The Moral Basis of the Business World

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1 Introduction

The culture of the business world is determined in part by the values transmitted by training of its leaders. For four decades neoclassical economic theory has dominated business school teaching. Neoclassical economic theory, however, employs an incorrect, *Homo economicus*, model of human behavior that treats people as selfish maximizers of personal material gain. This theory thus fosters a corporate culture that ignores the ethical standards associated with influential positions in the modern enterprise, and considers honesty, decency, and integrity to be mere social façades. This means that business education is deeply complicit in the high level of corporate misconduct witnessed in recent years because it has failed to provide a plausible alternative to the *Homo economicus* model and its corporate culture of greedy materialism.

Many consider this corporate culture a necessary part of a highly competitive market economy. Most likely it is not. If we taught students in medical school that people are purely selfish and they should prescribe medical treatments that maximized their financial gain, we would soon have an ungovernable medical system. The same is likely true for most of professional training, including law, science, journalism, and education. Conversely, if the training of business professionals were built on a strong moral foundation, it is likely that a corporate culture that discourages and punishes unethical behavior would emerge.

Those who see the market as the ultimate arbiter of what is best for society might argue that other fields are wrong to fight the less attractive urges of the species and reject the homo economicus model. After all, morality is hardly a science. Unlike setting a price for fish, it has no empirical basis. Not so

We know that the *Homo economicus* model is incorrect because laboratory and field experiments, as well as behavior in other professions, show that honesty,

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integrity, intrinsic job satisfaction, and peer recognition are powerful motivators. Most people value honesty and integrity, and often sacrifice material gain to maintain these virtues. Business schools should develop and teach a professional code of ethics similar to those promoted in law, education, science, and medicine, that corporate hiring and firing be guided by considerations of moral character, within a corporate culture based on integrity and mutual regard.

Changing the dominant business culture can be done. In 1974 the Hong Kong government, which had endured a culture of corruption going back hundreds of years, initiated an extremely successful anti-corruption campaign (Hauk and Maraez-Marti 2002) that included an intense anti-corruption campaign in the schools. The result was that in 1986, 75.1% of the 15–24 age group, the first generation to experience this campaign, believed that corruption was a social problem, compared to only 54% of the 45-64 age group. Similarly, in 1977 32% believed that "tipping" government employees to encourage them to perform their prescribed duties was illegitimate, compared to 72% only nine years later in 1986. By 1999, 85% of respondents aged 15–24 said they would not tolerate corruption either by government or businesses. Such programs draw upon the innate desire of a majority of citizens to lead a moral life, and to contribute to the punishment of those who behave immorally.

2 Rationality Includes Having Moral Values

Perhaps because of the stunning success of the twin principles of rationality and self-interest in the analysis of market behavior, economists are wont to conflate the two concepts. However, rationality does not imply selfishness. It can be entirely rational to be altruistic. The economist's rational actor model applies wherever the individual has *consistent preferences*, in the sense that if he prefers A to B and he prefers B to C, then he prefers A to C. Given this assumption and a few technical conditions, it is easy to model the individual as maximizing a preference function (subject to constraints).

The Nobel laureate economist Gary Becker pioneered the extension of the beliefs, preferences, and constraints model to such non-market areas as drug addiction, racial discrimination, crime and punishment, the family, education, and fertility (Becker 1976, Becker et al. 1995). It is clear that consistent preferences are compatible with the application of ethical values to individual choice. This point has been made with great clarity by Andreoni and Miller (2002).

3 Altruistic Cooperation and Punishment

Reciprocity is the predisposition to cooperate in a group task, to respond to the cooperative behavior of others by maintaining or increasing one's level of cooperation, and to respond to noncooperative behavior of others by punishing the offenders, even at personal cost, and even when one cannot not reasonably expect future personal gains to flow from such punishment (Gintis 2009). The reciprocator is thus neither the selfless altruist of utopian theory, nor the selfish *Homo economicus* of neoclassical economics. The cooperative aspect of reciprocity is commonly known as *altruistic cooperation* and the punitive side is *altruistic punishment*. The altruistic element in these behaviors comes from the fact that reciprocators, at a cost to themselves, induce selfish players to cooperate and hence benefit the group as a whole.

The Nobel Price winning economist Akerlof (1982) suggested that many puzzling facts about labor markets could be better understood if it were recognized that in many situations, employers pay their employees higher wages than necessary, in the expectation that workers will respond by providing higher effort than necessary. Of course, the relationship between employer and employee is of the same type as that between stockholder and business leader. Hence, if Akerlof is correct, we would equally expect trust and reciprocity to play a role in the market for business leaders. Fehr et al. (1997,1998) performed experiments that dramatically validate this *reciprocity* model of the market for employees.

4 Character Virtues

Character virtues are ethically desirable behaviors that individuals value for their own sake. Character virtues include *honesty*, *trustworthiness*, *integrity*, and *fairness*. Character virtues are not absolutes. If the cost of virtue is sufficiently high and the probability of detection sufficiently low, many individuals will decide to ditch the virtuous behavior. When they are aware that others are not virtuous in a particular region of their lives (e.g., fidelity in marriage, paying taxes, obeying traffic rules, rejecting bribes), people are more likely to allow their own virtue to lapse. Moreover,the more easily one can delude oneself into inaccurately classifying an non-virtuous act as virtuous, the more likely one is to carry out such an act.

