2009

Back to Basics: The New Moral Economy?

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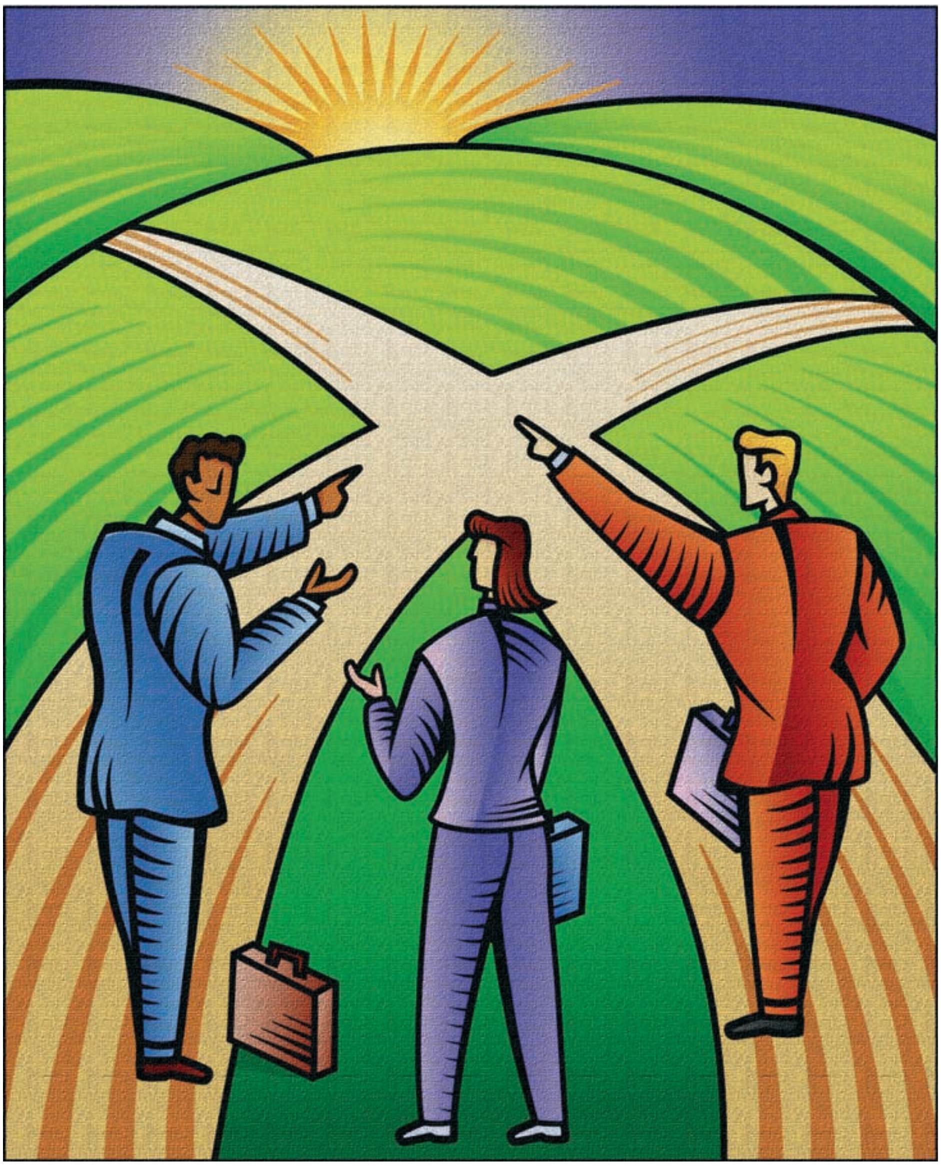

To what extent is wealth creation for the common good? And what is the final objective of a market society? Eugene KB Tan weighs in.

In the aftermath of the fall of communism two decades ago, Francis Fukuyama – adopting the phrase used by Hegel and Karl Marx – triumphantly declared 'the end of history' with capitalism as the ultimate winner.[1] Such over-exuberance has now taken a painful reality check.

