robust set of checks and balances through the dispersal of executive power. This effectively places the executive board in a web of surrounding bodies that must offer approval of certain decisions. For instance, most boards in the Nordic countries are legally required to have a permanent audit committee for oversight. A second key principle is treating shareholders equally. All shareholders are entitled

to attend and participate through voting in the annual general meeting (AGM). Unlike the Anglo-Saxon or continental European models, the AGM has executive decision-making powers above the board itself. As a measure to protect minority shareholders, many decisions taken by the AGM are based on a qualified voting majority and not a simple majority.[29]

Given the magnitude of the topic at hand, the merits of the Scandinavian model or corporate governance structures in general remain to be explored in far greater depth. However, in view of the lack of definitive evidence it would be unfair to place the blame on the dual-board governance structure or a single 'family' owner for Volkswagen's situation. What can be concluded with certainty is that:

1. The checks did not prevent the crisis.
2. The emissions scandal was ultimately a failure of corporate culture and of the upholding of moral values from within the company itself.

Again the principal–agent theory can highlight some of the conflicts of self-interest at play in this situation. In this case there was a clear misalignment of interests between the principal, Porsche SE (and in theory the minority shareholders), and the agent, VW's CEO Martin Winterkorn and the senior management.

Such was the drive for economic performance that not only legal but also moral business practices were breached. How much of the blame is to be placed on Porsche SE or VW's senior management remains difficult to determine – common sense would tell us that the majority shareholder would have the long-term interests of the company at heart. Yet at the same time the immediate, short-term financial performance is equally if not more important. Performance pressures, broker and analyst expectations, remuneration and the

associated demands of a public company in a competitive marketplace create the need for a fine balancing act between short/medium-term goals and long-term stability.

It could be argued, therefore, that the agent's (VW's CEO; senior management) excessive focus on short-term profitability came at the cost of resorting to illegal business practices. Many of the minority shareholders are blaming Porsche SE (the principal) rather than VW's management (the agent) for this situation.[30] Within the principal–agent theory, the minority shareholders could be seen as 'angry principals' because of their lack of real power in influencing the agent (CEO; senior management). Merryn Somerset attributes this to a 'co-ordination problem' among minority shareholders:

> Most have only modest stakes in a company, so they have more incentive to sell than to take corporate action when they aren't happy … Individuals held 50% of shares in the 1960s and 10% of shares today.[31]

It is useful to explore and see if there is anything more specific, more concrete that drove the agent (CEO; senior management) to resort to illegal business practices. One area worth looking at is employee remuneration and incentives. Sir Chris Hohn, Chief Executive of TGI hedge fund, holds a €1.2 billion stake in Volkswagen and has been highly critical of 'excessive top management compensation … [that] has encouraged aggressive management behaviour contributing to the diesel emission scandal'.[32]

If a senior executive is promised €1 million in bonus if he or she meets target sales for product 'x' (diesel cars, for instance), would he or she be prone to unethical behaviour? Might they be looking to cut corners in reaching that sales target? Business sales targets or any form of employee incentives are set for two main reasons:

to encourage the staff to work harder and to grow the business in doing so. There is nothing wrong with incentives – indeed, they can be crucially important within some business models. However, it is wrong to set unrealistic incentives that may tempt unethical or even illegal behaviour. An unrealistic sales target may indirectly force the 'agent' to resort to unethical or even unlawful means of reaching it. Within the principal–agent dilemma, Edward Lotterman believes that:

> the agents in [the VW emissions] case did not set out to harm the principals. Nor did they necessarily want to harm the environment or the purchasers of VWs and Audis with diesel engines. They merely responded to the incentives they faced.[33]

'It is wrong to set unrealistic incentives that may tempt unethical or even illegal behaviour'

The key lesson here is that employee incentives must be realistic and achievable so as to prevent unethical and even illegal activity.