Character virtues are ignored in neoclassical economics, which prefers to ground social cooperation in *enlightened self-interest*. This predilection goes back to Bernard Mandeville's "private vices, public virtues" (1924 [1705]) and Adam Smith's "invisible hand" (2000[1759]). Numerous laboratory and field experiments indicate that most subjects are willing to sacrifice material reward to maintain a virtuous character even when there is no chance that their behavior will be revealed to others (Gintis 2009). Sally (1995) undertook a meta-analysis of 137 experimental treatments, finding that face-to-face communication, in which subjects are capable of making verbal agreements and promises, was the strongest predictor of cooperation. Indeed, the face-to-face aspect of the interaction is unnecessary. Both Brosig et al. (2003) and Bochet et al. (2006) report that the ability to exchange verbal information under conditions of complete anonymity alone induces increased cooperation.

5 Community Culture

Prosocial behavior occurs not only because those directly helped and harmed by an individual's actions are likely to reciprocate but also because there are general *social norms* that foster prosocial behavior. Many people are willing to bestow favors on someone who conforms to social norms, and to punish someone who does not, even if they are not personally helped or hurt by the individual's actions. In everyday life, third parties who are not the beneficiaries of an individual's prosocial act, will help the individual and his family in times of need, will preferentially trade favors with the individual, and otherwise reward the individual in ways that are not costly but are nonetheless of great benefit to the cooperator. Similarly, individuals who have not been personally harmed by the selfish behavior of an another individual will refuse to aid the offender, even when it is not costly to do so, and will shun the offender and approve of the offender's ostracism from beneficial group activities. They encourage a community culture.

By *community culture* we mean the sharing of cultural norms among community members and the willingness of community members to reward and punish other community members based on their adherence to and violation of these norms, even if they are not personally the object of the resulting benefit or harm. Professional standards are the cultural norms of occupational groups, and once established, lead members of the profession to reward and punish each other informally, usually without the need for costly litigation, legislation, and incarceration. By leaving behind professional standards in favor of a culture of pure self-promotion, it is likely that business schools have so undercut the culture of professional honor among managerial personnel. If this is so, it may also be that the mechanism of informal third-party punishment and reward has been broken in some way, contributing to a deficit in moral behavior in the contemporary business world.

There is strong experimental evidence supporting this line of reasoning. While self-regarding actors will never engage in third party reward or punishment if such behavior is at all costly, experimental subjects chosen at random routinely punish and reward others who have impacted upon the welfare of other group members, even if they have not been hurt themselves (Gintis 2009). If professional standards in business were in line with the wider cultural norms seen in these experiments on community, pure self-promotion would not be acceptable.

6 Re-professionalizing Business Education

Recently business school scholars like Jensen (2006)—himself a former strong supporter of the *Homo economicus* model, have thought to how to introduce the notion of character virtue as a central element of economic value creation. Jensen has proposed a framework for value creation that resonates with one of the character virtues most associated with professionalism: integrity. He argues that intgegrity is a integrity is a necessary condition of maximizing value. An economic entity has integrity when it is "whole and complete and stable." Jensen then defines the behavioral characteristics of economic entities (agents inside organizations, groups inside organizations, and organizations themselves) that are in integrity mode: "nothing is hidden, no deception, no untruths, no violation of contracts or property rights, etc."For those who chose not to play by these rules, integrity requires that the renegade approach be made clear to all others. This framework is then applied to financial and capital markets. It suggests that many of the recent corporate scandals can be traced to the institutions, like investment banks, analysts, and auditors, purposefully setting aside the integrity imperative.

Recent research has demonstrated that business schools have a rich treasure of wisdom, idealism and vision on which to draw to move away from this dominant model (Khurana et al. 2005). It is an inheritance whose roots can be traced to the mission of the larger university as social institution charged with advancing the public good and one rooted in the original professionalizing mission of the university-based business school charter. The notion that those who lead and manage our society's major private economic institutions might provide, or be responsible for providing, a public good is quite foreign to our current way of thinking about management. Yet this idea was often voiced by those who led American business schools in the early decades of their existence. For example, in a speech titled "The Social Significance of Business" that he delivered at Stanford University's School of Business shortly after its founding in 1925 (subsequently published as an article in Harvard Business Review of the same title), Wallace B. Donham, the second dean of the Harvard Business School, declared that the " development, strengthening, and multiplication of socially minded business men is the central problem of business." As Donham went on to say:

> The socializing of industry from within on a higher ethical plane, not socialism nor communism, not government operation nor the exercise of the police power, but rather the development from within the business group of effective social control of those mechanisms which have been placed in the hands of the race through all the recent extraordinary revolutionizing of material things, is greatly needed. The business group largely controls these mechanisms and is therefore in a strategic position to solve these problems. Our objective therefore, should be the multiplication of men who will handle their current business problems in socially constructive ways.

The founders of business schools never envisioned the notion that the sole purpose of the corporation was to serve only one master, the shareholder. Nor could they have ever imagined that the model that students would be trained into a world view that would conceive managers as self-interested agents with no consideration of any other values or imperatives but their own wallets. Those of us who study society, coach soccer, help our neighbors, raise children, and look within ourselves, all know such a view of human behavior is not true, and more important, if such a vision were fully realized, would not offer the foundation for creating a sustainable society. Business schools need to recover professional ethics. To this end, business schools have an institutional responsibility to present students with a model of behavior that inspires them to respect other institutions in society, especially basic units like the family and community, and to inspire students to accept the responsibilities and obligations that come with occupying society's most powerful positions.

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