Yes, there is no alternative to capitalism; well, not yet. Capitalism can still provide the all-important economic ballast but it has to be urgently and fundamentally right-sized in order to regain its legitimacy and effectiveness.

Right-sizing Capitalism

While anchored in economic rationality, capitalism, at its core, is both a human system and a human enterprise. Apart from profit-making, capitalism enables society to achieve a variety of human goals. These goals range from meeting basic needs to fulfilling exuberant wants and desires. They include wealth generation, provision of employment opportunities and stoking of human ingenuity. The emphasis here is on the 'human' dimension. Ultimately, capitalism must reflect a human-centred and a values-oriented society. We often talk about a business license to operate but that requires, and it is often forgotten, a moral obligation on the part of businesses to conduct their activities in ways that promote the common good, instead of privatising interests at the expense of the larger good.[2]

Undoubtedly, business is about competition that does not harm the larger society but rather, brings out the best in it. It is also about inter-generational equity in which current resources used by the present generation will not compromise the usage of similar resources for future generations. Competition is also about cooperation, which in turn, is about trust.

In order for capitalism to function optimally, trust is a necessity. The 'sub-prime' mortgage crisis in the United States – which shocked global markets in 2008 – was a manifestation of the abuse of trust, in which key stakeholders of the financial industry developed or allowed the sale of inherently flawed financial instruments. It was not a competition of the best products but rather, a competition that was destructive and self-annihilating. Adair Turner, Chairman of UK's Financial Services Authority sums it up well:

> *And in the years running up to 2007, too much of the developed world's intellectual talent was devoted to ever more complex financial innovations, whose maximum possible benefit in terms of allocative efficiency was at best marginal, and which in their complexity and opacity created large financial stability risks.*[3]

Moral hazard was creatively packaged as financial ingenuity and profitability. Adair Turner describes it in the following terms:

> *For there must be a suspicion that some and perhaps much of the structuring and trading activity involved in the complex version of securitised credit, was not required to deliver credit intermediation efficiently, but achieved an economic rent extraction made possible by the opacity of margins and the asymmetry of information and knowledge between end users of financial services and producers.*

This abuse of trust was so severe in its ramifications that the sectoral excesses transmogrified into a systemic failure of trust which affected the financial sector of the major markets in the world before engulfing the entire global economic system. In turn, economic rents, allocative inefficiency and risks became overwhelmingly disproportionate to the benefits that were generated by the financial instruments. As a result, people are now left to grapple with the consequential effects of the economic crisis. The failure of trust, in this case, was essentially about competition bereft of cooperation.[4]

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Thus, if we reconceptualise business as maximising and giving full expression to the positive human values, then business cannot be just about making profits. Instead, it has to be about ensuring that the economic enterprise is able to further and enhance those human values instead of detracting from it.

Instead, it has to be about ensuring that the economic enterprise is able to further and enhance those human values instead of detracting from them. Responsibility is one value that got marginalised in the mindless search for profits. American President Barack Obama emphasised responsibility in his inauguration address in January 2009: "Our economy is badly weakened – a consequence of greed and irresponsibility on the part of some but also our collective failure to make hard choices and prepare the nation for a new age." His prescription for the ill: "What is required of us now is a new era of responsibility…"[5] It was an overdue reminder and spoke of the need for a values-based leadership in the business world.

Moral Reasoning and Leadership in the Economic Ecosystem

Capitalism is not a zero-sum game. Serving markets and society equates to serving business shareholders. In this respect, adding value to stakeholders and society will equally benefit shareholders too. Although profits are a legitimate objective, business also has a larger purpose of ensuring long-term profitability. This can only come about through capitalism which is inherently responsible, and mindful that it has the capacity to do good or wreck havoc at the systemic, organisational and individual levels.