There is no doubt that the emissions scandal has had a severe negative impact on Volkswagen, both reputationally and financially. In the short to medium term, no amount of advertising or campaigning will be able to redeem Volkswagen's image – especially in the eyes of its customer base. However, this is an opportunity for a fresh start in building the company's future. This future will only be sustainable if the senior management at Volkswagen lay a foundation of genuine ethics, clear transparency and good intentions – not just for Volkswagen but for all stakeholders. As David Jones writes: 'transparency, authenticity and speed are the rules of modern business. Social responsibility needs to be at the core of business strategy, not in a silo.'[34] Regardless of Volkswagen's ownership structure, the senior management within the firm will have to understand this. Porsche now has the opportunity to

create a new Volkswagen that is truly built on moral values.

Notes

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[29] *Corporate Governance in the Nordic Countries*, p. 7.
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Chapter 3

Lessons for today

Throughout, this study has attempted to frame the argument for ethical business and a market economy built on a foundation of morality and responsibility. Chapter 1 showed how faith was the principal actor in driving the Quakers' strong convictions and belief in moral values such as equality, honesty, integrity and community: their values transcended both private and business lives, leading them to establish some of the UK's most successful businesses, and their approach has a striking similarity to modern-day 'stakeholder theory', managing compassionately and effectively all stakeholder relationships within their respective business ecosystems. Ultimately, we have seen how Quakers were successful precisely because ethical behaviour and a deep understanding of their responsibilities in the pursuit of profit were the foundation of how they conducted business.

An attempt was then made to understand the consequences of becoming a large, publicly owned business and the impact this can have on a company's incentive to uphold ethical values. Here it was argued that public ownership may weaken the relationship between the owners (shareholders) and the business itself, therefore resulting in a weaker corporate culture and sense of collective responsibility that otherwise a hands-on owner might be able to mitigate. We have seen how Barclays, a Quaker-established financial institution, suffered a serious blow to its reputation during the Libor scandal of 2012. Through the 'principal–agent' theoretical framework we have seen how there was a misalignment of interests: Bob Diamond prioritised profit at the expense of establishing a strong ethical culture within the bank. Given the advent of broadband internet and the widespread use of social media, controversies like the Libor scandal will be exposed tenfold and will remain on record for ever.

Chapter 2 considered the financial and reputational damage incurred when a company falls into illegal business practices, looking at the emissions scandal that engulfed the Volkswagen Group. Decades of history in building a reputation as the reliable and honest makers of the 'peoples' car' was tarnished in a matter of hours – a scandal that could have been avoided (the technology and the right people to implement it were there). Greed for profitability trumped ethical business practices. This really was a scandal that Volkswagen could have avoided had senior management understood the importance of establishing and truly upholding an ethical culture within the firm. As its sole majority shareholder, it remains to be seen how Porsche begins the process of rebuilding the firm.

Therefore, based on all that has been said above, what are some key lessons for today?

3.1 Purpose is greater than profit

Purpose trumps profit. The successful business of the twenty-first century is one that sets its aims above profitability. The objective of profit does not stand alone but is set in the context of a business's wider purposes. It is one that brings value to our ever globalised, ever competitive marketplace, in a manner that continually strives for a goal that is greater than itself. Profit becomes a by-product of this purpose-driven business model. The Quakers set up businesses in obedience to God and fair treatment of others. Cadbury's founder, George Cadbury, was a great social activist in Birmingham and a driving force behind establishing the state old-age pension and the RSPCA.[1] Since its early days, Clarks Shoes used company profit to invest in the local community, building local infrastructure and even homes for its employees.[2] But it is not only Quaker businesses that were successful because they had

'Profit becomes a by-product of this purpose-driven business model'

a purpose beyond profit. Arthur Guinness wanted to help alleviate the severe alcoholism that plagued seventeenth-century Dublin, so he introduced a lighter and more nutritious alternative to gin or the other spirits of the time: Guinness stout.[3] Henry Ford envisaged a nation on wheels and in 1908 introduced the first mass-production vehicle, the Ford Model T. He is quoted as having once said that 'A business that makes nothing but money is a poor business.'[4]