Take Timberland, a well-known apparel company, for example.[6] The company, a long-time supporter and practitioner of corporate social responsibility (CSR), views the current economic malaise as an opportunity for companies to engage more meaningfully with their stakeholders – especially consumers – to overcome the massive loss of confidence. Its CEO, Jeff Swartz, is confident that companies who engage consumers on social and environmental issues (in short, the triple 'Environmental-Social-Governance' bottomline) will win back trust and develop social capital.

Swartz argues that 'consumers are starting to value brands as social institutions'. As such, a key locus of power in getting companies to address social and environmental issues is consumers themselves. Increasingly, these issues – comprising corporate governance, climate change, sustainability, human rights and supply chain management – resonate with consumers and other stakeholders. Timberland engages its stakeholders on various fronts, addressing ethical issues arising from its global supply chain as well as issues of its own environmental footprint. It is also a passionate advocate of a low carbon economy. Although a public advocacy role is rare for a company, Timberland embarked on public advocacy as it felt that its own actions were inadequate in dealing with the challenge of climate change.

In 2007, the company unified its CSR team from four different business units into one, with the concomitant outcome of a 'unified strategy with clearly articulated social and environmental goals' and demonstrating 'transformative value' to their stakeholders. In 2008, Timberland started reporting on key CSR performance indicators on a quarterly basis as it believed that this would represent 'an evolution in its CSR reporting process from static data presentation to dynamic information exchange; corporate statement to stakeholder engagement as well as from delayed annual reports to quarterly updates'. Timberland believes that the high level of disclosure and reporting, as a real expression of stakeholder awareness and collaboration, will provide invaluable feedback loops to help it achieve the bold goals set forth in its long-term CSR strategy. Such significant reporting means that the company is ready to stand by its performance in the social and environmental spheres and demonstrates its readiness to manage risks that are non-conventional in nature.

Other loci of power in challenging companies to address social and environmental concerns include employees, investors, government and suppliers. Not surprisingly, these stakeholders often have competing interests at stake. Hence, it will always be a significant challenge for them to rally companies to be socially responsible whilst producing good business performance. Essentially, a lodestone of action and commitment found within a company is that of leadership. A leadership that genuinely believes in values, shared purpose as well as responsibility to stakeholders and the community at large can provide the much-needed impetus to drive the company forward and contribute optimally to society, while also producing a reasonable financial performance.

CSR – Time for Change

What is often forgotten is that issues relating to corporate accountability, social responsibility and ethical conduct were not alien to the forerunners of today's modern corporate entities and multinationals. The early colonial-era British East India Company itself was caught up in the debate over the use of slaves in sugar production in the West Indies.[7] Likewise, the colonial Dutch government's 'Ethical Policy' in the Dutch East Indies (now Indonesia), almost two centuries later at the turn of the 20th century, ostensibly professed a humanitarian concern for the welfare of the colonial subjects even as 'exploitation and subjugation' remained widespread.[8]

Activists and scholars have elaborated at length on how businesses pay lip-service to CSR. What is urgently needed is a new paradigm of responsible business that incorporates social and environmental concerns into its corporate agenda. The leadership role in engendering meaningful CSR, while often under-estimated[9], is much needed to drive a framework that would help make CSR a *sine qua non* of business, while also cementing the trust between business and society.

Porter and Kramer argue that if corporations, in their approach to CSR, use the same frameworks that guide their core business choices, CSR presents a potential well-spring of ideas and motivation as well as a potent source of innovation and competitive advantage. Citing examples such as Toyota (hybrid automobile engines), Whole Foods (sustainable consumerism) and Nestle (supply chain quality assurance), they demonstrate that these corporations have successfully transformed CSR from what is construed as a necessary business cost, into a vibrant generator of innovation and competitive advantage. In turn, this translates into competitive success that is sustainable and not at odds with society's long-term interests and needs.