The vast majority of long-term, successful businesses have one thing in common: they are driven by a purpose that goes beyond profit. As Dan Price puts it in an article entitled 'Purpose – Not Profit – Driven Companies Will Take Over the Economy', 'when it comes to business, purpose is key […] Purpose is something that rallies people in a way that profit never will.'[5] Research has shown that today's best employees are more motivated by the opportunity to achieve something meaningful than they are by financial reward.[6] Consultancy firms that deal with performance management and improvement have recognised the importance of purpose and, as a result, have started implementing it in their programmes. For instance, the consulting arm of Ernst and Young (EY) offers a programme called 'Purpose-Led Transformation'. EY recognised that 'When companies focus on a purpose that is rooted in creating value for others, improving the world we live in and inspiring the organisation at all levels, they increase their ability to drive profits and create sustainable value.'[7] EY's market research has found overwhelming evidence in favour of a purpose-driven business model: 89 per cent of clients believe a purpose-driven company will deliver the highest quality products/services; 72 per cent of global consumers would recommend a company with a purpose; and purpose-led companies outperformed the S&P 500 by 10 times between 1996 and 2011.[8]

3.2 Moral values must become an intrinsic part of the business

The second lesson stems from the first: companies must truly uphold a set of moral values in the pursuit of their goals.

Let us step back for a moment and ask the question: 'What precisely are values?' According to Wayne Visser, 'Values are exactly what they say they are – a reflection of the things we value.'[9] If a company sets a goal to, let's say, manufacture the most environmentally friendly vehicles on the planet, how it goes about achieving this aim is just as important as the aim itself. This is where, sooner or later, companies that truly uphold their values will reap the reward of establishing a solid reputation, while those that don't will be exposed – as Visser rightly claims: 'Companies' values are betrayed by their actions, not their words or their spin-doctor's marketing material.'[10] In the global marketplace of the twenty-first century, a company's set of values must be seen as a critical part of the long-term business plan, not a mere document that employees have to sign when first joining the firm. They have to be practised, not just preached.

'Companies' values are betrayed by their actions, not their words'

Therefore, it comes as no surprise that setting a number of values is the easy bit; the difficult part is truly upholding them. Virtually all of the larger corporates profess to operate or believe in a set of values or 'ethical code of conduct'. They are often clearly – and beautifully – presented on their websites and annual reports. Barclays believes in 'Respect, Integrity, Service, Excellence and Stewardship'.[11] Volkswagen stands for 'Sustainability', 'Social Responsibility', 'Partnership' and 'Volunteering'.[12] BP believes in 'Safety', 'Respect', 'Excellence', 'Courage'.[13] There are many examples. Even Lehman Brothers had

an ethical code of practice prior to its collapse in 2008. A study from Elon University in North Carolina found that:

> The code was fairly generic, commonplace and had few aspects of originality; it lacked transformational, guiding concepts that could help in a crisis. The code did not provide much detail about the unique ethical values of the institution and what behaviours might be most desired. They forbid behaviours that violated the law, such as insider trading and those that would harm the firm's reputations, but did not discuss the company's specific ethical culture.[14]

In other words, Lehman's 'ethical code' was effectively a document warning Lehman employees against conducting illegal activity and gross behaviour that could significantly damage the firm's reputation – no mention of establishing an ethical culture as a collective, unified institution. One could argue that this contributed to Lehman becoming Wall Street's leader in corporate greed and excessive leverage. Nonetheless, the point here is that too many 'ethical codes' or 'set of values' remain on the company website or in annual reports and not in the hearts and minds of the employees, from board members and executives to recent graduate hires and interns. Values must be lived out in the day-to-day activity of the business.

'The senior management and leaders within the company have to practise the values they are trying to promote'

How? The responsibility to lead the way rests on the shoulders of the executives and senior management. They must strive to be the embodiment of the company's culture and shared values. To increase the effectiveness of implementing a set of values, research

conducted by Lisa Newton stressed the importance of involving the organisation in the development stages: 'in order to encourage commitment and "buy-in" [on behalf of the entire firm]'.[15] In line with her research, 'Participation' is the first of three key stages in successfully implementing a set of values. The second stage places emphasis on 'validity'; that is, the set of values must be consistent with the dictates of the moral conscience (justice, respect, truthfulness). Last but not least, the third stage focuses on 'authenticity'. The senior management and leaders within the company have to practise the values they are trying to promote.[16] This not only adds legitimacy to the entire effort, but the influencing power of individual moral behaviour within the company itself can cement a moral corporate culture in the long run. So Newton's research emphasises three key elements when implementing a set of values: participation; validation; authenticity.

Another study, by Simon Welby, adds to the discussion in arguing that disciplining employees who violate the firm's values or its code of ethics might also be a viable incentive for effective implementation.[17] The study continues by suggesting a 'small group of senior staff, often with a non-executive director as chairman, to be given responsibility to implement the code and to monitor its adoption and effectiveness'.[18] While this may not be faultless, having a dedicated body that actively monitors the firm's practices from an ethical standpoint would be a step in the right direction. In this sense it provides an open platform for discussion which, in turn, would not only give the senior management a better understanding of the company's current situation but could also give them the capacity to head off future disasters like the ones mentioned here. The study argues that when an employee – regardless of seniority – is found to be in breach of the ethical code, then depending on the seriousness of the case, the discipline should range 'from warning to dismissal'.[19] If a company is serious about upholding its ethical code, then clearly the consequences of failing to do so

should also be serious. Punishing unethical behaviour proves, to some extent, the firm's commitment to upholding its values. Furthermore, any action of discipline sends a clear message both internally, to other employees/staff, as well as externally, to competitors, observers and so on. Of course, a company should be cautious of adopting too extreme a position here, becoming analogous to a police state where staff are overly fearful to the point that it becomes an unhealthy working environment.[20]

Despite its faults, Newton's three-phase implementation strategy – participation, validation, authenticity – and Simon Welby's emphasis on staff discipline provide us with a strong blueprint. Needless to say, there is no one-size-fits-all approach to implementing a set of values, rather there are multiple elements that must come into play. As mentioned earlier, Edward Freeman's stakeholder theory gives us a good theoretical framework in which to operate, but it is ultimately those on the upper half of the corporate ladder who have to set the benchmark and trigger the moral conscience of each individual employee.

There can of course be the problem that middle management may not accept, or may have difficulty adapting to, the cultural framework imposed by the board. This could be interpreted as 'pressure', which in turn is passed down the corporate ladder. It is key to understand that moral values are to be lived, not checked off as part of a corporate 'transformation' programme. It would be very difficult to make the right business decisions guided purely by a set of moral values written on a piece of paper. However, every human being has a moral conscience: each individual knows right from wrong. It is whether we act on our conscience that makes all the difference. No amount of academic theory or corporate transformation programmes will be able to substitute for the effectiveness of having a team that is led by a moral conscience. Senior executives and managers must act to

promote this and advance those within the firm who deliver 'business' results, but do so ethically.

The good news is that all this is very feasible. Wayne Visser brings us an analogy from nature. He categorised companies into two types: lion and elephant. The lion-company is one that claims to uphold a set of moral values but under the surface behaves like a carnivorous predator, devouring everything in its path to reach its goal. The elephant-company also claims to uphold a set of moral values, but unlike the lion-company, it pursues its goals in a far more dignified, calculated manner, well aware of its surroundings. The elephant-company does not hide behind corporate masks or claim to uphold values it neither believes in nor practises.[21] Visser's analogy is remarkably accurate of today's corporate landscape: all profess to be elephants but many are lions. Again, the good news is that it is possible to be an elephant-company and be very successful in the marketplace. Now this is not to say that the record must be spotless; it is to say that the company is truly striving to uphold a set of moral values in its day-to-day conduct and business activity. A good example of an elephant-company would be Ben & Jerry's ice cream. Equity is one of their core values, so the management ensured that the difference between a top salary and an entry-level one is no greater than 7:1.[22] Ben & Jerry's also commits 7.5 per cent of all pre-tax profit to charity. Now again, this is not to say that Ben & Jerry's is perfect, but it is a company that strives to apply the values it claims to uphold. And in the long term, this makes all the difference.