The thrust of Porter and Kramer's arguments is that corporations and society should not treat corporate growth and social welfare as a zero-sum game. They introduce a strategic framework that seeks to integrate business and society to create 'shared value' – outcomes that benefit both businesses and society. Treat CSR like a serious strategy formulation and one

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will reap dividends. Of course, strategising alone is not enough. Companies have to be persuaded and believe that CSR is a force for good for their financial bottomline, and more.

Back to Basics: Fundamental Rules of Ethics and Social Responsibility

Traditionalists would view this expanded mandate as an unnecessary encroachment that would undermine the first priority of business – which is to contribute to economic wealth. To be sure, that is still of primary importance but as the corporate scandals over the last two decades have shown, a singular determination to make profits at all costs will only damage the larger economic eco-system and make capitalism untenable.

The late Milton Friedman – Nobel laureate and guru of free market capitalism – had called CSR a 'fundamentally subversive doctrine' in a free society. But he also reminded us that while a company's responsibility is to make as much profits for its shareholders, that goal must not violate the fundamental rules of ethics and social responsibility:

> *… there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits; so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.*

Friedman also reiterated this requirement in another equally well-cited article where he argued that business is about making 'as much money as possible' but 'conforming to the basic rules of the society – both those embodied in law and those embodied in ethical custom'.[10] This important caveat is often ignored.

In short, CSR can be the driver by which business and society are symbiotically and synergistically linked. It need not be a zero-sum game. As Thomas Friedman observes of green technology, 'You can't make a product greener... without making it smarter – smarter materials, smarter software or smarter design'.[11]

Capitalism is arguably facing a deep crisis of legitimacy. This chasm between business and society is not a recent development but a state of affairs that has persisted and heightened since the 1970s. In these extraordinary times, CSR epitomises equilibrium and demonstrates how businesses and society can co-exist and thrive. Put simply, business is a *humanistic* enterprise and a *moral* economy that we ignore to our peril. ❖

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[1] Francis Fukuyama, *The End of History and the Last Man* (London: Penguin Books, 1992)

[2] Heiko Spitzeck et al. eds., *Humanism in Business* (Cambridge: Cambridge University Press, 2008)

[3] Speech by Adair Turner, Chairman, Financial Services Authority (UK) at The Economist's Inaugural City Lecture, January 21, 2009 <http://www.fsa.gov.uk/pages/Library/ Communication/Speeches/2009/0121_at.shtml>

[4] The marketplace adage, 'Trust me, I'm a banker,' now seems like a bad joke given the excesses in the financial and banking sector. The collapse of well-known brands and institutions, like Lehman Brothers and AIG, have shattered the veneer of dependability, trustworthiness, and stability in the financial world. Banks are now wary of even lending to other banks, crippling the access to funds for economic players and individuals.

[5] President Barack Obama's Inaugural Address, January 20, 2009 <available at http://www.whitehouse.gov/blog/inauguraladdress/>

[6] John Russell, "Consumer trust that's good for the sole," *Ethical Corporation*, May 2009, 14-16, and Timberland's website <http://www.timberland.com/corp/index.jsp?page=csr_strategy>

[7] John Micklethwait and Adrian Woolridge, *The Company: A Short History of a Revolutionary Idea* (New York: The Modern Library, 2003). See also Nick Robbins, *The Corporation that Changed the World: How the East India Company Shaped the Modern Multinational* (London: Pluto Press, 2003)

[8] M.C. Ricklefs, *A History of Modern Indonesia since c. 1200*, 3rd Edition (Basingstoke: Palgrave, 2001), 193-205

[9] My focus here, however, is on CSR although it would be clear that the role of leadership in calibrating a company's commitment to CSR is crucial.

[10] Milton Friedman, "The Social Responsibility of Business is to Increase its Profits," *The New York Times Magazine*, September 13, 1970

[11] Thomas Friedman, "The Green Road Less Traveled," *The New York Times*, July 15, 2007. See also Peter Senge *et al.*, *The Necessary Revolution: How Individuals and Organizations Are Working Together to Create a Sustainable World* (New York: Doubleday, 2008)