3.3 Companies that fail to implement an ethical culture will suffer

The third and final lesson is rather straightforward: businesses that fail to instil a sense of morality and collective responsibility will, sooner or later, have to suffer the consequences. We have seen the vast financial and reputational damage incurred by Volkswagen, Barclays and BP

(six years after the Gulf of Mexico oil spill disaster, news outlets are still discussing the environmental damage[23]). The point here is that in today's world, a lion-company that conducts its business activity without any solid sense of morality runs a very high risk of being exposed – not least by two dominant global forces: globalisation and the widespread use of social media. Let us briefly touch on each of these.

Globalisation holds the essence in its name – to become globalised. Fundamentally, the concept can be defined as 'the process of intensifying interconnectedness' at a global level.[24] Anthony Giddens defines it as an 'intensification of worldwide social relations which link distant localities in such a way that local happenings are shaped by events occurring many miles away and vice versa'.[25] There are multiple dimensions to globalisation, whether social, technological, political or cultural, but essentially it is about 'a process of intensifying interconnectedness'. We can see this happening all around us, instability in Syria causing a migrant crisis in Europe or the stock market crash in China causing immediate shockwaves throughout the global financial markets. We are living in an increasingly interconnected world. Nonetheless, what does this mean for business? It means that business decisions can have a greater negative – or positive – impact than ever before. Decisions made in Germany can have an immediate impact in Singapore and vice versa. Shareholders, managers, customers, suppliers or competitors are more likely to be placed in different countries and even different continents. The marketplace is becoming increasingly global. Unethical business practices will not only have local but global consequences. Andrew Crane and Dirk Matten suggest that business ethics in the context of globalisation creates a space of activity beyond the realm

'Unethical business practices will not only have local but global consequences'

of the nation state.[26] In upholding an ethical culture, the stakes for international firms have never been higher.

In this sense the rapid growth of social media can be seen as an effect of technological globalisation. Driven by an increase in high-speed internet availability, social media has become a global platform of discussion and sharing of information at remarkable speeds. It has brought millions of people closer together regardless of geographical distance. Again, what does this mean for business? It means that customers, employees and shareholders are more powerful precisely because they have instant access to a vast amount of information. Social media – and the internet in general – has enabled people to become more aware, more engaged and subsequently more powerful than ever before. As David Jones rightly observes, 'Social media is creating what I believe will be a bigger transformation for business than the arrival of television. If this generation … can topple previously immovable dictatorships, as we have seen across the Arab world, then imagine what they can do to your brand.'[27]

Notes

[1] Robert Hardman, 'Cadbury's and the Quakers' Vision of Utopia that built a British Institution', *Daily Mail*, 20 January 2010 – www.dailymail.co.uk/debate/article-1244582/Cadburys-Quakers-vision-Utopia-built-British-institution.html.
[2] Clarks Shoes, 'Slippers, Prizes and Sewing Machines' – www.clarks.co.uk/historyandheritage_1825-1900.
[3] Stephen Mansfield, *The Search for God and Guinness: A Biography of the Beer that Changed the World*, Nashville, TN: Thomas Nelson, 2009, p. 14.
[4] Estelle Brachlianoff, '"A Business that makes Nothing but Money is a Poor Business" – Henry Ford', *The Huffington Post*, 13 July 2016 – www.huffingtonpost.co.uk/estelle-brachlianoff-/a-business-that-makes-not_b_10958310.html.
[5] Dan Price, 'Purpose – Not Profit – Driven Companies Will Take Over the Economy', *The Huffington Post*, 11 February 2015 – www.huffingtonpost.com/dan-price/purpose-not-profit-driven_b_8454612.html.
[6] Randy Pennington, 'A Study in Building a Purpose-Driven Business: How you can balance your Desire to do Good with the Necessity to run a successful Business', *Fast Company*, 23 March 2015 – www.fastcompany.com/3044096/a-study-in-building-a-purpose-driven-business.
[7] Ernst and Young, 'Purpose-Led Transformation: Ignite long-lasting Change and fuel Growth and Innovation. Why Purpose?' – www.ey.com/GL/en/Services/Advisory/EY-purpose-led-transformation-why-purpose.
[8] Ernst and Young, 'Purpose-Led Transformation'.
[9] Wayne Visser, *Corporate Sustainability and Responsibility: An Introductory Text on CSR Theory & Practice – Past, Present and Future*, London: Kaleidoscope Futures Publishing, 2013, p. 62.

[10] Visser, *Corporate Sustainability and Responsibility*.
[11] Barclays Bank, 'Purpose and Values' – www.home.barclays/about-barclays/barclays-values.html#respect.
[12] Volkswagen, 'Our Values. Responsibility and Sustainability' – www.volkswagen-karriere.de/en/what_we_stand_for/our_values.html.
[13] British Petroleum, 'Our Values' – www.bp.com/en/global/corporate/about-bp/people-and-values/our-values.html.
[14] Betsy Stevens and Scott Buechler, 'An Analysis of the Lehman Brothers Code of Ethics and the Role It Played in the Firm', *Journal of Leadership, Accountability and Ethics* 10(1), 2013, p. 54.
[15] Andrew Crane and Dirk Matten, *Business Ethics: Managing Corporate Citizenship and Sustainability in the Age of Globalisation*, Oxford: Oxford University Press, 2010, p. 197.
[16] Crane and Matten, *Business Ethics*.
[17] Simon Welby, 'Values-Based Codes', in Chris Moon and Clive Bonny, *Business Ethics: Facing Up to the Issues: The Issues and How to Manage Them*, London: The Economist Books, 2001, p. 163.
[18] Welby, 'Values-Based Codes', p. 163.
[19] Welby, 'Values-Based Codes', p. 163.
[20] Equally, it is difficult to impose a disciplinary system that is free from employee favouritism. In theory, all employees should be evaluated equally when confronted with accusations of unethical behaviour, but common sense tells us this is not the case. Whether it's charisma, job performance or simply connections, inevitably some employees will be favoured over others. In the end, the firm's commitment to upholding ethical values should strive to promote both rules and culture in harmony – not conflict – with each other.
[21] Visser, *Corporate Sustainability and Responsibility*, pp. 62–4.
[22] Visser, *Corporate Sustainability and Responsibility*, pp. 62–4.
[23] 'US Gulf Oil Spill nearly ruined BP, says Chief Bob Dudley', BBC News, 2 January 2016 – www.bbc.co.uk/news/uk-35210450.
[24] Jan Aart Scholte, *Globalization: A Critical Introduction*, Houndmills: Palgrave Macmillan, 2000, p. 43.

[25] Scholte, *Globalization*, p. 64.
[26] Crane and Matten, *Business Ethics*, p. 547.
[27] David Jones, *Who Cares Wins: Why Good Business is Better Business*, Harlowe: Pearson Education, 2012, pp. xiii, 21.

Conclusions

It has been argued here that the future of free enterprise will belong to companies that take a holistic management approach to conducting business. They have to take issues of moral purpose, corporate culture and ethics seriously. This means truly striving to live out the values many of them claim to uphold. The company that will excel in twenty-first-century capitalism will pursue shareholder returns and ethical behaviour with equal determination.

Further research remains to be done, especially into greater incentives for ethical corporate behaviour and how ownership structures can have impact on the culture of a firm. What can be concluded for now, however, is that business profitability and a strong moral purpose are partners of the highest order.